Contracts II Section 419
Professor Meyerson
Spring 2018

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COURSE INFORMATION AND SYLLABUS

Meeting Times: Tuesdays and Thursdays: 6:15pm – 7:30pm

Location: Room assignments are available through MyUB.

Class Attendance, Preparation, and Participation: You are required to attend class regularly and be prepared for class; adequate class attendance, preparation, and participation are also essential if you wish to understand the material.

To conform with ABA and law school guidelines, you are entitled to 5 absences per semester. A student with more than 5 unexcused absences will not be permitted to take the final.

Unless told otherwise, for each class, you are responsible for: 1) any unfinished material from the preceding assignment: **PLUS** 2) the assignment following the one discussed in the preceding class. If you miss a class, you must obtain the class notes from the missed class *before* attending the next class.

Class participation is an essential part of process of becoming a lawyer. All students are expected to be prepared to participate in each class session, as I will call on students randomly and solicit volunteers. If you are not prepared to discuss the day's reading and the questions for the day's assignment, please give me a note prior to class. This will avoid embarrassment for both of us.

You must prepare answers to the questions in the syllabus which accompany each assignment. Details on how your answers will be handed in will be provided in class.

Use of the Internet during class (This is huge.)
You absolutely can neither be on the Internet nor text during class. You are required to turn off your access to wireless Internet before the start of class. We will discuss this more on the first day. Suffice to say- texting or internet use during class will be prima facie evidence of unsatisfactory class participation.

I reserve the right to decrease a grade for unsatisfactory class participation or preparation.

Materials

The course packet, sold at the bookstore, will contain most of the cases we will be reading this semester. Additional readings may be distributed throughout the semester.

Some students have found certain supplemental books to be useful. In particular, students have found the following hornbooks or treatises helpful both in preparing for class and for exams: Farnsworth, **Contracts** (4th ed in paper, 2004), **Murray on Contracts** (5th ed. 2011), and Calamari and Perillo **Hornbook on Contracts** (7th ed. 2014), Brian A. Blum, **Examples & Explanations: Contracts** (6th ed. 2013)

In contrast to the above books, students have found that the commercial outlines can be detrimental to their performance on exams. These outlines generally focus on material that I consider irrelevant and are sometimes simply incorrect.

Course Website

This course has a TWEN page that links to this syllabus, announcements, the class assignments, and other class materials. You are responsible for self-enrolling in the TWEN page and for checking it regularly for course information.

Grading

Your grade will be determined as followed:
10%: Written answers to syllabus questions
90%: Three-hour, closed-book final examination.

As stated above, I reserve the right to lower grades for inadequate class attendance, preparation, and participation.

Course Expectations

American Bar Association Standards for Law Schools establish guidelines for the amount of work students should expect to complete for each credit earned. Students should expect approximately one hour of classroom instruction and two hours of out-of-class work for each credit earned in a class in order to obtain a *minimum* passing grade.

You are also expected to complete all reading and written assignments before class, to participate consistently in class discussion, to work collaboratively on all group assignments, and to be able to demonstrate that you have read and reflected on the issues raised in each assignment.

Student Learning Outcomes

Students will learn the rules of contract interpretation, contract damages, and excuses and defenses; they will learn how to structure legal arguments in a logical sequence; they will learn how to be precise with legal language; and they will learn how to apply the concept of "objective intent." They will also learn how to work collaboratively to solve legal problems.

Office Hours

My scheduled Office Hours for Spring, 2018 are:
Tuesdays: 9:30- 10:20, 5:00 – 6:10 (except for certain faculty obligations)
Thursdays: 9:30- 10:20, 5:00 – 6:10

IMPORTANT: If you know you would like to meet ahead of time, please let me know if you want to make an appointment. That will ensure that we will have time to talk. If you cannot find a convenient time, ***please*** let me know and we will find a mutually convenient time to meet or talk on the phone. You should be assertive in making appointments

Class Cancellation:

If I must cancel a class, I will either let you know ahead of time or, if need me, notify you via email. If there is inclement weather, students should visit the University of Baltimore web site or call the University's Snow Closing Line at (410) 837-4201. If the University is open, students should presume that classes are running on the normal schedule.

Academic Integrity:

Students are obligated to refrain from acts that they know or, under the circumstances, have reason to know will impair the academic integrity of the University and/or School of Law. Violations of academic integrity include, but are not limited to: cheating, plagiarism, misuse of materials, inappropriate communication about exams, use of unauthorized materials and technology, misrepresentation of any academic matter, including attendance, and impeding the Honor Code process. The School of Law Honor Code and information about the process is available at http://law.ubalt.edu/academics/policiesandprocedures/honor_code/.

If you have even the slightest doubt about whether certain actions would violate the Honor Code, please contact me or Associate Dean Amy Sloan

Title IX Sexual Misconduct and Nondiscrimination Policy:

The University of Baltimore's Sexual Misconduct and Nondiscrimination policy is compliant with Federal laws prohibiting discrimination. Title IX requires that faculty, student employees and staff members report to the university any known, learned or rumored incidents of sex discrimination, including sexual harassment, sexual misconduct, stalking on the basis of sex, dating/intimate partner violence or sexual exploitation and/or related experiences or incidents. Policies and procedures related to Title IX and UB's nondiscrimination policies can be found at: http://www.ubalt.edu/titleix.

Disability Policy:

If you are a student with a documented disability who requires an academic accommodation, please contact Leslie Metzger, Director of Student Services, at 410-837-5623 or lmetzger@ubalt.edu.

SYLLABUS AND QUESTIONS

1) Introduction to Damages I
Adams v. Lindblad Travel, Inc., Hadley v Baxendale RS §§ 347 & 350-52

What is the goal of contract damages?
How are damages calculated in *Adams?*
What are "consequential damages" and why didn't the plaintiff in *Hadley* recover them?

2) Introduction to Damages II
Mader, S. J. Groves & Sons Co., Gruber and *Anglia TV*

What are the limitations on consequential damages?
What is the policy rationale[s] for each limitation?

In *Gruber* and *Anglia TV*:
a) What does the "new business rule" as described in *Gruber* have to do with the concept of "reasonable certainty"?
b) In *Gruber* and *Anglia TV*, what are the different rules on reliance damages for pre-contract expenses? Which is better?

3) UCC, Lost Volume, and Employment
Chronister Oil, In re WorldCom, Inc.; UCC §§ 2-703, 2-706(1), 2-708--712, 2-718(2)

Chronister Oil: What does "cover" mean? Why did the plaintiff lose?
In Re WorldCom, Inc.:
a) What is meant by the phrase "lost volume seller"? What needs to be proven for the seller-victim to recover damages as a lost volume seller?
b) What are the rules on mitigation of damages for victim-employees?

[Note: you do not need to hand in your answer to this problem]
Consider the following example:
Employee has a job as an associate at a law firm specializing in "Mergers and Acquisitions." Employee has a one-year contract for $5000/month.
After 4 months, Employee is wrongfully fired by the law firm.
Employee stays home and watches Judge Judy for the next 8 months.
Employee sues for 8 months damages, at $5000/month = $40,000
a) What will a court award?
b) What if the only other job in the city is in entertainment law, paying$ 5,000/month?
c) What if employee takes job at night shift at McDonald's earning $1000/month [a total of $8,000 for the period]?

4) Construction Damages & Punitive Damages
Jacob & Youngs; Emery, Patton; UCC § 2-718(1) RS § 355
How does a court figure out damages in construction breach? When are damages not awarded for the "cost of repair"?

What is rule for punitive damages and WHY?
What does *Patton* court mean by "efficient breach"?

5) Liquidated Damages & Restitution
NPS; Kvassay; Lake River Corp.; and *Oliver*

In *NPS; Kvassay; Lake River Corp*.
Define "liquidated damages." When do courts enforce liquidated damages clauses?

In *Oliver*
What is meant by "restitution"? When does a plaintiff prefer restitutionary damages to expectancy damages? When is a plaintiff unable to recover restitutionary damages?

6) Specific Performance I
Centex Homes Corp.; Laclede Gas Co.; Northern Indiana PSC; and *American Brands;* UCC §2-716(1); RS§§ 371,373

When does a plaintiff get Specific Performance?
How does this rule apply to different types of contract such as land and the UCC?

7) Specific Performance II
Schlegel; Meyer; Duane Sales; Beverly Glen Music, Inc.; Karpinski and *Howard Schultz*

Schlegel; Meyer:
What is meant by "equitable defenses" and why do courts relying on them to avoid awarding specific performance?

Duane Sales:
When does a plaintiff get *both* specific performance and damages?

Beverly Glen Music, Inc.; Karpinski and *Howard Schultz*
How and why do the rules change for specific performance when applied to an EMPLOYEE who breaches?
When is a covenant not to compete legitimate? Illegitimate?
How does the reasoning in *Karpinski* and *Howard Schultz* differ?

8) Contract Interpretation I RS § 203
Read "Employment Contract" and answer the questions that follow.

9) Contract Interpretation II
Frigaliment Importing; Beanstalk Group

What is the key contractual word or phrase in each case?
How does the court in each case decide their meaning?
In *Frigaliment:* List the different sources of meaning referenced by the court? Which do you find most convincing?
In *Beanstalk:* How does Judge Posner determine the meaning of the contractual language?

10) Parol Evidence I UCC§§ 2-202;1-205 RS§§ 209,210,213-17
Interstate Industrial Uniform Rental Service; Val-Ford; Nanakuli; and *Luria Bros*

Define Parol Evidence.
What is purpose of the Parol Evidence rule?
What is the difference in the rules for completely integrated agreements and partially integrated agreements?
In *Val-Ford:* Why did the court allow in Parol Evidence?
According to *Nanakuli*, what does the UCC add to common law Parol Evidence rule?
What is the difference between *Nanakuli*'s definition of "consistent" and "contradict" and the one utilized in *Luria Bros?* Whose definition allows in more parol evidence?

11) Parol Evidence II
River's Edge Homeowners' Ass'n, Pacific Gas, Raffles, Colfax
Define Ambiguity.
How does the approach to deciding if language is ambiguous in *River's Edge* differ from that in *Pacific Gas*?
What are the different reasons for the differing approaches?

What was problem in *Raffles*? How was it resolved?
What does *Colfax* say is the real holding of *Raffles?*

12) Conditions v Promises I
Audette; General Credit Corp.; New York Bronze Powder Co., RS §§ 224-25

[NOTE: Make sure you can identify the key contractual language in each case.]

1) Why doesn't the insurance company have to pay in *Audette?*
2) What is the difference between a "condition" and a "duty"?
3) What are the differing consequences from the failure to fulfill a condition as opposed to failure to fulfill a duty?

13) Conditions v Promises II
Dyer; *JJ Shane, Hicks,* and *Flynn*

1) What is the key contract language in *Dyer*? Is it a condition?
Why is there a different result in *JJ Shane*?
2) Compare *Hicks* and *Flynn*: In each case, what is the condition a condition to? How was this determined and why does it matter?
[Hint: Find the most important language in each contract]

14) Constructive Conditions I
Stewart, Monroe Street, Jacobs & Young RS §234

1) Define Constructive Condition
2) In *Stewart* and *Monroe Street*, who needs to perform first? Why?
3) In *Jacobs & Young*, why does the homebuyer not get what the contract promised?

15) Constructive Conditions II
K+G Construction and *Walker* RS§§ 237,241,242
1) Define substantial performance.
2) What is difference between a material, an immaterial and a total breach?
3) What are the differing consequences of each?
4) When can you end a contract over a constructive condition?

16) UCC Conditions
Bartus; Parker; Emanuel Law Outlines UCC §§2-508; 2-601; 2-602(1); 2-606; 2-607(3a); 2-612; 2-307
1) Define the "perfect tender rule".
2) When does a seller who has delivered non-conforming goods get a second chance?
3) Assuming non-conforming goods, how does one a) accept the goods, b) reject the goods and c) revoke acceptance? How are damages calculated for each?
4) Read UCC §2-612 and define installment contracts and give the rule for rejecting non-conforming installment contract deliveries.

17) Quasi-Contract; Divisibility
Martin, Lancelotti, Gill UCC §2-718 (2), RS §240

1) In *Martin* and *Lancelotti*: What are the arguments for and against recovery by a **breaching** party for work done? Which approach would lead to fewer breaches?
What is the rule from UCC §2-718?
2) How are damages calculated for a "divisible K"? What makes a K divisible? [*Gill* and RS 240]
3) What is difference between quasi-K and divisibility?

18) Prevention
Cantrell-Waind; Swartz; Stop & Shop, Market Street
1) What is the rule of "wrongful prevention"?
2) How does the concept of assumption of risk fit into the doctrine of wrongful prevention?
3) Is there a "duty to cooperate"?

19) Estoppel; Forfeiture; Satisfaction
Shipsview Corp. , Burger King; Western Hills

1) What does "Time is of the essence" mean?
2) How does a "waiver" occur? What is the legal consequence of a waiver?
3) Define forfeiture. What is the legal consequence of a finding of "forfeiture"?
4) What did the courts identify as being "forfeited" in *Burger King?*
5) How do courts determine if one party is "satisfied"?
*6) When it this a subjective or an objective standard?

20) Anticipatory Breach and Intervening Excuses I
Hochster, Daniels, Drake, Paradine, Taylor v Caldwell, UCC §2-609 & Comments; RS §§ 250-53 & 256

1) According to *Hochster,* when can someone sue for a breach BEFORE performance is due? Why does Daniels reach the opposite conclusion?
2) Define repudiation.
3) How does the UCC right to demand assurances [UCC §2-609] change the common law?
4) What was the rationale for forcing the lessee to pay in *Paradine*?
5) What is the modern rule, and rationale, from *Taylor v Caldwell*?

21) Intervening Excuses II
American Trading, Eastern Air Lines UCC §2-615 & Comments; RS §261
Krell ,Western Properties, RS §265

1) In *American Trading,* under what theories did the ship owner seek recovery? Why did it lose?
2) What is the difference between impracticability and impossibility?
3) What is the role of assumption of risk in the court's decision?
4) What is the function of a "force majore clause"?
*5) What is meant by "frustration"?
6) Why was frustration found in *Krell* and *Western Property*?

22) Duress, Undue Influence
Gallon; Resolution Trust Corp. v. Ruggiero; and *Francois*

Duress and Undue Influence:
What are the legal rules for each? What are the elements that need to be proven?
What facts in each case do the courts rely on to determine if a contract may be avoided under either doctrine?

23) Capacity and Misrepresentation
Pettit v Liston and *Ortelere v. Teachers' Retirement Bd* RS 14 and 15
Cousineau; Vokes

a) *Pettit v Liston*
i) What is the difference between executed and executory K's?
ii) Trick question: Which kind of K is the K in Pettit?
iii) How does the law of contracts for minors differ from that for adults?
b) In *Ortelere v. Teachers' Retirement Bd* :
i) What are the two types of mental disability?
ii) Where does the dissent disagree with the majority: On the facts, law or both?
*iii) Who's argument is stronger, the majority or the dissent?
c) Cousineau; Vokes
What are the elements of common law fraud? What facts in *Cousineau* were most important for the court?
When can you rely on an opinion?
*What is the difference between fact and opinion?

24) Mistake, Reformation
Wood, Sherwood, Lewanee, Wil-Fred's Inc., and *Bollinger* RS §§ 151-154

1. What is a "Mistake" in terms of contract law?
2. Looking at *Wood, Lewanee*, and *Sherwood v Walker*:
When can one avoid a K due to mistake? Who bears the "risk of a mistake"?
3. Why is there a different rule for avoiding a K due to a unilateral mistake?
4. Why isn't "Reformation" controlled by the Parol Evidence rule?

25) Unconscionability
Sitogum; Amoco Oil
UCC §2-302 & Comments
1) Define Unconscionability.
*2) What is the "test" for Unconscionability [look at UCC 2-302, and Comments 1,2,3]?
3) What is the difference between "procedural unconscionability" and "substantive unconscionability"?

26) Standard Form Contracts I
K.D.; *C & J Fertilizer* RS §211
1) Define a "contract of adhesion".
2) Should the courts treat "contracts of adhesion" differently from other contracts?
3) How did the court in *K.D.* treat the "contract of adhesion" in a different way than if it were a "normal" contract?
4) How does the *C & J Fertilizer* court's treatment of "contracts of adhesion" differ from *K.D*'s?

27) Standard Form Contracts II
Gelbman; Armendariz, Hancock v. AT&T Co
1) How do these cases treat form contracts?
2) What is the relationship between the "law of unconscionability" and the "law of form contracts"?
3) Reviewing the cases in the last three assignments, which possible way of dealing with form contracts makes the most sense to you and why?
4) *Hancock*: Does [and should] the nature of Internet contracting change our rules?

INTRODUCTION TO DAMAGES

ADAMS V. LINDBLAD TRAVEL, INC., 730 F.2d 89 (2nd Cir. 1984)

CARDAMONE, Circuit Judge:

In this breach of contract case plaintiff obtained a jury verdict for $7,650 in damages against defendants in the United States District Court for the Southern District of New York (Metzner, J.). Plaintiff has appealed claiming principally that the trial court's charge on the issue of damages incorrectly limited the amount he was entitled to recover.

I. *BACKGROUND*

Bruce Adams, d/b/a Southwest Safaris, is in the business of designing and conducting adventure tours. A comfortable chartered bus is not part of this tour package. For those who subscribe to Adams' tours of the Four Corners region -- where the states of Colorado, New Mexico, Arizona and Utah meet -- travel is by more imaginative means. Taking groups of five or less, Adams utilizes a helicopter, horse, jeep and river raft to show his clients America's Southwest. Defendant Lindblad Travel, Inc. is a prominent wholesaler of adventure tours, and its subsidiary, defendant Special Expeditions, Inc., promotes such tours within the United States. Since its beginnings in 1979, Special Expeditions has been managed by its president, defendant Sven Olof Lindblad.

Defendants sought out Adams in 1978 with a proposal for a joint business venture. According to the terms and conditions of an agreement reached in the fall of 1979, the parties were to develop a number of air tour programs for the Four Corners region to be conducted in 1980 and 1981. These programs, known as Special Expeditions' American Wing Safari, featured Adams as tour operator. Defendants, meanwhile, were to promote, market and sell the tours and pay Adams a set price per planeload of passengers (which in 1980 was $5,700 for "lodge" trips and $4,030 for "camping" trips). The specific itineraries, dates and prices of all tours would be mutually agreed upon by the parties in advance of sale, and it was agreed that the identity of Bruce Adams as founder of Southwest Safaris would be mentioned in all advertising and marketing materials.

During 1980 the American Wing Safari program ran smoothly. Defendants did in fact market and sell several five-passenger safaris, four of which actually departed. At the outset of negotiations for 1981, defendants expressed their dissatisfaction with the four-to-five passenger format. They insisted that each tour be increased to 20 passengers to make the venture more profitable. By letter to Adams of December 29, 1980 defendants proposed an itinerary for September 16, 1981, which required Adams to accommodate 20 passengers in groups of five passengers each. Adams rejected it. He asserted that safety considerations related to hazardous flying conditions at the South Rim Airport on the edge of the Grand Canyon resulting from its high altitude (thin air) and dangerous turbulence precluded an itinerary that required tightly

scheduled landings with a fully loaded aircraft, *i.e.*, the itinerary proposed by defendants. It soon became clear that the parties were nearing an impasse.

During the last week of January 1981 defendants sold their version of the September 16 itinerary to Eli International, Inc., a branch of the Yale University Alumni Association. The sale took place without Adams' prior knowledge or consent and violated the parties' earlier agreement that Adams and Lindblad mutually agree on itineraries, dates and prices in advance of sale. [On March 4, defendants contracted with a different company to conduct the American Wing Safari tour] Meanwhile, defendants continued to take advantage of Adams' expertise and reputation. Specifically, they mailed out more than 11,000 newsletters on March 2, 1981 promoting the American Wing Safari, emphasizing that Adams, with extensive knowledge of the Southwest and a 10-year perfect flying safety record, would be conducting the aerial tours….

Because of defendants' sale of the September 16 itinerary without his knowledge and their insistence that he fly that itinerary with 20 passengers, Adams terminated the business relationship on March 5, 1981. As a result, he found himself in difficulties with respect to the 1981 season. Having relied entirely on defendants' agreement to promote his business, Adams was faced with the prospect of putting together a marketing campaign at the last minute. Consequently, from 1980 to 1981 the number of passengers he carried dropped drastically -- from 134 to 57. Meanwhile, defendants continued blithely to appropriate the information and itineraries obtained by them from Adams and through Wild & Scenic conducted their own aerial tours of the Southwest. The proof at trial showed that during the summer of 1981 defendants carried 34 passengers they otherwise would have referred to Adams.

From this background the present litigation ensued in district court. [It] awarded Adams $7,650 as damages for breach of contract. This amount was the top limit imposed by the court's charge. On appeal Adams argues that the district court erred by: limiting contract damages to $7,600….

II. CONTRACT DAMAGES

Since defendants do not dispute the jury finding that defendants had breached the contract they had with Adams, liability is not an issue on appeal. With respect to damages, Adams claims that the district court's charge placing a ceiling of $7,650 on his contractual recovery was erroneous. [The District Court concluded that but for the breach Adams would have carried 91 passengers, the 57 Adams actually carried in 1981 plus the 34 referred to Wild & Scenic by defendants.]

The way in which the district court arrived at this figure was to make the following calculations:

(1)	$57,000	Adams' actual 1981 gross revenues (57 passengers carried by Adams at $1,000 each)
(2)	+ 32,060	Adams' lost revenues (8 planeloads at $4,060 each -- mathematical error should be $32,480)
(3)	89,060	Adams' projected gross revenues but for the breach

(4)	- 24,000	Average fixed costs
(5)	65,060	
(6)	- 44,530	Variable costs (one-half of gross revenues)
(7)	$ 20,530	divided by 91 passengers = $225 net profit/ per passenger
		x34 passengers
		$7650 Lost Profits

In essence, the district court was attempting to determine how much Adams would have profited from handling the eight additional planeloads (or 34 customers) referred by defendants to Wild & Scenic in 1981.

Adams challenges the court's figures on several grounds. First, he argues that the district court should have instructed the jury to award Adams the difference between his profits in 1979 -- the year prior to his agreement with defendants -- and his losses in 1981. Second, he claims that the formula used by the court was flawed because it mistakenly took into account Adams' fixed costs. Finally, he asserts that the numbers the trial court plugged into this formula are erroneous.

The general rule for measuring damages for breach of contract has long been settled. It is the amount necessary to put the plaintiff in the same economic position he would have been in had the defendant fulfilled his contract. *Perma Research & Development v. Singer Co.*, 542 F.2d 111, 116 (2d Cir.), *cert. denied*, 429 U.S. 987, 97 S. Ct. 507, 50 L. Ed. 2d 598 (1976); *Chamberlain v. Parker*, 45 N.Y. 569, 571 (1871); 11 S. Williston *A Treatise on the Law of Contracts*, § 1338, at 198 (3d ed. 1968); 5 A. Corbin, *Corbin on Contracts* § 992 (1964). Therefore, Adams improperly seeks damages based on his 1979 profits. Even were defendants to have fulfilled their 1981 contractual obligations, there is no reason to believe that such would have guaranteed Adams the same success he enjoyed two years earlier. Too many variables, apart from the breach, could have caused a discrepancy between Adams' 1979 and 1981 profits. That is to say, the 1979 economy might have been more conducive to domestic travel, or Adams' potential market might be finite and his pool of possible customers might diminish each year.

Even more important for our purposes is the fact that Adams' lost revenues for 1981 can readily be measured in terms of the business taken from him by defendants. With profit as the

incentive, defendants promoted the tours conducted by Wild & Scenic just as vigorously as they would have promoted tours conducted by Adams. Further, defendants used Adams' name in their March 1981 newsletter, as they would have done had Adams agreed to conduct the tours. Thus, Adams cannot successfully argue that he lost any more business in 1981 than that represented by the eight planeloads (or 34 passengers) handled by defendants.

Having established the basis for computing Adams' lost revenues, it is relatively easy to find the proper formula for his lost profits. But for the breach, Adams' lost 1981 profits equal the revenues he would have received from the 34 additional passengers (*i.e.*, additional revenues) minus the additional costs he would have incurred in handling those passengers (*i.e.*, additional costs). The district court's error was in considering Adams' "fixed costs." Simply stated, fixed costs represent the total dollar expense that occurs regardless of output and include such "overhead" items as an enterprise's commitments for rental and maintenance, depreciation and the like. *See, e.g.*, P. Samuelson, *Economics* 443 (8th ed. 1970). Adams has already paid his fixed costs for 1981 and by definition would have paid the same amount of fixed costs regardless of whether he carried 57 passengers, 91 passengers or even zero passengers. Thus, he would not have incurred any additional fixed costs handling 34 extra passengers. What he would have incurred are "variable costs," such as expenses for additional fuel and supplies. *See id.*

We restate the correct damage formula as follows:

(1) Additional Revenues from carrying 34 extra extra passengers
(2) - Additional Costs incurred in carrying 34 extra passengers (i.e., additional variable costs)
(3) Additional Profits Adams would have made but for the breach.

The remaining task is to determine what numbers should be plugged into this formula. "Additional revenues" equal the number of additional passengers (34) times the tariff Adams would have received from each passenger. If the evidence shows that Adams would have collected per planeload, as urged by plaintiff, rather than per passenger, as stated in defendants' brief, then additional revenues equal the number of additional planeloads he would have flown times the tariff

he would have received from each planeload. These are questions of fact, and on remand the parties should be permitted to present to the jury any evidence that might bear on them. Similarly, the parties should present evidence as to the additional costs Adams would have incurred in handling the extra passengers. Additional costs equal either the number of extra passengers times the variable costs per passenger or, under a planeload approach, the number of extra planeloads Adams would have handled times the variable costs per planeload. If, for example, Adams proves that the breach cost him 34 passengers, that each passenger would have paid him $1000 and that each would have cost him an additional $500, the jury must award him $17,000:

(1)	$34,000	revenues (34 passengers at $1000)
(2)	-17,000	costs (34 passengers at $500)
	17,000	profits

Accordingly, the judgment is reversed and remanded for a redetermination of damages.

HADLEY v BAXENDALE, 156 Eng.Rep. 145. (Court of Exchequer, 1854)

At the trial before Crompton, J., at the last Gloucester Assizes, it appeared that the plaintiffs carried on an extensive business as millers at Gloucester; and that on the 11th on May, their mill was stopped by a breakage of the crank shaft by which the mill was worked. The steam-engine was manufactured by Messrs. Joyce & Co., the engineers, at Greenwich, and it became necessary to send the shaft as a pattern for a new one to Greenwich. The fracture was discovered on the 12th, and on the 13th the plaintiffs sent one of their servants to the office of the defendants, who are the well-known carriers trading under the name of Pickford & Co., for the purpose of having the shaft carried to Greenwich. The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately; and in answer to the inquiry when the shaft would be taken, the answer was, that if it was sent up by twelve o'clock any day, it would be delivered at Greenwich on the following day. On the following day the shaft was taken by the defendants, before noon, for the purpose of being conveyed to Greenwich, and the sum of 2£ 4s. was paid for its carriage for the whole distance; at the same time the defendants' clerk was told that a special entry, if required, should be made to hasten its delivery. The delivery of the shaft at Greenwich was delayed by some neglect; and the consequence was, that the plaintiffs did not receive the new shaft for several days after they would otherwise have done, and the working of their mill was thereby delayed, and they thereby lost the profits they would otherwise have received.

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

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

[Note:The above was the statement of the Court Reporter; what follows are the comments of one of the judges]

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

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

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

Now we think the proper rule in such a case as the present is this:-- Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in

that case; and of this advantage it would be very unjust to deprive them. Now the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract. It is said, that other cases such as breaches of contract in the nonpayment of money, or in the not making a good title of land, are to be treated as exceptions from this, and as governed by a conventional rule. But as, in such cases, both parties must be supposed to be cognizant of that well-known rule, these cases may, we think, be more properly classed under the rule above enunciated as to cases under known special circumstances, because there both parties may reasonably be presumed to contemplate the estimation of the amount of damages according to the conventional rule. Now, in the present case, if we are to apply the principles above laid down, we find that the only circumstances here communicated by the plaintiffs to the defendants at the time of the contract was made, were, that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of the mill.

But how do these circumstances shew reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person? Suppose the plaintiffs had another shaft in their possession put up or putting up at the time, and that they only wished to send back the broken shaft to the engineer who made it; it is clear that this would be quite consistent with the above circumstances, and yet the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill. Or, again, suppose that, at the time of the delivery to the carrier, the machinery of the mill had been in other respects defective, then, also, the same results would follow. Here it is true that the shaft was actually sent back to serve as a model for the new one, and that the want of a new one was the only cause of the stoppage of the mill, and that the loss of profits really arose from not sending down the new shaft in proper time, and that this arose from the delay in delivering the broken one to serve as a model. But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would not, in all probability, have occurred; and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably

contemplated by both the parties when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such cases occurring under ordinary circumstances, nor were the special circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants. The Judge ought, therefore, to have told the jury that upon the facts then before them they ought not to take the loss of profits into consideration at all in estimating the damages. There must therefore be a new trial in this case.

Rule absolute.

Hypothetical

Defendant built a building for the Plaintiff. The building was erected by the defendant in the late summer and fall of 1961. The premises were leased on October 18, 1961, after the completion of the construction contract, to a bowling alley operator names Twin City Lanes, Inc. and a restaurant owner named T. C. Restaurant, Inc.

A leaky roof developed during the winter of 1961-1962 and leaked again the following winter. The bowling alley and restaurant have sued for their lost profits caused by the leaking roof.

Berlin Dev. Corp. v. Vermont Structural Steel Corp., 127 Vt. 367 (1968)

MADER V. STEPHENSON, 552 P.2d 1114 (Wyo. 1976)

PER CURIAM

Plaintiffs-appellants were awarded a judgment against defendant-appellee in the sum of $1000 with interest from October 11, 1973, the date of the contract, in the sum of $143.86, for a total of $1143.86.

[Plaintiffs now] assert and argue the right to recover certain general items of damage, being $500 as the amount of the fee paid to their attorney for prosecuting this action, and also a claim for $212, being for air transportation to return from Kentucky for the trial, and a $500 estimate of the costs for the time spent in travel, for telephone calls, and various expenses in what they style the 'pursuit of justice' ….

Absent statutory authority, or contractual agreement, attorney fees are not recoverable by a party, nor are travel expenses in connection with the suit recoverable, There is no statutory provision for recovery of travel expenses or time for preparation of a lawsuit. Any recovery for costs is purely statutory,

…

We are required by Rule 72(k), W.R.C.P., to determine whether there was reasonable cause for the appeal and if we cannot so certify to tax as part of the costs a reasonable fee of not less than $25 nor more than $300 to the counsel of the appellee, and further to adjudge to the appellee damages in such sum as may be reasonable, not exceeding $500. We have found nothing in this record justifying the conclusion that there was reasonable cause for the appeal and therefore direct the clerk to tax as costs herein the sum of $150 as counsel fees for the appellee, and $50 as penalty and damages to the appellee.

Affirmed.

S. J. GROVES & SONS CO. V. WARNER CO., 576 F.2d 524 (3rd Cir. 1978)

WEIS, Circuit Judge.

A contract for the concrete work on a bridge being constructed over the Schuylkill River in Southwest Philadelphia resulted in heavy losses for appellant S.J. Groves & Sons Company. Alleging that much of its loss was caused by the performance of its subcontractor who supplied ready-mixed concrete, Groves filed suit against Warner in the

district court. At trial, however, efforts to recoup a substantial portion of the loss from the subcontractor met with only partial success. Concluding that disallowance of many of Groves' claims was based upon factual determinations supported by the record, we affirm the judgment of the district court except insofar as it too narrowly interpreted the duty to mitigate damages.

As part of a highway improvement program, the Pennsylvania Department of Transportation undertook the erection of the Girard Point Bridge in Southwest Philadelphia and selected American Bridge Company as the prime contractor. Plaintiff-appellant Groves was awarded a subcontract for the placement of the bridge's concrete decks and parapets and contracted with the defendant Warner for the delivery of ready-mixed concrete for use at the Girard Point site. Groves filed this lawsuit claiming extensive losses because of Warner's failure to deliver adequate supplies at scheduled times. The case was tried to the court and after preparing detailed findings of fact and conclusions of law, the trial judge entered judgment in favor of the plaintiff in the amount of $35,401.28. Dissatisfied with the denial of a large part of its claimed damages, Groves appealed.

The contract at issue provided that Warner would supply approximately 35,000 cubic yards of ready-mixed concrete at a rate of 40 cubic yards per hour and at times specified by Groves. Having its plant close to the job site, Warner was equipped to prepare and deliver large quantities of concrete. The agreement was executed in March, 1970, and the first concrete was delivered to the job site in July of that year. Groves' progress was hindered by three lengthy strikes in the spring and summer of 1970, 1971, and 1972 which postponed completion of its contract from July of 1972 to October of 1972. The work was also delayed by rejections of concrete that failed to meet state specifications, although the number of rejections was within expectations on such a project. Although concrete pours were completed at a later date than anticipated, the number of weeks during which the pours were made remained substantially the same as was originally planned.

Groves expected to pour concrete for the decks of the bridge in the mornings and then to use some of the crew to construct parapets in the afternoons. This general plan was frustrated by Warner's frequent failures to make deliveries in compliance with

Groves' instructions. As a result, deck pours originally scheduled for the mornings often extended into the afternoons and evenings and created overtime labor expense.

Concerned with its lagging progress, Groves considered securing other sources of concrete as early as 1971 but found no real alternatives. It was too expensive to build its own batching plant at the site and the only other source of ready-mixed concrete in the area was the Trap Rock Company, located near the Warner plant. Trap Rock, however, was not certified to do state work in 1971 and its price was higher than Warner's. Moreover, the production facilities at Trap Rock were limited, as was the number of trucks it had available. Meanwhile, Warner continued to assure Groves that deliveries would improve.

Despite its promises, Warner's performance continued to be erratic and on June 21, 1972, the Pennsylvania Department of Transportation ordered all construction at Girard Point halted until the quality of Warner's service could be discussed at a conference. A meeting took place the next day with state officials and representatives from Warner, Groves, and other contractors in attendance. Based on Warner's renewed assurances of improved performance, state officials allowed work to resume on June 26, 1972. From that date until July 20, 1972, Warner's delivery service improved significantly, although it still did not consistently meet Groves' instructions. In the months following and until completion in October of 1972, Warner's performance continued to be uneven and unpredictable.

On June 14, 1972, when Groves again approached Trap Rock, that firm maintained that it could service the job at the desired delivery rate but did not reduce its price. On July 11, 1972, Trap Rock was certified by the state and the next day agreed to accept the same price as Warner. Groves, nevertheless, decided to continue with Warner as its sole supplier.

The district judge found that Warner had acted in bad faith by deliberately overcommitting its ability to manufacture and deliver enough concrete, providing an inadequate number of trucks to service Groves' project, and following a policy of providing delivery at only 75 percent of the ordered rate. …In the court's view, on June 15, 1972 Groves had no reasonable expectation that Warner's performance would improve to “totally satisfactory levels” and by July 11, 1972, “there were no practical

impediments to employing Trap Rock as a supplemental supplier." The court therefore concluded that "as of July 12, 1972, Groves had an obligation to utilize Trap Rock as a supplemental supplier . . . in order to mitigate any possible 'delay damages' resulting from Warner's service." Accordingly, the court did not award Groves all the delay damages it sought, allowing only $12,534 for overtime which had been paid on days when Warner's deliveries were late before, but not after, July 12, 1972.

Since the first pour on July 9, 1970 resulted in an unacceptable deck panel due to Warner's defective concrete and inadequate workmanship by Groves, the court allocated the cost of removing and replacing the panel. The total expenditure was $42,357.11 and Groves was awarded $10,589.43. In another mismanaged pour on June 20, 1972, Warner's deliveries were late and Groves was required to spend an additional $5,861.55. That sum was awarded to Groves and is not now disputed. Neither is the sum of $26,674.75 attributed to Warner's miscalculation of the volume of concrete actually delivered. The court also disallowed Groves' claims for extra parapet crews, construction of extra forms, and loss of overhead and profits, having concluded the plaintiff had not met its burden of proof.

Although Groves sustained heavy losses in its work on the bridge, the district court recognized that not all were properly attributable to Warner. The lengthy strikes occurring each year at the very beginning of the pouring season adverse weather, and an overly optimistic expectation of the efficiency which could be obtained on a project of this nature were also substantial factors leading to Groves' misfortune. Thus, rejection of many of Groves' claims was based primarily on factual findings which we may not disturb unless they are clearly erroneous. The trial judge was exceptionally painstaking in his preparation of the extensive findings of fact and our review does not reveal any of them to be clearly erroneous. ….

.

The other matter of law which warrants attention is that of mitigation of damages. The district court determined that since the contract was essentially one for the sale of a product with an additional requirement of proper and timely delivery, the Uniform Commercial Code should govern. See Bevard v. Howat Concrete Co., 140 U.S.App.D.C.

96, 433 F.2d 1202 (1970). We agree that in this diversity case the Pennsylvania courts would treat the contract as one for the sale of goods and so we look to the Code.

The court described the transaction between Groves and Warner as an installment contract as that term is defined in Pa.Stat.Ann. tit. 12A, §2-612(1) (Purdon 1970), that is, an agreement to deliver goods in "separate lots to be separately accepted." Where there is non-conformity with respect to one or more installments which substantially impairs the value of the whole contract, there is a breach of the whole. § 2-612(3). In the district court's view, such a breach occurred as of July 12, 1972 and should have been apparent to Groves. At that time Warner had been recertified by the Pennsylvania Department of Transportation and Trap Rock had also received state approval. The district court reasoned that in order to recover consequential damages for defective performance after that date, Groves had to prove that it had complied with the obligation to "cover" or otherwise mitigate damages incurred after Warner's breach in July, 1972.

Section 2-715 provides that the consequential damages a buyer may recover are those which "could not reasonably be prevented by cover or otherwise." Thus, generally, when a seller refuses to deliver goods, the buyer must attempt to secure similar articles elsewhere as a prerequisite to receiving consequential damages. "Cover" is defined in s 2-712(1):

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

Since Trap Rock was available in July, 1972 as a source of ready-mixed concrete, the district court held that Groves was under "a duty to attempt to prevent the consequential damages . . . by obtaining the supplemental supplier" and that Groves' failure to do so barred it, as a matter of law, from receiving such compensation. In this ruling the trial court erred.

The requirement of cover or mitigation of damages is not an absolute, unyielding one, but is subject to the circumstances. Comment 2 to §2-712 says:

"(t)he test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective."

Essentially the cover rules are an expression of the general duty to mitigate damages and usually the same principles apply.[1] The burden of proving that losses could have been avoided by reasonable effort and expense must be borne by the party who has broken the contract. Carl Beasley Ford, Inc. v. Burroughs Corp., 361 F.Supp. 325, 335 (E.D.Pa.1973), aff'd, 493 F.2d 1400 (3d Cir. 1974); 5 A. Corbin, Contracts s 1039 (1964).

In July, 1972, Groves found itself confronted with a breach by Warner and the consequent necessity to choose among a number of alternative courses of action. In the circumstances, Groves could have:

1. Declared the contract breached, stopped work, and held Warner liable for all damages. This was not a realistic alternative.
2. Set up its own cement batching plant at the job site. Time and expense made this impractical.
3. Accepted Warner's assurances that it would perform satisfactorily in the future, see §2-609(1). The court, however, found that it would have been unreasonable to have any faith in continued assurances from Warner.
4. Substituted Trap Rock for Warner for the remainder of the contract. The court made no finding on the reasonableness of this choice but it appears questionable whether Trap Rock had the resources to meet all of Groves' requirements.
5. Engaged Trap Rock as a supplemental supplier; or
6. Continued dealing with Warner in the belief that though its performance would not be satisfactory, consequential damages might be less than if the other alternatives were adopted.

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[1] It has been said that there is not a "duty" on the part of a plaintiff to mitigate damages but rather the principle is that he is entitled to only those damages which he could not avoid by reasonable effort. The "duty" to mitigate cannot be enforced and it is only when recovery is sought that the defense may be invoked. See RESTATEMENT of CONTRACTS § 336, comment d; 5 A. CORBIN, CONTRACTS § 1039 (1964). D. DOBBS, HANDBOOK on the LAW of REMEDIES, § 3.7 at 188 (1973). The test for plaintiff's efforts is reasonableness, MCCORMICK on DAMAGES § 35 (1935).

Of the six alternatives, Groves was seemingly faced with three practical ones all subject to drawbacks. Groves had to: allow Warner to continue in the hope of averting even greater losses; substitute Trap Rock for all of Warner's work a choice made doubtful by Trap Rock's ability to handle the project; or, lastly, use Trap Rock as a supplemental supplier.

The last choice the option chosen by the district court was subject to several difficulties which the court did not discuss. Even if Trap Rock supplied part of the contract with perfect scheduling, there would be no guarantee that Warner would do so. The element of erratic deliveries by Warner would not necessarily be cured, nor would the problems with the quality of concrete it delivered to the site. The presence of two independent suppliers acting separately might indeed pose problems more severe than those which existed before. Moreover, the record reveals that Trap Rock received some of its raw material from Warner and Groves suspected that Warner might not have been too cooperative if part of the Girard Bridge contract were taken away by Trap Rock.

Confronted with these alternatives, Groves chose to stay with Warner, a decision with which the district court did not agree. The court's preference may very well have been the best; that, however, is not the test. As Judge Hastie wrote in In re Kellett Aircraft Corp., 186 F.2d 197, 198-99 (3d Cir. 1950):

"Where a choice has been required between two reasonable courses, the person whose wrong forced the choice can not complain that one rather than the other was chosen. (McCormick on Damages, § 35 (1935).) The rule of mitigation of damages may not be invoked by a contract breaker as a basis for hypercritical examination of the conduct of the injured party, or merely for the purpose of showing that the injured person might have taken steps which seemed wiser or would have been more advantageous to the defaulter. . . . One is not obligated to exalt the interest of the defaulter to his own probable detriment."

There are situations in which continuing with the performance of an unsatisfactory contractor will avoid losses which might be experienced by engaging others to complete the project. 5 Corbin, supra, § 1039 at 249. See also Hillman, Keeping the Deal Together After Material Breach Common Law Mitigation Rules, The UCC, and

the Restatement (Second) of Contracts, 47 U.Colo.L.Rev. 553 (1976). In such a setting, mitigation is best served by continuing existing arrangements. As the troubled Prince of Denmark [ed note, Hamlet] once observed we

" . . . rather bear those ills we have,
Than fly to others that we know not of . . .."

[W] e hold that the district court erred in imposing on Groves as a matter of law a duty to engage Trap Rock. Accordingly, we vacate that portion of the court's judgment which allowed damages for delay only until July 12, 1972. We remand for assessment of damages from that point to completion of the contract on the same basis as that used for the pre-July 12 delay damages. In all other respects, the judgment of the district court will be affirmed.

GRUBER V. S-M NEWS CO., 126 F.Supp. 442 (D.C.N.Y. 1954)

MURPHY, District Judge.

Plaintiffs, invoking jurisdiction of this court on the basis of diverse citizenship, seek damages for breach of contract. Plaintiffs allege in the first count of their complaint (the other two have been withdrawn), that a contract between them and defendant was made about September 10, 1945 at their principal place of business in New York. Under this agreement, plaintiffs allege that they promised to manufacture in conformity with samples approved by defendant, 90,000 sets of twelve Christmas greeting cards for the impending Christmas season; to pack every set in a box of design approved by defendant and be ready for shipment to a list of wholesalers to be furnished by defendant not later than the second week in October; to give defendant exclusive sale and distribution rights to these sets. According to plaintiffs' complaint, in consideration of their promises, defendant bound itself to exercise reasonable diligence to sell all of the sets and use its resources for scientific sales promotion, national advertising, news stand outlets and sales organization. Defendant further agreed, plaintiffs claim, to pay eighty-four cents for each set f. o. b. its wholesalers' respective places of business where, according to defendant's

regular checkup, the cards had been sold at retail. Credit was to be allowed for all sets returned to plaintiffs unsold. It is further alleged that plaintiffs manufactured and packed the sets in accordance with the agreement, notified the defendant to this effect on October 2, 1945, and that defendant then refused its promised performance. Damages for $101,800 are demanded.

…

It is clear that distribution of samples in September to four out of over 700 wholesalers and jobbers who in turn supply over 90,000 outlets, is not an exercise of ‘reasonable diligence’ to sell, in the face of a binding agreement requiring production by plaintiffs of 90,000 sets by the second week in October. Accordingly, the defense of performance by defendant is far from complete, and defendant must assume liability for breach of this contract.

…

For breach of a contract of exclusive distribution and return, plaintiffs should be entitled to damages measured by the difference between what they actually obtained for their cards and what they would have obtained had defendant exercised its promised reasonable diligence. On this, plaintiffs have the burden of proof to the extent of a reasonably certain and definite factual basis of computation. Under the evidence, such basis in this case is too speculative for an award in a sum certain. The past experience of the defendant in distribution of a high proportion of jig-saw puzzles, maps and cleaning fluids is hardly a basis for prophecy with respect to Christmas cards. And a single retailer's opinion that he would have disposed of 50 boxes of the cards is a precarious foundation for generalization with respect to 90,000 such boxes. Accordingly, plaintiffs have not sustained their burden of proof with respect to their expectation under the breached agreement.

However, alternative to damages for loss of their expectation, plaintiffs have demanded at the close of trial at least their out-of-pocket expenses. The basis for these damages is not plaintiffs' expectation of profits but rather their expenditures made in ‘essential reliance’ upon defendant's promise. Defendant, for its part, insists that there can be no recovery upon this theory of essential reliance because there would have been a loss to plaintiffs had defendant fully performed its promise of distribution.

The few cases in point in New York are apparently not entirely in accord with respect to the relationship between anticipated loss in event of full performance by the defendant, on one hand, and a plaintiff's recovery of his out-of-pocket expenses in reliance on defendant's unperformed promise, on the other. There are situations where there is no such relationship, and a plaintiff may recover his expenditures in reliance upon defendant's promise without regard to profit if that promise had been fully performed by defendant, as in actions for restitution and ones based upon fraud. The Restatement has suggested that if full performance by defendant would have resulted in loss to a plaintiff, then this loss must be deducted from plaintiff's expenditures. "[O]n those occasions in which the performance would not have covered the promisee's outlay, such a result [i. e., recovery of expenses by the promisee] imposes the risk of the promisee's contract upon the promisor." We cannot agree that the promisor's default in performance should under this guise make him an insurer of the promisee's venture.

We accept as the rule that plaintiffs' recovery for their out-of-pocket expenses must be diminished by any loss that would result from defendant's full performance. We are not persuaded that defendant has established the probability of such loss. True plaintiffs were able to obtain merely six cents per box on a sale of 40,000 boxes in 1949, rather than the promised eighty-four cents for sale in 1945 under their agreement with defendant. But the Christmas cards had a novelty appeal, designed as they were to exploit a dozen different nations at the time of the newly-formed United Nations in 1945. The glamour of the caricatures may well have been clouded by the worsening world situation that gathered in the succeeding years.

The burden of proving loss in event of performance properly rests on the defendant who by its wrong has made the question relevant to the rights of the plaintiffs. We do not find that defendant has sustained this burden.

Only the amount of plaintiffs' expenditures reasonably made in performance of the contract or in necessary preparation therefore, may be recovered. This does not include, as plaintiffs have requested, the cost of making the plates from which the cards were printed since these had already been fabricated prior to making the contract with defendant. The amount of plaintiffs' expenditures for labor and material reasonably made in essential reliance on defendant's promise was $19,934.44. From this sum must be

deducted the net amount realized by plaintiffs from sale of 40,000 sets at six cents a set which was $2,080. Accordingly plaintiffs are entitled to $17,854.44 in damages.

Judgment accordingly.

ANGLIA TELEVISION LTD. V. REED, House of Lords, [1971] 3 W.L.R. 528

The defendant, a well known actor, contracted with the plaintiffs to play the leading man's part in a television play which they were producing. A few days afterwards the defendant repudiated the contract. The plaintiffs could not get a substitute for the defendant and accepted his repudiation. They abandoned the production.
The plaintiffs sued the defendant for damages. They claimed their total wasted expenditure of £2,750. The defendant contended that they could only recover their expenditure after the contract was concluded of £854. Master Elton gave judgment for the plaintiffs for £2,750.

LORD DENNING M.R.

Anglia Television Ltd., the plaintiffs, were minded in 1968 to make a film of a play for television entitled "The Man in the Wood." It portrayed an American man married to an English woman. The American has an adventure in an English wood. The film was to last for 90 minutes. Anglia Television made many arrangements in advance. They arranged for a place where the play was to be filmed. They employed a director, a designer and a stage manager, and so forth. They involved themselves in much expense. All this was done before they got the leading man. They required a strong actor capable of holding the play together. He was to be on the scene the whole time. Anglia Television eventually found the man. He was Mr. Robert Reed, the defendant, an American who has a very high reputation as an actor. He was very suitable for this part. By telephone conversation on August 30, 1968, it was agreed by Mr. Reed through his agent that he would come to England and be available between September 9 and October 11, 1968, to rehearse and play in this film. He was to get a performance fee of £1,050, living expenses of £100 a week, his first class fares to and from the United States, and so forth. It was all

subject to the permit of the Ministry of Labour for him to come here. That was duly given on September 2, 1968. So the contract was concluded. But unfortunately there was some muddle with the bookings. It appears that Mr. Reed's agents had already booked him in America for some other play. So on September 3, 1968, the agent said that Mr. Reed would not come to England to perform in this play. He repudiated his contract. Anglia Television tried hard to find a substitute but could not do so. So on September 11 they accepted his repudiation They abandoned the proposed film. They gave notice to the people whom they had engaged and so forth.

Anglia Television then sued Mr. Reed for damages. He did not dispute his liability, but a question arose as to the damages. Anglia Television do not claim their profit. They cannot say what their profit would have been on this contract if Mr. Reed had come here and performed it. So, instead of claim for loss of profits, they claim for the wasted expenditure. They had incurred the director's fees. the designer's fees, the stage manager's and assistant manager's fees, and so on. It comes in all to £2,750. Anglia Television say that all that money was wasted because Mr. Reed did not perform his contract.

Mr. Reed's advisers take a point of law. They submit that Anglia Television cannot recover for expenditure incurred *before* the contract was concluded with Mr. Reed. They can only recover the expenditure *after* the contract was concluded. They say that the expenditure *after* the contract was only £854.65, and that is all that Anglia Television can recover.

The master rejected that contention: he held that Anglia Television could recover the whole £2,750; and now Mr. Reed appeals to this court.

Mr. Butler, for Mr. Reed, has referred us to the recent case of Perestrello & Companhia Limitada v. United Paint Co. Ltd., The Times, April 16, 1969, in which Thesiger J. quoted the words of Tindal C.J. in Hodges v. Earl of Litchfield (1835) 1 Bing. N.C. 492, 498:

“The expenses preliminary to the contract ought not to be allowed. The party enters into them for his own benefit at a time when it is uncertain whether there will be any contract or not.”

Thesiger J. applied those words, saying: "In my judgment pre-contract expenditure, though thrown away, is not recoverable."

I cannot accept the proposition as stated. …If he has not suffered any loss of profits - or if he cannot prove what his profits would have been - he can claim in the alternative the expenditure which has been thrown away, that is, wasted, by reason of the breach. That is shown by Cullinane v. British "Rema" Manufacturing Co. Ltd. [1954] 1 Q.B. 292, 303, 308.

If the plaintiff claims the wasted expenditure, he is not limited to the expenditure incurred *after* the contract was concluded. He can claim also the expenditure incurred *before* the contract, provided that it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken. Applying that principle here, it is plain that, when Mr. Reed entered into this contract, he must have known perfectly well that much expenditure had already been incurred on director's fees and the like. He must have contemplated - or, at any rate, it is reasonably to be imputed to him - that if he broke his contract, all that expenditure would be wasted, whether or not it was incurred before or after the contract. He must pay damages for all the expenditure so wasted and thrown away.

Hypothetical

Phyllis Locke, doing business as Paris Freight Company, entered into a contract with Mistletoe on October 18, 1984, which provided that Locke would perform a pickup and delivery service for Mistletoe at various locations in Texas. The contract term was one year from October 1, 1984. At the expiration of the initial term, the agreement would continue on a month-to-month basis until either party terminated it by thirty-day written notice.

In order to perform her contract, it was necessary for Locke to make certain investments and expenditures. In uncontroverted testimony, she stated that she spent $ 3,500.00 for materials to build a steel and pipe ramp and $ 1,000.00 for dirt work. She also borrowed $ 15,000.00, with which she purchased two vehicles for $ 9,000.00 and paid $ 6,000.00 for starting-up expenses. She testified that she would not have done any

of these things had she not made the contract with Mistletoe. Locke's company never made a profit, although the losses decreased each month while the contract was in force.

On May 15, 1985, Mistletoe notified Locke that it planned to cancel the contract effective June 15, 1985. Locke closed her business and sold the vehicles for $ 6,000.00, taking a loss of $ 3,000.00. At the time of trial, Locke still owed $ 9,750.00 on her $ 15,000.00 loan, and had paid $ 2,650.00 in interest. She testified that the customized ramp was worth $ 500.00 as scrap. She considered the $ 1,000.00 expended for dirt work a lost expense.

The jury found Locke's damages at $ 19,400.00. The court entered judgment for that amount, plus prejudgment interest and attorney's fees of $ 2,000.00.
Mistletoe's sole contention is that the trial court should have granted it a directed verdict or judgment notwithstanding the verdict, because there is no evidence to support the damages which the jury awarded.

Mistletoe Express Service v. Locke, 762 S.W.2d 637 (Tex. App. 1988)

UCC, LOST VOLUME, AND EMPLOYMENT

CHRONISTER OIL CO. V. UNOCAL REFINING AND MARKETING, 34 F.3d 462 (7th Cir. 1994)
POSNER, Chief Judge.

Chronister Oil Company brought this diversity suit for breach of contract against Union Oil Company (Unocal), to which Chronister had agreed to sell 25,000 barrels of gasoline. Unocal counterclaimed, charging that it was Chronister, not Unocal, that had broken their contract. The case is governed by the Uniform Commercial Code as interpreted by the Illinois courts; and the magistrate judge, to whom the case was assigned for trial by consent of the parties, held after a bench trial that Chronister had

broken the contract, and he awarded damages of $26,000 to Unocal, precipitating this appeal.

The contract, made February 9, 1990, provided that Chronister, an oil trader, would deliver the 25,000 barrels to Colonial Pipeline (for shipment to Unocal) on the "front seventh cycle," and fixed a price of 60.4¢ a gallon. The term "front cycle" is pipelinese for the first half of what is normally a ten-day period for shipping a particular grade of product in a petroleum pipeline. The cycles begin on January 1, so the "front seventh cycle" would be approximately the first five days of March-apparently no effort is made to pin down the dates of the cycles and half cycles more precisely. To fulfill the contract, Chronister on March 1, 1990, made a contract with another oil trader, Enron, which in turn made a contract with a supplier, Crown Petroleum, to deliver the 25,000 barrels to Colonial Pipeline's pipeline at Pasadena, Texas for shipment east and north to terminals from which Unocal would deliver the gasoline to its dealers. Enron decided to have the gasoline delivered to Colonial's pipeline on March 5. But when the day arrived and Colonial tested the gasoline preparatory to taking it into its pipeline, it found that the gasoline contained too much water, and refused to take it. Unocal was informed on the morning of March 6 (which apparently was still within the front seventh cycle) and immediately called Chronister, demanding (at least implicitly, as we'll explain) assurances that Chronister would comply with the contract. Chronister got in touch with Enron, which agreed to supply another 25,000 barrels, but for shipment on the back seventh cycle, that is, later in March, or on the eighth cycle, later still. Unocal wasn't interested, and within hours, while Chronister was trying to solve the problem, Unocal took the precaution of diverting 25,000 barrels of gasoline that it already owned and that were in the pipeline in transit to a storage facility to Baton Rouge to its distribution terminals farther up the line-a measure Unocal describes as "provisional cover"-in effect supplying the 25,000 barrel deficit from inventory, but giving Chronister until the following day (March 7) to come up with conforming product.

Yet later the same day (March 6), Chronister, despite Unocal's adamant refusal to accept anything but front seventh cycle gasoline, accepted Enron's offer of substitute performance on the back seventh cycle and again offered this to Unocal. Again Unocal insisted that it would take only front seventh cycle product-either the Crown Petroleum

gasoline drained of its water or other product that could be injected into the pipeline in time. With Unocal unwilling to accept the 25,000 barrels on the back seventh cycle that Chronister had perhaps precipitately agreed to take from Enron, Chronister sold this gasoline to another company, Aectra Refining, at 55.3¢ a gallon. Claiming that by refusing to accept the substitute performance Unocal had broken the contract, Chronister filed this suit for damages based on the difference between the contract price and the lower price at which it sold the 25,000 barrels to Aectra. Unocal counterclaimed, contending that it was Chronister that had broken the contract and seeking damages equal to the difference between the contract price and the average cost of its inventory (63.14¢), from which it had made up the loss of the 25,000 barrels promised by Chronister. The district court agreed with Unocal that Chronister, not Unocal, had broken the contract, and it awarded damages to Unocal on its counterclaim. [NOTE: The Court of Appeals affirmed the finding that Chronister had breached the contract]

We move to the issue of damages. The point of an award of damages, whether it is for a breach of contract or for a tort, is, so far as possible, to put the victim where he would have been had the breach or tort not taken place. *Nicolet Instrument Corp. v. Lindquist & Vennum,* 34 F.3d 453, 457 (7th Cir.1994). Unocal had, back in February, promised to pay Chronister 60.4¢ a gallon. By the first week of March the price of gasoline for delivery to the Colonial Pipeline had fallen. On March 6, Chronister sold 25,000 barrels to Aectra at 55.3¢ a gallon, and it is not argued that Chronister could have gotten a higher price. Uncontradicted evidence revealed that there had been a similar sale at a similar price on March 2. Had Unocal gone out in the market and covered by buying 25,000 barrels on March 6 or 7 it would have paid somewhere in the neighborhood of 55¢ a gallon and thus would have *saved* 5¢ a gallon as a result of Chronister's breach. It makes no difference that instead of buying the gasoline on the open market it took it from inventory. As a matter of fact, because of an impending change in pressure by Colonial Pipeline that would make Unocal's inventory, stored mainly in a 300,000 barrel storage facility in Baton Rouge, shortly unshippable, Unocal had a strong interest in drawing down its inventory. The breach was a godsend. At argument Unocal's counsel candidly acknowledged that Unocal was made better off as a result of the breach and that this was

evident not only by the time of trial, and hence early enough to figure in the calculation of damages, *Rea v. Ford Motor Co.,* 560 F.2d 554, 557 (3d Cir.1977), but within fifteen days after Chronister's breach.

Nevertheless, argues Unocal, it was entitled by UCC § 2-712 to cover by obtaining a substitute for the lost 25,000 barrels, even from itself, and to obtain as damages the difference between the cover price, which it deems to be 63.14¢ a gallon, the average cost of the inventory from which it obtained the substitute supply of gasoline, and the contract price of 60.4¢. This is a misreading of section 2-712, as the only two Illinois-law cases pertinent to the issue hold. *Draper v. Minneapolis-Moline, Inc.,* 100 Ill.App.2d 324, 241 N.E.2d 342, 345 (1968); *Rash Ranco Corp. v. B.L.B. Inc.,* 762 F.Supp. 1339, 1341 (N.D.Ill.1991). Section 2-712 defines cover as purchasing or making a contract to purchase a substitute good. Unocal did not purchase any gasoline to take the place of the lost 25,000 barrels. It decided *not* to purchase a substitute good but instead to use a good that it already owned. You can't "purchase," whether in ordinary language or UCC speak (see § 1-201(32)), what you already own. The purpose of the cover provision is not to allow buyers to obtain damages when they have not been hurt, but to provide a market measure of the hurt. Taking a good out of your inventory and selling it is not a purchase in a market. There is no purchase price to use as a ready index of the harm that the buyer incurred by the seller's breach.

Two cases from other jurisdictions have shoehorned this kind of "self-cover" into section 2-712. *Cives Corp. v. Callier Steel Pipe & Tube, Inc.,* 482 A.2d 852, 858 (Me.1984); *Dura-Wood Treating Co. v. Century Forest Industries, Inc.,* 675 F.2d 745, 753-54 (5th Cir.1982). They had no need to do this violence to the text. Section 2-712 is not the only buyer's remedy that the UCC authorizes. The very next section allows the buyer to obtain damages measured by the difference between market price and contract price. If a reasonable response for the buyer to the breach would be to make the product itself, then the difference between the market price of that product and the contract price would be an appropriate measure of the harm from the breach. That is what *Cives* and *Dura-Wood* hold; they merely cite the wrong section.

Unocal's response in diverting gasoline in transit to storage was reasonable; the only question, upon which its damages if any turn, is what that cost it. What it had paid

for the gasoline-even less, the *average* price that it had paid for *all* the gasoline that it had not yet sold (the average cost of its inventory, in other words)-was not the cost of diverting the gasoline from storage to sale. At least it was not cost in a sense relative to damages. The object of an award of damages, as we have already noted, is to put the victim in the same place that he would have been in had the breach or other wrong of which he complains not occurred. It is to compensate him for a loss *that he would have avoided* had the violation not occurred. The concept of loss that underlies the computation of legal damages thus resembles the economist's concept of "opportunity cost": the opportunity one gives up by engaging in some activity is the cost of that activity, *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358, 1369-70 (7th Cir.1985). We must ask what Unocal gave up as a consequence of the breach, and whether it was something of value.

By diverting the gasoline in order to protect itself against Chronister's breach of contract, Unocal gave up the opportunity either to sell the gasoline on the market (in order to lighten its inventory), which we know would have yielded it substantially less than the average cost of its inventory because the market price was much lower than that cost, or to have a larger-an unnecessarily and, it would soon prove, unusably larger-inventory. Neither course of action would have yielded value equal to Unocal's average cost of inventory or equal to the contract price. The first point shows that the average cost of inventory was the wrong figure to use in estimating Unocal's damages, and the second point shows that it had no damages. The 25,000 barrels it diverted to its dealers cost it less-was worth less-than the 25,000 barrels that Chronister failed to deliver to it as promised. Sellers usually break their contracts in a rising market, where they can get more for the product by selling to someone other than the buyer with whom they signed the contract. Here a seller in a declining market broke a contract that he desperately wanted to perform, conferring a windfall gain on the buyer-which the latter would like as it were to double with the help of the courts.

The judgment of the district court is affirmed insofar as it determined that Chronister broke its contract with Unocal. But it is reversed with respect to damages and remanded with directions to enter judgment for Unocal for nominal damages (to which

for reasons we do not understand every victim of a breach of contract, unlike a tort victim, is entitled, *Stromberger v. 3M Co.*, 990 F.2d 974, 976 (7th Cir.1993)).

In re WorldCom, Inc., 361 B.R. 675 (Bankr. S.D.N.Y. 2007)
Opinion by: Arthur J. Gonzalez,

INTRODUCTION

Before the Court are cross-motions for summary judgment separately brought by Michael Jordan ("Jordan") and WorldCom, Inc. (hereafter referred to as the "Debtors" or "MCI").

BACKGROUND

On or about July 10, 1995, Jordan and the Debtors entered into an endorsement agreement (the "Agreement"). At that time, Jordan was considered to be one of the most popular athletes in the world. The Agreement granted MCI a ten-year license to use Jordan's name, likeness, "other attributes," and personal services to advertise and promote MCI's telecommunications products and services beginning in September 1995 and ending in August 2005. The Agreement did not prevent Jordan from endorsing most other products or services, although he could not endorse the same products or services that MCI produced. In addition to a $ 5 million signing bonus, the Agreement provided an annual base compensation of $ 2 million for Jordan. … The Agreement provided that Jordan was to make himself available for four days, not to exceed four hours per day, during each contract year to produce television commercials and print advertising and for promotional appearances. The parties agreed that the advertising and promotional materials would be submitted to Jordan for his approval, which could not be unreasonably withheld, fourteen days prior to their release to the general public. From 1995 to 2000, Jordan appeared in several television commercials and a large number of print ads for MCI.

On July 1, 2002, MCI commenced a case under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the Bankruptcy Court for the Southern District of New York. On January 16, 2003, Jordan filed Claim No. 11414 in the amount of $ 2 million plus contingent and unliquidated amounts allegedly due under the Agreement. On

July 18, 2003, the Debtors rejected the Agreement as of that date, pursuant to §365(a) of the Bankruptcy Code. Following that rejection of the Agreement, Jordan filed Claim No. 36077 (the "Claim") in the amount of $ 8 million -- seeking $ 2 million for each of the payments that were due in June of 2002, 2003, 2004, and 2005. MCI does not object to the Claim to the extent Jordan seeks $ 4 million for the 2002 and 2003 payments under the Agreement. As of the rejection in July 2003, two years remained under the Agreement.

The Parties' Contentions

MCI argues that Jordan had an obligation to mitigate his damages and failed to do so. ….Jordan argues that the objection should be overruled and dismissed for three independent reasons (1) Jordan was a "lost volume seller" and thus mitigation does not apply, (2) there is no evidence that Jordan could have entered into a "substantially similar" endorsement agreement, and (3) Jordan acted reasonably when he decided not to pursue other endorsements after MCI's rejection of the Agreement.

DISCUSSION

…

C. Mitigation

The doctrine of avoidable consequences, which has also been referred to as the duty to mitigate damages, "bars recovery for losses suffered by a non-breaching party that could have been avoided by reasonable effort and without risk of substantial loss or injury." *Edward M. Crough, Inc. v. Department of General Services,* 572 A.2d 457, 466 (D.C. 1990). The burden of proving that the damages could have been avoided or mitigated rests with the party that committed the breach. *See Obelisk Corp. v. Riggs Nat'l Bank of Washington, D.C.,* 668 A.2d 847, 856 (D.C. 1995); *see also Norris v. Green,* 656 A.2d 282, 287 (D.C. 1995) ("The failure to mitigate damages is an affirmative defense and the [breaching party] has the burden of showing the absence of reasonable efforts to mitigate"). The efforts to avoid or mitigate the damages do not have to be successful, as long as they are reasonable. *See Edward M. Crough,* 572 A.2d at 467.

Jordan argues that as a "lost volume seller" he was under no obligation to mitigate damages. Alternatively, Jordan argues that MCI failed to establish that Jordan could have entered a "substantially similar" endorsement contract and that Jordan acted reasonably in not entering another endorsement agreement after MCI's breach. MCI counters that Jordan is not a lost volume seller and that MCI has shown that Jordan failed to take reasonable steps to mitigate damages….

1. Whether Jordan Was a "Lost Volume Seller"

Jordan argues that MCI's mitigation defense does not apply here because Jordan is akin to a "lost volume seller." Jordan points to testimony demonstrating that he could have entered into additional endorsement contracts even if MCI had not rejected the Agreement. Thus, he argues, any additional endorsement contracts would not have been substitutes for the Agreement and would not have mitigated the damages for which MCI is liable.

"A lost volume seller is one who has the capacity to perform the contract that was breached in addition to other potential contracts due to unlimited resources or production capacity." *Precision Pine & Timber, Inc. v. United States,* 72 Fed. Cl. 460, 490 (Fed. Cl. 2006). A lost volume seller does not minimize its damages by entering into another contract because it would have had the benefit of both contracts even if the first were not breached. *See Jetz Servs. Co. v. Salina Props.,* 19 Kan. App. 2d 144, 865 P.2d 1051, 1055-56 (Kan. Ct. App. 1993). The lost volume seller has two expectations, the profit from the breached contract and the profit from one or more other contracts that it could have performed at the same time as the breached contract. *See Snyder v. Herbert Greenbaum & Assocs.,* 38 Md. App. 144, 380 A.2d 618, 624 (Md. Ct. Spec. App. 1977). "The philosophical heart of the lost volume theory is that the seller would have generated a second sale irrespective of the buyer's breach" and that "[i]t follows that the lost volume seller cannot possibly mitigate damages." D. Matthews, *Should the Doctrine of Lost Volume Seller Be Retained? A Response to Professor Breen,* 51 U. MIAMI L. REV. 1195, 1214 (July 1997); *see also Snyder,* 380 A.2d at 625 (under this theory, "the original sale and the second sale are independent events").

The lost volume seller theory is recognized in the Restatement (2d) of Contracts, §§347, 350 (1981) (the "Restatement (2d)"). [8] The lost volume seller theory applies to

contracts for services as well as goods. *See* Restatement (2d), ß 347, ill. 16; *see also Jetz Servs. Co.,* 865 P.2d at 1055-56 (applying theory to seller of services).

8 Comment f to §347 states in part

> "Lost volume." Whether a subsequent transaction is a substitute for the broken contract sometimes raises difficult questions of fact. If the injured party could and would have entered into the subsequent contract, even if the contract had not been broken, and could have had the benefit of both, he can be said to have "lost volume" and the subsequent transaction is not a substitute for the broken contract. The injured party's damages are then based on the net profit that he has lost as a result of the broken contract.

Comment d to §350 states

> "Lost volume." The mere fact that an injured party can make arrangements for the disposition of the goods or services that he was to supply under the contract does not necessarily mean that by doing so he will avoid loss. If he would have entered into both transactions but for the breach, he has "lost volume" as a result of the breach. See Comment f to §347. In that case the second transaction is not a "substitute" for the first one. See Illustrations 9 and 10.

This case offers a twist on the typical lost volume seller situation. In what the Court regards as the typical situation, the non-breaching seller has a near-inexhaustible supply of inventory. *See, e.g., Katz Commc'ns, Inc. v. Evening News Ass'n,* 705 F.2d 20, 26 (2d Cir. 1983). In the typical situation, when a buyer breaches an agreement to buy a good or service from the seller, the item is returned to inventory and the lost volume seller continues in its efforts to sell its goods or services. However, the transactions that occur following the breach are not necessarily the result of the breach but fundamentally the result of the seller continuing efforts to market its goods and services. It is this continuous effort coupled with a virtually limitless supply that warrants the lost volume exception to mitigation. As stated above, the transactions that may occur after the breach would in the context of the lost volume seller have occurred independent of the breach. Here, Jordan lacked a nearly limitless supply and had no intention of continuing to market his services as a product endorser.

Although not addressed by a D.C. court, the majority of cases hold that Jordan bears the burden of proving that he is a lost volume seller. *See generally Precision Pine,* 72 Fed. Cl. at 495 ("The case law demonstrates that . . . plaintiff bears the burden of demonstrating that it should be compensated as a lost volume seller"); *Snyder,* 380 A.2d at 624; *Ullman-Briggs, Inc. v. Salton, Inc.,* 754 F. Supp. 1003, 1008-09 (S.D.N.Y. 1991); *R.E. Davis Chemical Corp. v. Diasonics, Inc.,* 826 F.2d 678, 684 (7th Cir. 1987).

To claim lost volume seller status, Jordan must establish that he would have had the benefit of both the original and subsequent contracts if MCI had not rejected the Agreement. *See Ullman-Briggs,* 754 F. Supp. at 1008. Although there is no definitive set of elements that the non-breaching party must show, many cases seem to follow the language from the Restatement (2d), Section 347, that the non-breaching party must show that it "could and would have entered into" a subsequent agreement. *See, e.g., Donald Rubin, Inc. v. Schwartz,* 191 A.D.2d 171, 172, 594 N.Y.S.2d 193, 194-95 (1st Dep't 1993); *Precision Pine,* 72 Fed. Cl. at 496-97; *Gianetti,* 833 A.2d at 897; *Jetz Servs. Co.,* 865 P.2d at 1056; *see also Green Tree Financial,* 2002 U.S. Dist. LEXIS 18764, 2002 WL 31163072, at *9 ("[t]o recover lost profits under this theory, a non-breaching party must prove three things: (1) that the seller of services had the capability to perform both contracts simultaneously; (2) that the second contract would have been profitable; and (3) that the seller of service would have entered into the second contract if the first contract had not been terminated").

In his arguments, Jordan focuses primarily on his *capacity* to enter subsequent agreements, arguing that the loss of MCI's sixteen-hour annual time commitment hardly affected his ability to perform additional endorsement services. On this prong alone, Jordan likely would be considered a lost volume seller of endorsement services because he had sufficient time to do multiple endorsements. Although he does not have the "infinite capacity" that some cases discuss, a services provider does not need unlimited capacity but must have the requisite capacity and intent to perform under multiple contracts at the same time. *See Gianetti,* 266 Conn. at 561-62 (plastic surgeon could be considered a lost volume seller if it were determined that he had the capacity and intent to simultaneously work out of three or four hospitals profitably).

Contrary to Jordan's analysis, courts do not focus solely on the seller's capacity. The seller claiming lost volume status must also demonstrate that it *would* have entered into subsequent transactions. *See Diasonics*, 826 F.2d at 684; *Green Tree Financial*, 2002 U.S. Dist. LEXIS 18764, 2002 WL 31163072, at *9; *Gianetti*, 779 A.2d at 853 ("for sellers of personal services to come within the purview of the Restatement's lost volume seller theory . . . , they must establish," in addition to capacity, that additional sales would have been profitable and that they would made the additional sale regardless of the buyer's breach). Jordan has not shown he could and *would have* entered into a subsequent agreement. Rather, the evidence shows that Jordan did not have the "subjective intent" to take on additional endorsements. *See Ullman-Briggs*, 754 F. Supp. at 1008. The testimony from Jordan's representatives establishes that although Jordan's popularity enabled him to obtain additional product endorsements in 2003, Jordan desired to scale back his level of endorsements. Jordan's financial and business advisor, Curtis Polk ("Polk"), testified that at the time the Agreement was rejected, Jordan's desire was "not to expand his spokesperson or pitchman efforts with new relationships." *See* Debtors' Mot. Summ. J., App. 5, at 32. Polk testified that had Jordan wanted to do additional endorsements after the 2003 rejection, he could have obtained additional deals. *See id.* at 64-65. Jordan's agent, David Falk ("Falk"), testified that "there might have been twenty more companies that in theory might have wanted to sign him" but that Jordan and his representatives wanted to avoid diluting his image. *See* Debtors' Mot. Summ J., App. 6, at 24. Jordan's Memorandum for Summary Judgment stated that at the time the Agreement was rejected, Jordan had implemented a strategy of not accepting new endorsements because of a belief that new deals would jeopardize his ability to achieve his primary goal of National Basketball Association ("NBA") franchise ownership.

In a district court case in the Southern District of New York, the court held that the test of whether a plaintiff has established lost volume seller status has both subjective and objective components. *See Ullman-Briggs*, 754 F. Supp. at 1008-09. That case involved the breach of a sales distribution agreement; the plaintiff was a sales representation company that had represented the defendant, a manufacturer of small electrical appliances. *Id.* at 1004. After the defendant terminated the contract, the plaintiff took on seventeen new lines of products to represent. *Id.* at 1006. The plaintiff argued that its

damages award should not be offset by the commissions it earned from these new lines. *Id.* at 1008. The court disagreed, finding that the plaintiff failed to show it had the subjective intent to take on these accounts even if the defendant had not terminated their agreement. *Id.* at 1009 (plaintiff's "own proof refuted that intent as to many of the additional lines"). The court stated that the plaintiffs "admission that it would not have had the subjective intent to take on many of the additional lines if Salton had not terminated the contract" was "fatal to Ullman-Briggs' claim that it may be properly be regarded as a lost volume seller." *Id.* Here, although the situation is not strictly parallel because there were no subsequent deals by Jordan, the testimony by Jordan's agent and advisor shows he lacked the subjective intent to take on additional endorsement opportunities regardless of MCI's rejection of the Agreement.

Jordan's situation is akin to that of the plaintiff in *Samaritan Inns, Inc. v. District of Columbia,* 325 U.S. App. D.C. 19, 114 F.3d 1227 (D.C. Cir. 1997). In that case, Samaritan Inns, the plaintiff, provided below-market rental housing to recovering substance abusers. *Id.* at 1229. It successfully sued the District of Columbia and District officials for violations of the Fair Housing Act, such as unlawfully enforcing a stop-work order and initiating proceedings to revoke the plaintiff's construction permits. At issue on appeal, and of relevance here, was a portion of the damages award. The defendants appealed the award of more than $ 2 million in damages for potential contributions the plaintiff claimed it lost because of the defendants' conduct. *Id.* at 1229, 1232. Once the controversy began, Samaritan Inns had chosen not to begin a planned fundraising campaign and argued that its damages included the lost contributions from this campaign. *Id.* The court analogized the plaintiff's argument to the lost volume seller theory, as the plaintiff claimed that charitable contributions are given on a regular basis. *Id.* at 1236. "[I]f a charity solicits money on an annual basis, a donation in one year will not compensate the charity for a donation 'lost' in a prior year." *Id.* If not for the disruption of an annual fundraising drive, "the charity would have received contributions in both years." *Id.* The problem with the damages award, according to the district court, was that the fundraising campaign was of "limited duration" and not an annual program. *Id.* The district court noted that if the fundraising program had been an annual event, a fact-finder could reasonably conclude that the plaintiff irretrievably lost the contributions, but it was

unexplained under the circumstances -- circumstances that included the "limited" duration of the campaign -- why the plaintiff could not "simply make up the 'lost' contributions in later years and still achieve the goals of the [fundraising] campaign." *Id.* Here, if Jordan had been seeking additional endorsement agreements independent of the Agreement's rejection, the Court could conclude that Jordan was a lost volume seller and irretrievably lost the money from the MCI Agreement. However, given Jordan's planned limitation on his endorsement activity based upon a desire to cultivate an image he perceived more compatible with that of an owner of an NBA team, rather than to continue to market his celebrity athlete image, the Court cannot make that conclusion.

One of the classic examples of the lost volume seller is found in *Neri v. Retail Marine Corp.,* 30 N.Y.2d 393, 399-400, 285 N.E.2d 311, 334 N.Y.S.2d 165, 169-70 (N.Y. 1972)

> [I]f a private party agrees to sell his automobile to a buyer for $ 2,000, a breach by the buyer would cause the seller no loss (except incidental damages, i.e., expense of a new sale) if the seller was able to sell the automobile to another buyer for $ 2,000. But the situation is different with dealers having an unlimited supply or standard-priced goods. Thus, if an automobile dealer agrees to sell a car to a buyer at the standard price of $ 2,000, a breach by the buyer injures the dealer, even though he is able to sell the automobile to another for $ 2,000. If the dealer has an inexhaustible supply of cars, the resale to replace the breaching buyer costs the dealer a sale, because, had the breaching buyer performed, the dealer would have made two sales instead of one. The buyer's breach, in such a case, depletes the dealer's sales to the extent of one, and the measure of damages should be the dealer's profit on one sale.

This example would surely have a different result if the car dealership was winding down its business and had agreed to sell one of its last cars to a buyer. If that buyer subsequently breached the contract and did not purchase the car, the dealership could hardly be expected to recover lost profits damages if the dealer put the car back onto a deserted car lot, made no attempts to sell it, and kept the dealership shuttered to new customers. Those modifications are analogous to Jordan's situation, with his stated desire to withdraw his services from the endorsement marketplace, and the lost volume seller theory accordingly does not apply to his circumstances.

Jordan states that it is a "red herring" to speculate under the lost volume analysis on what he *would* have done because that

> ignores the central point of the lost volume principle: if Jordan had . . . accepted a substantially similar endorsement opportunity -- exactly what [MCI] argues he was required to do to mitigate damages -- the damages for which [MCI] is liable would not have been reduced by one penny because the lost volume principle would allow Jordan to retain the benefits of both the [MCI] Agreement and the hypothetical additional endorsement.

See Michael Jordan's Reply Brief, at 14-15.

Jordan overlooks an important point about the lost volume seller theory -- that the "original sale and the second sale are independent events," *Snyder,* 380 A.2d at 625, because the lost volume seller's intent to enter into new contracts is the same before and after a purchaser's breach. The lost volume seller's desire to sell more units of goods or services is virtually unaffected by the loss of a single sale or agreement.

Next, even if Jordan had mitigated damages by entering one subsequent endorsement agreement, this, without more, does not mean that Jordan was a lost volume seller. The lost volume seller has the intent and capacity to sell multiple units despite the breach of a contract for one transaction.

Finally, if Jordan had entered into a subsequent agreement or agreements, and if he had showed both the capacity and the intent to make subsequent sales, that might have had the effect of helping him to establish his status as a lost volume seller, which generally would relieve him of the duty to mitigate. This would not be a novel situation but it ignores the fact that he did not do so. *See, e.g., Storage Tech. Corp. v. Trust Co. of N.J.,* 842 F.2d 54, 57 (3d Cir. 1988) ("The lost volume seller theory is a response to a breaching buyer's right to have a non-breaching seller mitigate damages. In other words, a seller can avoid the effect of its failure to mitigate by proving that it was a lost volume seller."); *Chicago Title Ins. Corp. v. Magnuson,* No. 2:03-CV-368, 2005 U.S. Dist. LEXIS 43884, 2005 WL 2373430, at *23 (S.D. Ohio Sept. 26, 2005) (when there is no evidence in the record that plaintiff "turned away or would have turned away business during the relevant period" and the "only evidence on the issue supports that the [plaintiff] could and would have completed such transactions," the consequent

instructions to the jury that the plaintiff was a lost volume seller and therefore had no duty to mitigate its damages were not erroneous).

Because the evidence establishes, among other things, that Jordan would not have entered into subsequent agreements, Jordan has not established that he is a lost volume seller. This theory thus does not relieve Jordan from the duty to mitigate damages.

2. *Whether Jordan Made Reasonable Efforts to Mitigate*

Jordan argues at length that MCI must show that Jordan could have entered a "substantially similar" endorsement contract in order to mitigate damages. However, this is not the law of the mitigation of damages or the avoidable consequences theory. This language stems from federal employment cases concerning back pay and mitigation, which this case, while similar in many respects, is not. *See, e.g., Ford Motor Co. v E.E.O.C.*, 458 U.S. 219, 231-32, 102 S.Ct. 3057, 3065-66, 73 L. Ed. 2d 721 (1982) (the duty to mitigate damages, "rooted in an ancient principle of law, requires the claimant to use reasonable diligence in finding other suitable employment. Although the . . . claimant need not go into another line of work, accept a demotion, or take a demeaning position, he forfeits his right to back pay if he refuses a job substantially equivalent to the one he was denied") (footnotes omitted); *Ingrassia v. Shell Oil Co.*, 394 F. Supp. 875, 886 (S.D.N.Y. 1975) ("The general rule in wrongful discharge actions is that the employee is obliged to mitigate damages by seeking and accepting other available employment of the same or substantially similar character but not employment of a substantially different kind").

Several of the justifications for the "substantially similar or equivalent" standard of employment law, aside from the general remedial policy of making the non-breaching party whole for losses caused by the breaching party, show why there is less concern here regarding a "substantially equivalent" opportunity as Jordan was not an employee of MCI. For one, the standard exists in part to ensure the employee's future advancement by mandating that the employee's promotional opportunities and status should be virtually identical to the prior position. *See Sellers v. Delgado Community College*, 839 F.2d 1132, 1138 (5th Cir. 1988). Since Jordan was never an employee of MCI, this is not relevant. Second, to require acceptance of inferior employment can mean "that one who has been

discriminated against would be obliged, in order to mitigate damages, to submit to the very discrimination of which he complains. *See Williams v. Albemarle City Bd. of Ed.,* 508 F.2d 1242, 1244 (4th Cir. 1974). This, obviously, has no application here. Finally, the employee's duty to make reasonable efforts in finding substantially equivalent employment is "based both on the doctrine of mitigation of damages and on the policy of promoting production and employment." *See N.L.R.B. v. Miami Coca-Cola Bottling Co.,* 360 F.2d 569, 575 (5th Cir. 1966).

The main case relied on by Jordan for this argument regarding a "substantially similar" opportunity is a case analyzed under employment law and one that presented a completely different factual and procedural background. *See Parker v. Twentieth Century-Fox Film Corp.,* 3 Cal. 3d 176, 89 Cal. Rptr. 737, 474 P.2d 689 (Cal. 1970). In *Parker,* the plaintiff, a leading movie actress, agreed to perform in a musical-type film in California. *Id.* at 690. The employer studio later decided not to make the movie and offered to the plaintiff as a substitute the leading role in a dramatic "western type" movie set in an opal mine and to be filmed in Australia. *Id.* at 694. The plaintiff turned down that offer, sued for damages on the original agreement, and the trial court ruled on a summary judgment motion that the earnings from this substitute employment that the plaintiff refused could not be applied in mitigation because the second offer was "different" and "inferior." *Id.* The California Supreme Court affirmed. *Id.*

More accurately, MCI must show the absence of reasonable efforts by Jordan to avoid consequences or minimize his damages. *See Norris v. Green,* 656 A.2d 282, 287 (D.C. 1995); Joseph M. Perillo, *Calamari & Perillo on Contracts,* ß 14.15, at 584 (5th Ed. 2003) ("The doctrine of avoidable consequences merely requires reasonable efforts to mitigate damages"). As the D.C. law has not addressed this issue in any depth, the Court again turns to other jurisdictions where necessary.

Since "reasonable efforts in the form of affirmative steps are required to mitigate damages," *see Robinson v. United States,* 305 F.3d 1330, 1334 (Fed. Cir. 2002) (emphasis added) (citing Restatement (2d) §350), MCI carries its burden by showing that Jordan has not taken affirmative steps to mitigate damages. Jordan admits in his brief that at the time of the rejection of the Agreement, "Jordan had already implemented a business strategy of not accepting new endorsements." *See* Jordan's Memo, in Support of

Mot. Summ. J. at 17. Falk testified that a replacement telecommunications company was not approached. *See* Debtors' Mot. Summ. J., App. 6, at 25-26. Polk testified that Jordan did not return to the endorsement marketplace to try and replace the revenue he was to be paid under the Agreement. *See* Debtors' Mot. Summ. J., App. 5, at 28-29, 55. Polk explained that Jordan did not wish to expand his "pitchman efforts with new relationships" because of his primary goal of becoming the owner of an NBA team. *Id.* at 31-32. Although Jordan points to his discussions with another company, Nextel, as showing that he was willing to listen to endorsement agreements after MCI's bankruptcy, MCI effectively responds that responding to an inquiry by giving them contact information and indicating a willingness to respond to another call "is not trying to find an alternative" agreement -- it is, in effect, "doing nothing." *See* Transcript of Sept. 12, 2006 Hearing, at 32-33. Based on the foregoing, and drawing all permissible factual inferences in favor of Jordan, the Court determines that MCI has established that Jordan did not take affirmative steps to mitigate damages.

3. *Whether Jordan's Beliefs that Another Endorsement Would Dilute His Impact as an Endorser or Harm His Reputation Were Reasonable Justifications for not Mitigating Damages*

Jordan cites the risk that entering another endorsement contract could dilute his impact as an endorser or damage his reputation or business interests.

a. Dilution

Jordan's dilution argument is not convincing. Jordan's agent Falk testified that although there were no "fixed numbers" for the amount of endorsements, Jordan and his representatives were wary about dilution and sensitive about "protecting the brand" of Jordan. *See* Debtors' Mot. Summ. J., App. 6, at 11. Jordan does not set forth any facts showing that Jordan's image was at risk of dilution. MCI convincingly responds that adding an agreement to replace a lost one is merely maintaining the status quo, not a dilution of Jordan's impact by addition. MCI's expert stated that Jordan had previously had sixteen endorsement agreements in place (*see* Debtors' Memo, in Opp. to Jordan's

Mot. for Summ. J., Ex. A (Carter Depo. at 50, 91)), which further weakens Jordan's dilution argument and casts doubt on Falk's statement that Jordan and his advisors "always felt that less is more" in terms of endorsements. *See* Michael Jordan's Memo. In Support of Mot. for Summ. J. at 16-17. While the Court recognizes that Jordan's image is the true commodity here and its market value could be diluted from overexposure, MCI has shown that Jordan's image was not at risk of dilution by replacing the MCI endorsement agreement with another one. The only statements Jordan offers to support his argument that he behaved reasonably by not seeking another endorsement in 2003 because of a concern with diluting his image are conclusory in nature and contradicted by the available evidence. The contention that pursuing an endorsement opportunity would dilute the image Jordan wished to cultivate as one befitting an NBA team owner, may well raise factual issues regarding the impact an endorsement may have on a team owner's image but that impact is irrelevant to Jordan's duty to mitigate damages for his "rejected" endorsement contract. There is no genuine issue of material fact that dilution did not excuse Jordan's duty to mitigate damages.

b. Risk to Reputation

Under the risk to reputation theory Jordan cites, an injured party is not allowed to recover from a wrongdoer those damages that the injured party "could have avoided without undue risk, burden or humiliation." *See* Restatement (2d), ß 350(1). Jordan's "harm to reputation" argument is flawed because the envisioned harm to Jordan's reputation does not rise to the level of harm found in the cited case law.

The cases cited by Jordan illustrate the harm to reputation that will excuse a party's duty to mitigate. In *Eastman Kodak Co. v. Westway Motor Freight, Inc.,* 949 F.2d 317 (10th Cir. 1991), Kodak shipped a load of sensitized photographic material on a truck operated by the defendant. Most of the material was destroyed in transit because of the defendant's mishandling. The Tenth Circuit held that Kodak was not required to sell the damaged merchandise to mitigate damages, stating that the record revealed that Kodak's reputation, which it spent considerable resources in developing, "could be harmed if it was required to sell damaged merchandise in order to mitigate damages." *Id.* at 320….

Those cases show the uncontroversial maxim that a plaintiff faced with the choice of (1) selling a sub-standard product to the public to mitigate damages caused by the breach of another and (2) doing nothing -- can choose to do nothing, but Jordan was not confronted with those circumstances. While Jordan's reputation is considerable and obviously the result of careful development, there are no factual assertions that support the proposition that Jordan's choosing another endorsement opportunity is akin to being forced to sell damaged goods….

The above analysis also applies to Jordan's cited case of *Citizens Fed. Bank v. United States,* 66 Fed. Cl. 179 (Fed. Cl. 2005). There, the court held that the breaching party cannot engage in "Monday-morning quarterbacking" to criticize the wronged party's choice of mitigation. *Id.* at 185. "Where a choice has been required between two reasonable courses, the person whose wrong forced the choice can not complain that one rather than the other was chosen." *Id.* Here, MCI is not complaining about the choice between "two reasonable courses" of mitigation. MCI is arguing that choosing to take no steps to mitigate is not a reasonable course.

In arguing that Jordan acted reasonably by avoiding further endorsements based on a belief that those efforts would harm his business interests or reputation, Jordan argues essentially that he would be harmed by doing precisely what he originally contracted to do under the Agreement and what he has been doing for other clients for a number of years -- endorsing products and services. The Court recognizes the possibility of Jordan's market saturation being a valid concern but Jordan's argument that he wanted to get out of endorsements to pursue other ventures does not relieve the duty to mitigate….

D. **The Need for a Further Determination of Damages**

A case cited by MCI shows the correct path for further resolution of this matter. *Wisconsin Ave. Nursing Home v. D.C. Human Rights Comm'n,* 527 A.2d 282 (D.C. 1987), did not, as MCI asserts, hold that the plaintiff's failure to mitigate damages *barred* any recovery. After finding that the discharged employee had not exercised reasonable diligence in seeking substitute employment, the court remanded the case for the factual determination, with the burden of proof on the defendant, of the wages the plaintiff could have earned had she diligently sought substitute employment. *Id.* at 291-92. *See also*

Obelisk Corp. v. Riggs Nat'l Bank of Washington, D.C., 668 A.2d 847, 856 (D.C. 1995) (affirming this jury instruction "if you find . . . that a party should have taken advantage of a business opportunity which was reasonably available to a party under all of the circumstances shown by the evidence, then you should reduce the amount of that party's damages by the amount that the party would have received if it had taken advantage of such opportunity. However, the burden of proving that the damage could have been avoided or mitigated rests with the party that committed the breach."); *In re Rowland*, 292 B.R. 815, 820 (Bankr. E.D. Pa. 2003) ("To prove a failure to mitigate, a defendant must show: (1) what reasonable actions the plaintiff ought to have taken, (2) that those actions would have reduced the damages, and (3) the amount by which the damages would have been reduced") (quoting *Koppers Co., Inc. v. Aetna Cas. & Surety Co.*, 98 F.3d 1440 (3rd Cir. 1996)). Thus, even though the Court finds that Jordan has failed as a matter of law to mitigate damages, the Court does not disallow the Claim in full.

In this case, there has been no determination and no evidence presented of what Jordan could have reasonably earned had he fulfilled his obligation to mitigate damages by entering the endorsement marketplace following MCI's rejection of the Agreement. It is not clear that Jordan could have found an endorsement agreement in 2003 that paid him $ 2 million a year for the contract years 2004 and 2005. It is also unlikely that Jordan would have been obligated to accept a large number of endorsements of smaller value to make up the $ 2 million, due to the dilution effect such a number would have, because such efforts would likely be unreasonable. However, the facts may reveal that one or more endorsements could have been found without "diluting" his image and partially or completely mitigating the damages. Although MCI's expert stated that he believed that Jordan could have easily earned $ 2 million from an additional endorsement in 2003, (*see* Debtors' Memo. In Opp. to Jordan Mot. for Summ. J., Ex. A (Carter Depo. at 92)), that opinion was not presented with any objective evidence of the marketplace, such as what other celebrity endorsers of Jordan's stature earned that year and which companies were in the market for an endorser of Jordan's stature. Although the Court finds that as a matter of law Jordan has not mitigated damages, there must be an evidentiary hearing on how much his claim should be reduced to reflect what portion would have been mitigated had he used reasonable efforts to do so.

Conclusion

The Court finds that Jordan failed to mitigate damages but a further evidentiary hearing is necessary to determine what Jordan could have received had he made reasonable efforts to mitigate, a determination that consequently will affect the Claim.

Hypothetical

[An attorney with the State was wrongfully fired from his job] and at a hearing was he was ordered reinstated to the position of class attorney IV. The Review Board made findings and an order on February 2, 1949, wherein it found that during the time of his separation from state service plaintiff, if he had not been so separated, would have been paid a salary as class attorney II amounting to $ 18,310; that by reasonable diligence plaintiff could have obtained employment as an attorney with the federal civil service during this period of separation and could have earned $3,000 per year; and that the award of back pay should be reduced by that amount.

Plaintiff made no effort to obtain employment with Twin Cities law firms, nor did he make application to the various federal agencies or the United States civil service for employment; and that plaintiff had practiced law in Minneapolis between 1926 and 1934, earning an average of $ 3,000 per year in such practice. Plaintiff testified that the stigma associated with his discharge made it futile to seek employment in the Twin Cities; that the federal positions were menial and would take him away from home; that he maintained an office in Bloomington and had a wide acquaintance there; and that he would have had a good practice there had it not been for the publicity attending his discharge.

The board found that plaintiff, by the exercise of reasonable diligence, could have earned an average of $ 3,000 a year from the practice of law with the federal position during the time in question. Since the board allowed plaintiff six months in which to open an office or find legal employment, it appears to have concluded that he would have earned $7,750 during the period of his separation. The board also found that plaintiff's

actual earnings from legal work averaged $ 208.56 a year, while his earnings from other work and personal ventures averaged $ 797.88 per year.
Spurck v. Civil Service Board, 231 Minn. 183 (1950)

CONSTRUCTION DAMAGES & PUNITIVE DAMAGES

JACOB & YOUNGS V. KENT, 130 N.E. 933 (N.Y. 1921)
CARDOZO, J.

The plaintiff built a country residence for the defendant at a cost of upwards of $77,000, and now sues to recover a balance of $3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that--

"All wrought-iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture."

The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival,

failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value, and in cost as the brand stated in the contract-that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

…..

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure. Spence v. Ham, supra. The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. 'There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable.' Handy v. Bliss, 204 Mass. 513, 519, 90 N. E. 864, 134 Am. St. Rep. 673. Cf. Foeller v. Heintz, 137 Wis. 169, 178, 118 N. W. 543, 24 L. R. A. (N. S.) 321; Oberlies v. Bullinger, 132 N. Y. 598, 601, 30 N. E. 999; 2 Williston on Contracts, § 805, p. 1541. The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable

importance has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

EMERY V. CALEDONIA SAND & GRAVEL CO., INC., 117 N.H. 441, 374 A.2d 929 (N.H. 1977)

BOIS, Justice.

The plaintiffs, husband and wife farm operators, entered into a landfill removal contract with the defendant road construction company. Under the terms of the several written agreements, the plaintiffs allowed the defendant to remove earthfill from a certain site on their farmland at a specified unit charge. The agreements imposed upon the company the obligation to restore the "pit" (excavation area) upon completion of its operations. The defendant was obligated, inter alia, to leave the area "reasonably level with all back slopes no steeper 6:1"; to replace all topsoil; to spread all disturbed areas "with the original topsoil or strippings, or with some other material capable of supporting vegetation"; to fertilize and seed the pit area; and to clean up all areas disturbed by the operation to the owners' specifications."

The plaintiffs were fully paid for the fill removed but were dissatisfied with defendant's restoration of the land. Suit was brought to recover damages alleging defendant was in breach of its restoration obligations. The Trial Court (Douglas, J.) found for the plaintiffs in the sum of $17,520. Defendant's exceptions to the verdict and various rulings by the court have been reserved and transferred.

The evidence was undisputed that the defendant had failed to render the back slopes "no steeper than 6:1." There was also substantial evidence that much of the original topsoil from the pit area had been "lost" during the removal operation, and that topsoil depth had deteriorated from twelve inches before the operation to four inches or less after. Finally, there was evidence that the area had been the source of a substantial hay crop prior to the removal, but was later able to support only a meager stand of grass. The trial court found that the Emerys had been damaged in the following amounts:

1. $3,000 for the cost of 2,000 cubic yards of fill needed to bring the back slopes to the specified grade;

2. $10,500 for the cost of 6,000 cubic yards of topsoil required to restore the topsoil to its original depth;

3. $3,000 as the fair and reasonable value of lost hay crops for the years 1972 to 1975; and

4. $1,020 as the fair and reasonable cost of plowing, harrowing, disking, fertilizing, seeding and feathering the disturbed area (as specified by the owners) in order that the fertility of the topsoil would be restored.

Defendant's principal contention on appeal is that the court erred in considering certain parol evidence relative to plaintiffs' understanding that their land would be restored so as to be usable as a hayfield. The written agreements made no mention of use of the land as a hayfield, and defendant contends that the oral statements should have been excluded under the "parol evidence rule." This common law rule provides:

"When two parties have made a contract and have expressed it in a writing to which they have both assented as the complete and accurate integration of that contract, evidence, whether parol or otherwise, of antecedent understandings and negotiations will not be admitted for the purpose of varying or contradicting the writing."
3 A. Corbin, Contracts s 573, at 357 (1960).

We find no merit to defendant's contention. The written agreements provided that the defendant would replace all topsoil and otherwise prepare the soil to the owners' specifications. If these undertakings had been performed the land would have been usable as a hayfield. Thus the parol evidence in question did not vary or contradict contractual duties as expressed in the writing.

The defendant may not complain that the trier of fact considered the hayfield evidence. In awarding damages, it was incumbent on the court to grant compensation for those injuries the defendant had reason to foresee as a probable result of its breach when the contract was made. "If the injury is one that follows the breach in the usual course of

events, there is sufficient reason for the defendant to foresee it; otherwise, it must be shown specifically that the defendant had reason to know the facts and to foresee the injury." Johnson v. Waisman Bros., 93 N.H. 133, 135, 36 A.2d 634, 636 (1944); Restatement, Contracts §330 (1932). The court could properly consider the hayfield evidence in determining whether the claimed lost crops were a probable result of the defendant's breach. There was no damage limitation provision in the written agreements, and the evidence cannot be said to present any parol evidence problem.

The defendant also complains that the court erred in using the ordinary contract measure of compensatory damages. Under this measure, an effort is made "to put the injured party in as good a position, so far as money damages can put him, as he would have occupied had the defendant fully performed." Dunn & Sons, Inc. v. Paragon Homes of New Eng. Inc., 110 N.H. 215, 218, 265 A.2d 5, 8 (1970); Salvucci & Sons, Inc. v. State, 110 N.H. 136, 154, 268 A.2d 899, 911 (1970); Coos Lumber Co. v. Builders Supply Co., 104 N.H. 404, 406, 188 A.2d 330, 331 (1963).

The defendant relies on a tort case, Moulton v. Groveton Papers Co., 114 N.H. 505, 323 A.2d 906 (1974), involving damages to real property occasioned by flooding resulting from the breach of a dam. In Moulton we stated:

"These plaintiffs allege that their properties have unique value to them and that they do not seek to sell, but rather restore them. If it can be found on the evidence that these properties can and will be restored to their prior conditions without costs disproportionate to the actual injury, the cost of such restoration is the measure of damages. If restoration is impracticable, the difference between the value of the properties before and after the injury is the measure of damages." 114 N.H. at 513, 323 A.2d at 911.

The defendant here argues that "there is no evidence that the plaintiffs will restore the premises to their alleged prior condition if awarded damages," and thus that compensatory damages are inappropriate.

We note initially that Moulton is a tort case and it is thus readily distinguishable: "In a case of tort . . . the general purpose of compensation is to give a sum of money to the person wronged which as nearly as possible, will restore him to the position he would be in if the wrong had not been committed. In the case of a breach of contract, the goal of

compensation is not the mere restoration to a former position, as in tort, but the awarding of a sum which is the equivalent of performance of the bargain the attempt to place the plaintiff in the position he would be in if the contract had been fulfilled." C. McCormick, Law of Damages §137 at 560-61 (1935).

Further, assuming that the Moulton standard were applicable here, the court denied the defendant's proposed finding to the effect that there was "no evidence" that the plaintiffs would restore the land. It is a fair inference from plaintiff's testimony that restoration is contemplated, and we cannot say that the denial of the requested finding was clearly erroneous.

We agree that there are occasions when it would be economically wasteful to place the aggrieved party under the contract in the "same place" he would have occupied had the contract been fully performed, and on such occasions the ordinary measure of contract damages may not be employed. For example, in the context of a construction contract, the usual measure of damages may be withheld if "physical reconstruction and completion in accordance with the contract (would) involve unreasonable economic waste by destruction of usable property or otherwise." J. Calamari and J. Perillo, Contracts §230, at 363 (1970); see Danforth v. Freeman, 69 N.H. 466, 43 A. 621 (1898). It is said that the "true rationale" underlying this rule of damages is one of unjust enrichment since "(i)n all likelihood if the owner were to recover this (disproportionate) amount in such circumstances he would pocket the recovery." J. Calamari and J. Perillo supra. However, there is no showing of disproportionality in this case. A valuable income-producing asset has been rendered unproductive; the damages awarded constitute a reasonable means of bringing that asset back to life. If the plaintiffs choose to "pocket" their recovery, they will have foregone the restoration of their land; they will not have been unjustly enriched.

The defendant further complains that the damage award is excessive in that the plaintiffs failed to mitigate and avoid damages. Relying on testimony by the plaintiff husband that he witnessed the defendant's deficient restoration of the topsoil, the defendant argues that plaintiff should "have spoken up at that time"; additionally, defendant argues that plaintiffs could have taken steps to do what had to be done for the

damaged land. The trial court denied defendant's proposed findings on this issue, holding that the expenditures required by plaintiffs would have been prohibitive.

We find no reason to disturb the rulings of the trial court. The law requires reasonable efforts by a plaintiff to curtail his loss. Murray v. Boston & Maine R. R., 107 N.H. 367, 375, 224 A.2d 66, 72 (1966); Novak v. Company, 84 N.H. 93, 96, 146 A. 525, 526 (1929). Recovery will not be permitted of damages which could have been "avoided by reasonable effort without undue risk, expense, or humiliation." Restatement, Contracts, §336(1) (1932). The evidence in this case is clear that no hay crop would be possible without the restoration of topsoil. Since this would involve a $10,500 expenditure it was not error for the court to conclude that the expenditure was not within the plaintiffs' duty to mitigate. See Chambers v. Belmore Land Co., 33 Cal.App. 78, 164 P. 404 (1917). This case is obviously distinguishable from the situation where the required expenditure is one for seed only. Defendant's reliance on Wavra v. Karr, 142 Minn. 248, 172 N.W. 118 (1919), is thus misplaced.

Exceptions overruled.

PATTON V. MID-CONTINENT SYSTEMS, INC., 841 F.2d 742 (7th Cir. 1988)
POSNER, Circuit Judge.

The defendant, Mid-Continent Systems, appeals from a damages judgment entered upon a verdict for the plaintiffs (James Patton and R.L. Hildebrand, and their corporations) in a diversity breach of contract action. The jury awarded Patton and his company $592,000 in compensatory damages, and Hildebrand and his company $186,000. The jury also awarded the plaintiffs $2,250,000 in punitive damages, but the judge reduced this award to $100,000. Mid-Continent argues that it was entitled to a directed verdict on liability, that there was error in the jury instructions, that the compensatory damages were excessive, and that there was no legal basis for an award of punitive damages.

…

The question regarding punitive damages is not the amount after the judge cut down the jury's verdict, but whether the plaintiffs were entitled to any punitive damages at all.

…

Indiana allows punitive damages to be awarded in suits for breach of contract if, "mingled" with the breach, are "elements of fraud, malice, gross negligence or oppression." *Travelers Indemnity Co. v. Armstrong, supra,* 442 N.E.2d at 359; see also *Rose Acre Farms, Inc. v. Cone, supra,* 492 N.E.2d at 70; *Indiana & Michigan Electric Co. v. Terre Haute Industries, Inc., supra,* 507 N.E.2d at 610-12; *Canada Dry Corp. v. Nehi Beverage Co.,* 723 F.2d 512, 524-26 (7th Cir.1983). In trying to give concrete meaning to these terms (especially "oppression"), it is important to bear in mind certain fundamentals of contractual liability. First, liability for breach of contract is, prima facie, strict liability. That is, if the promisor fails to perform as agreed, he has broken his contract even though the failure may have been beyond his power to prevent and therefore in no way blameworthy. The reason is that contracts often contain an insurance component. The promisor promises in effect either to perform or to compensate the promisee for the cost of nonperformance; and one who voluntarily assumes a risk will not be relieved of the consequences if the risk materializes. See *Field Container Corp. v. ICC,* 712 F.2d 250, 257 (7th Cir.1983); *Fidelity & Deposit Co. v. City of Sheboygan Falls,* 713 F.2d 1261, 1269-70 (7th Cir.1983).

Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses. If he is forced to pay more than that, an efficient breach may be deterred, and the law doesn't want to bring about such a result. See *J. Yanan & Associates, Inc. v. Integrity Ins. Co.,* 771 F.2d 1025, 1034 (7th Cir.1985). Suppose that by franchising Truck-O-Mat in the plaintiffs' territory, Mid-Continent increased its own profits by $150,000 and inflicted damages of $75,000 on the plaintiffs. That would be an efficient breach. But if Mid-Continent had known that it would have to pay in addition to compensatory damages $100,000 in punitive damages, the breach would not have been worthwhile to it and efficiency would have suffered because the difference between Mid-Continent's profits of $150,000 and the plaintiffs' losses of $75,000 would (certainly after the plaintiffs were compensated) represent a net social gain.

Not all breaches of contract are involuntary or otherwise efficient. Some are opportunistic; the promisor wants the benefit of the bargain without bearing the agreed-upon cost, and exploits the inadequacies of purely compensatory remedies (the major inadequacies being that pre- and post-judgment interest rates are frequently below market levels when the risk of nonpayment is taken into account and that the winning party cannot recover his attorney's fees). This seems the common element in most of the Indiana cases that have allowed punitive damages to be awarded in breach of contract cases; see the discussion of cases in *Travelers Indemnity Co. v. Armstrong, supra,* 441 N.E.2d at 359. Granted, this is not how the legal test is phrased; in particular the category of "gross negligence" seems unrelated to opportunistic breach. We may have captured the core of the Indiana rule but missed the periphery. But whatever the exact dimensions of the rule, the facts of the present case are pretty clearly outside it.

There is no evidence that the action of Mid-Continent in franchising Truck-O-Mat in the plaintiffs' exclusive territory was opportunistic or even deliberate. So far as can be discerned from the record it was an honest mistake resulting from the ambiguous description of the territory in the franchise agreement with the plaintiffs. However, Mid-Continent's failure to correct the violation year after year after the plaintiffs had called its attention to it-even after it acknowledged the violation-converted an innocent breach into a deliberate one; but no clear and convincing evidence enables the breach to be characterized as malicious, fraudulent, oppressive, or even grossly negligent. As we saw in discussing the issue of compensatory damages, the breach did little, perhaps no, damage to either plaintiff, and it is therefore quite possible that it was an efficient breach in the sense that it increased Mid-Continent's profits by more than it caused anyone losses. If so, the refusal to rectify the breach, while deliberate, would not justify an award of punitive damages. See *J. Yanan & Associates, Inc. v. Integrity Ins. Co., supra,* 771 F.2d at 1034. Mid-Continent's unfulfilled promises to rectify the breach could be viewed as a form of deceit designed to prevent the plaintiffs from resorting to legal remedies, but this is just the kind of conjecture that seems excluded by the requirement of proving entitlement to punitive damages by clear and convincing evidence.

…

The award of punitive damages must be vacated. The finding of breach of contract is affirmed and the case remanded for a new trial limited to compensatory damages.

AFFIRMED IN PART, VACATED IN PART, REMANDED.

Hypothetical

In the trial court, plaintiffs Willie and Lucille Peevyhouse sued the defendant, Garland Coal and Mining Company, for damages for breach of contract. Judgment was for plaintiffs in an amount considerably less than was sued for. Plaintiffs appeal and defendant cross-appeals.

Briefly stated, the facts are as follows: plaintiffs owned a farm containing coal deposits, and in November, 1954, leased the premises to defendant for a period of five years for coal mining purposes. A 'strip-mining' operation was contemplated in which the coal would be taken from pits on the surface of the ground, instead of from underground mine shafts. In addition to the usual covenants found in a coal mining lease, defendant specifically agreed to perform certain restorative and remedial work at the end of the lease period. It is unnecessary to set out the details of the work to be done, other than to say that it would involve the moving of many thousands of cubic yards of dirt, at a cost estimated by expert witnesses at about $ 29,000.00.

During the trial, it was stipulated that all covenants and agreements in the lease contract had been fully carried out by both parties, except the remedial work mentioned above; defendant conceded that this work had not been done.

Plaintiffs introduced expert testimony as to the amount and nature of the work to be done, and its estimated cost. Over plaintiffs' objections, defendant thereafter introduced expert testimony as to the 'diminution in value' of plaintiffs' farm resulting from the failure of defendant to render performance as agreed in the contract -- that is, the difference between the present value of the farm, and what its value would have been if defendant had done what it agreed to do.

…

Under the most liberal view of the evidence herein, the diminution in value resulting to the premises because of non-performance of the remedial work was $ 300.00. After a careful search of the record, we have found no evidence of a higher figure, and plaintiffs do not argue in their briefs that a greater diminution in value was sustained *Peevyhouse v. Garland Coal & Mining Co.,* 382 P.2d 109 (1962)

LIQUIDATED DAMAGES & RESTITUTION

NPS, LLC vs. PAUL MINIHANE, 451 Mass. 417; 886 N.E.2d 670; (2008)

COWIN, J.

In this case we decide whether an acceleration clause in a ten-year license agreement for luxury seats for New England Patriots professional football games at Gillette Stadium is enforceable. The agreement requires the purchaser of the license to pay, upon default, the amounts due for all years remaining on the license. The plaintiff contends that the clause is a lawful liquidated damages provision; the defendant, who defaulted in the first year of the agreement, argues that it is an unlawful penalty. A judge in the Superior Court agreed with the defendant and refused to enforce the provision. Because we conclude the provision is enforceable, we modify the judgment accordingly.

Background.

The judge issued his ruling on the liquidated damages provision from the bench without detailed findings of fact. Most of the underlying facts, however, are not in dispute, as indicated by the joint stipulation of the parties. We supplement these facts with those that were found or implied by the judge. The plaintiff, NPS, LLC (NPS), is the developer of Gillette Stadium (stadium), the home field of the New England Patriots professional football team (Patriots). In 2002, while the stadium was still under construction, NPS

entered into an agreement with the defendant, Paul Minihane, for the purchase of a ten-year license for two luxury seats in the Club Level III section. The agreement called for the defendant to pay $ 3,750 per seat annually for each of the ten seasons from 2002 to 2011. The agreement included a liquidated damages provision, which provides that in the event of a default, including failure to pay any amount due under the license agreement, the payments would be accelerated so that the defendant would be required to pay the balance for all the years remaining on the contract:

> "15. Default. The following shall constitute an 'Event of Default' under this Agreement: (i) Licensee fails to pay when due any amounts to be paid by Licensee pursuant to the Agreement . . . . In the event of any such Event of Default, Owner may, at its option: (a) withhold distribution of tickets to Licensee for games and/or other Stadium Events until such time as such default is cured; and/or (b) terminate the rights of Licensee under the Agreement after giving Licensee not less than twenty (20) days prior written notice of such default or breach . . . . In the event that Licensee shall not have cured the default or breach specified in said notice [***4] by the date specified in said notice, Owner may terminate the right of Licensee to the use and possession of the Club Seats and all other rights and privileges of Licensee under the Agreement and declare the entire unpaid balance of the License Fee (which for the purposes hereof shall include the total aggregate unpaid balance of the annual License Fees for the remainder of the Term) immediately due and payable, whereupon Owner shall have no further obligation of any kind to Licensee. Owner shall have no duty to mitigate any damages incurred by it as a result of a default by Licensee hereunder. . . ."

Upon executing the agreement, the defendant paid a $ 7,500 security deposit; he later made a payment of $ 2,000 toward the license fee for the 2002 season. Although he or his guests attended all but one of the 2002 preseason and regular season Patriots games at the stadium using the tickets for the Club Seats, he made no further payments. After giving notice to the defendant, NPS accelerated the payments and filed a complaint in the Superior Court seeking the full amount due under the contract. After a bench trial, the judge ruled that the liquidated damages provision was unenforceable because the amount

due was "grossly disproportionate to a reasonable estimate of actual damages made at the time of contract formation." After taking further evidence on the issue of actual damages, the judge issued a memorandum of decision and order in which he awarded damages to NPS in the amount of $ 6,000. This appeal followed, and we transferred the case to this court on our own motion.

Discussion.

We accept the judge's findings of fact unless they are clearly erroneous. *Kendall v. Selvaggio,* 413 Mass. 619, 620, 602 N.E.2d 206 (1992). "On the other hand, to ensure that the ultimate findings and conclusions are consistent with the law, we scrutinize without deference the legal standard which the judge applied to the facts." *Id.* at 621. Whether a liquidated damages provision in a contract is an unenforceable penalty is a question of law. *Manganaro Drywall, Inc. v. Penn-Simon Constr. Co.,* 357 Mass. 653, 656, 260 N.E.2d 182 (1970). The burden of showing that a liquidated damages provision is unenforceable rests with the party challenging enforcement of the provision (here, the defendant), *TAL Fin. Corp. v. CSC Consulting, Inc.,* 446 Mass. 422, 423, 844 N.E.2d 1085 (2006), and we resolve reasonable doubts in favor of the aggrieved party (here, NPS). *Cummings Props., LLC v. National Communications Corp.,* 449 Mass. 490, 494, 869 N.E.2d 617 (2007).

It is well settled that "a contract provision that clearly and reasonably establishes liquidated damages should be enforced, so long as it is not so disproportionate to anticipated damages as to constitute a penalty." *TAL Fin. Corp. v. CSC Consulting, Inc., supra* at 431. A liquidated damages provision will usually be enforced provided two criteria are satisfied: first, that at the time of contracting the actual damages flowing from a breach were difficult to ascertain; and second, that the sum agreed on as liquidated damages represents a "reasonable forecast of damages expected to occur in the event of a breach." *Cummings Props., LLC v. National Communications Corp., supra* at 494. Where

damages are easily ascertainable, and the amount provided for is grossly disproportionate to actual damages, or unconscionably excessive, the court will award the aggrieved party no more than its actual damages. *A-Z Servicenter, Inc. v. Segall,* 334 Mass. 672, 675, 138 N.E.2d 266 (1956). Since there is "no bright line separating an agreement to pay a reasonable measure of damages from an unenforceable penalty clause," *TAL Fin. Corp. v. CSC Consulting, Inc., supra,* the reasonableness of the measure of anticipated damages depends on the circumstances of each case. *A-Z Servicenter, Inc. v. Segall, supra.* In assessing reasonableness, we look to the circumstances at the time of contract formation; we do not take a "second look" at the actual damages after the contract has been breached. *Kelly v. Marx,* 428 Mass. 877, 878, 705 N.E.2d 1114 (1999).

In this case, the trial judge found that, at the time the parties entered into the license agreement, the harm resulting from a possible breach was difficult to ascertain. That finding was supported by the evidence, which indicated that the damages sustained by NPS would vary depending on the demand for tickets at the time of breach. Although the Patriots had won their first Super Bowl championship in 2002, shortly before the parties entered into their agreement, the demand for luxury stadium seats was then and remains variable and depends, according to the evidence, on the current performance of the team, as well as other factors, such as the popularity of the players and the relative popularity of other sports, that are unpredictable at the time of contract. Therefore, to predict at the time of contract how long it would take NPS to resell the defendant's seat license would be extremely difficult, if not impossible.

The judge went on to find, however, that the sum provided for in the agreement -- acceleration of all payments for the remaining term of the contract -- was "grossly disproportionate to a reasonable estimate of actual damages made at the time of contract formation." That finding was not supported by the evidence. It is the defendant's burden to

show that the amount of liquidated damages is "unreasonably and grossly disproportionate to the real damages from a breach" or "unconscionably excessive." See *TAL Fin. Corp. v. CSC Consulting, Inc., supra* at 423; *A-Z Servicenter, Inc. v. Segall, supra* at 675. Having presented little evidence beyond his assertion that the contract as a whole was unconscionable, the defendant in this case has not sustained that burden.

The liquidated damages provision here is similar to one we upheld in *Cummings Props., LLC v. National Communications Corp., supra* (*Cummings*). In that case, a tenant who defaulted on a commercial lease was required by the terms of the agreement to pay the entire amount of rent remaining under the lease. *Id.* at 491-492. … In upholding the liquidated damages provision in *Cummings,* we noted that "to the extent that the liquidated damages amount represented the agreed rental value of the property over the remaining life of the lease, decreasing in amount as the lease term came closer to expiration, it appears to be a reasonable anticipation of damages that might accrue from the nonpayment of rent." *Id.* at 496-497. The same is true here. This, like *Cummings,* is a case where the damages were difficult to estimate at the outset, and the defendant is required to pay no more than the total amount he would have paid had he performed his obligations under the agreement. The sum provided for therefore bears a reasonable relationship to the anticipated actual damages resulting from a breach. It anticipates a worst-case scenario, that is, NPS's inability to resell the seat for the remaining term of the license.[1] However, the defendant has not shown that this outcome is sufficiently unlikely that it renders the amount grossly disproportionate to a reasonable estimate of actual damages.

The defendant stood to receive a substantial benefit from this agreement: guaranteed luxury seating for all Patriots home games, as well as a hedge against future price increases over ten years. He was not deprived of an opportunity to learn and consider

[1] We note in passing that there was evidence at trial that NPS in fact had not been able to resell the defendant's seat, some four years after the defendant committed a breach of the agreement. Although *Kelly v. Marx,* 428 Mass. 877, 878, 705 N.E.2d 1114 (1999), prevents our consideration of this fact, it suggests that it was not unduly pessimistic to think that NPS might have difficulty reselling the defendant's seat in the event of breach.

the terms of the agreement. Those terms may be harsh, especially when, as here, the breach occurred early in the life of the agreement. But the defendant has not shown that in the circumstances they are "unreasonably and grossly disproportionate to the real damages from a breach." *A-Z Servicenter, Inc. v. Segall,* 334 Mass. 672, 675, 138 N.E.2d 266 (1956).

On appeal, the parties have not raised the issue whether, if the liquidated damages provision is enforced, mitigation should be considered. However, because mitigation was raised (albeit obliquely) in the defendant's amended answer to the complaint, and because we hold that the liquidated damages provision is enforceable, we consider the issue, which appears to be one of first impression in Massachusetts.

We will follow the rule in many other jurisdictions and hold that, in the case of an enforceable liquidated damages provision, mitigation is irrelevant and should not be considered in assessing damages. When parties agree in advance to a sum certain that represents a reasonable estimate of potential damages, they exchange the opportunity to determine actual damages after a breach, including possible mitigation, for the "peace of mind and certainty of result" afforded by a liquidated damages clause. *Kelly v. Marx,* 428 Mass. 877, 881, 705 N.E.2d 1114 (1999), quoting *Kelly v. Marx,* 44 Mass. App. Ct. 825, 833, 694 N.E.2d 869 (1998) (Spina, J., dissenting). In such circumstances, to consider whether a plaintiff has mitigated its damages not only is illogical, but also defeats the purpose of liquidated damages provisions. See *Barrie Sch. v. Patch,* 401 Md. 497, 513-514, 933 A.2d 382 (2007) (sum that stipulates damages in advance "replaces any determination of actual loss," so that if liquidated damages provision is enforceable, court need not consider mitigation). Since the liquidated damages provision at issue here is enforceable, the question is irrelevant.

Conclusion. The ruling of the Superior Court that the liquidated damages provision of the license agreement is unenforceable is set aside, and the judgment is modified to award NPS the total amount of unpaid license fees due under the agreement, $ 65,500, plus interest. As so modified, the judgment is affirmed.

KVASSAY V. MURRAY, 15 Kan.App.2d 426, 808 P.2d 896 (Kan.App.,1991)

RICHARD B. WALKER, District Judge, Assigned:

Plaintiff Michael Kvassay, d/b/a Kvassay Exotic Food, appeals the trial court's finding that a liquidated damages clause was unenforceable and from the court's finding that damages for lost profits were not recoverable. Kvassay contends these damages occurred when Great American Foods, Inc., (Great American), which is owned by Albert and Deana Murray, breached a contract for the purchase of baklava. …

On February 22, 1984, Kvassay, who had been an independent insurance adjuster, contracted to sell 24,000 cases of baklava to Great American at $19.00 per case. Under the contract, the sales were to occur over a one-year period and Great American was to be Kvassay's only customer. The contract included a clause which provided: "If Buyer refuses to accept or repudiates delivery of the goods sold to him, under this Agreement, Seller shall be entitled to damages, at the rate of $5.00 per case, for each case remaining to be delivered under this Contract."

Problems arose early in this contractual relationship with checks issued by Great American being dishonored for insufficient funds. Frequently one of the Murrays issued a personal check for the amount due. After producing approximately 3,000 cases, Kvassay stopped producing the baklava because the Murrays refused to purchase any more of the product.

…

In April 1985, Kvassay filed suit for damages arising from the collapse of his baklava baking business….The trial court ruled that liquidated damages could not be recovered …

Kvassay first attacks the trial court's ruling that the amount of liquidated damages sought by him was unreasonable and therefore the liquidated damages clause was unenforceable.

Kvassay claimed $105,000 in losses under the liquidated damages clause of the contract, representing $5 per case for the approximately 21,000 cases of baklava which he was not able to deliver. The trial court determined that Kvassay's use of expected profits to formulate liquidated damages was improper because the business enterprise lacked duration, permanency, and recognition. The court then compared Kvassay's previous yearly income (about $20,000) with the claim for liquidated damages ($105,000) and found "the disparity becomes so great as to make the clause unenforceable."

Since the contract involved the sale of goods between merchants, the Uniform Commercial Code governs. See K.S.A. 84-2-102. "The Code does not change the pre-Code rule that the question of the propriety of liquidated damages is a question of law for the court." 4 Anderson, Uniform Commercial Code § 2-718:6, p. 572 (3d ed. 1983). Thus, this court's scope of review of the trial court's ruling is unlimited. *Hutchinson Nat'l Bank & Tr. Co. v. Brown,* 12 Kan.App.2d 673, 674, 753 P.2d 1299, *rev. denied* 243 Kan. 778 (1988).

Liquidated damages clauses in sales contracts are governed by K.S.A. 84-2-718, which reads in part:

"(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty."

To date, the appellate courts have not interpreted this section of the UCC in light of facts similar to those presented in this case. In ruling on this issue, the trial court relied on rules governing liquidated damages as expressed in *U.S.D. No. 315 v. DeWerff,* 6 Kan.App.2d 77, 626 P.2d 1206 (1981). *DeWerff,* however, involved a teacher's breach of

an employment contract and was not governed by the UCC. Thus, the rules expressed in that case should be given no effect if they differ from the rules expressed in 84-2-718.

In *DeWerff*, this court held a "stipulation for damages upon a future breach of contract is valid as a liquidated damages clause if the set amount is determined to be reasonable and the amount of damages is difficult to ascertain." 6 Kan.App.2d at 78, 626 P.2d 1206. This is clearly a two-step test: Damages must be reasonable and they must be difficult to ascertain. Under the UCC, however, reasonableness is the only test. K.S.A. 84-2-718. K.S.A. 84-2-718 provides three criteria by which to measure reasonableness of liquidated damages clauses: (1) anticipated or actual harm caused by breach; (2) difficulty of proving loss; and (3) difficulty of obtaining an adequate remedy.

In its ruling, the trial court found the liquidated damages clause was unreasonable in light of Kvassay's income before he entered into the manufacturing contract with Great American. There is no basis in 84-2-718 for contrasting income under a previous unrelated employment arrangement with liquidated damages sought under a manufacturing contract. Indeed, the traditional goal of the law in cases where a buyer breaches a manufacturing contract is to place the seller " 'in the same position he would have occupied if the vendee had performed his contract.' " *Outcault Adv. Co. v. Citizens Nat'l Bank*, 118 Kan. 328, 330-31, 234 P. 988 (1925). Thus, liquidated damages under the contract in this case must be measured against the anticipated or actual loss under the baklava contract as required by 84-2-718. The trial court erred in using Kvassay's previous income as a yardstick.

Was the trial court correct when it invalidated the liquidated damages clause, notwithstanding the use of an incorrect test? If so, we must uphold the decision even though the trial court relied on a wrong ground or assigned an erroneous reason for its decision. *Sutter Bros. Constr. Co. v. City of Leavenworth*, 238 Kan. 85, 93, 708 P.2d 190 (1985). To answer this question, we must look closer at the first criteria for reasonableness under 84-2-718, anticipated or actual harm done by the breach.

Kvassay produced evidence of anticipated damages at the bench trial showing that, before the contract was signed between Kvassay and Great American, Kvassay's accountant had calculated the baklava production costs. The resulting figure showed that, if each case sold for $19, Kvassay would earn a net profit of $3.55 per case after paying

himself for time and labor. If he did not pay himself, the projected profit was $4.29 per case. Nevertheless, the parties set the liquidated damages figure at $5 per case. In comparing the anticipated damages of $3.55 per case in lost net profit with the liquidated damages of $5 per case, it is evident that Kvassay would collect $1.45 per case or about 41 percent over projected profits if Great American breached the contract. If the $4.29 profit figure is used, a $5 liquidated damages award would allow Kvassay to collect 71 cents per case or about 16 1/2 percent over projected profits if Great American breached the contract.

An examination of these pre-contract comparisons alone might well lead to the conclusion that the $5 liquidated damages clause is unreasonable because enforcing it would result in a windfall for Kvassay and serve as a penalty for Great American. A term fixing unreasonably large liquidated damages is void as a penalty under 84-2-718.

A better measure of the validity of the liquidated damages clause in this case would be obtained if the actual lost profits caused by the breach were compared to the $5 per case amount set by the clause. However, no attempt was made by Kvassay during the bench trial to prove actual profits or actual costs of production. Thus, the trial court could not compare the $5 liquidated damages clause in the contract with the actual profits lost by the breach. It was not until the jury trial that Kvassay attempted to prove his actual profits lost as part of his damages. Given the trial court's ruling that lost profits were not recoverable and could not be presented to the jury, it is questionable whether the court would have permitted evidence concerning lost profits at the bench trial.

The trial court utilized an impermissible factor to issue its ruling on the liquidated damages clause and the correct statutory factors were not directly addressed. We reverse the trial court on this issue and remand for further consideration of the reasonableness of the liquidated damages clause in light of the three criteria set out in 84-2-718 …

LAKE RIVER CORP. v. CARBORUNDUM CO. 769 F.2d 1284 (7th Cir. 1985.)
POSNER, Circuit Judge.

This diversity suit between Lake River Corporation and Carborundum Company requires us to consider questions of Illinois commercial law, and in particular to explore the fuzzy line between penalty clauses and liquidated-damages clauses.

Carborundum manufactures "Ferro Carbo," an abrasive powder used in making steel. To serve its midwestern customers better, Carborundum made a contract with Lake River by which the latter agreed to provide distribution services in its warehouse in Illinois. Lake River would receive Ferro Carbo in bulk from Carborundum, "bag" it, and ship the bagged product to Carborundum's customers.

Carborundum insisted that Lake River install a new bagging system to handle the contract. In order to be sure of being able to recover the cost of the new system ($89,000) and make a profit of 20 percent of the contract price, Lake River insisted on the following minimum-quantity guarantee:

"In consideration of the special equipment [i.e., the new bagging system] to be acquired and furnished by LAKE-RIVER for handling the product, CARBORUNDUM shall, during the initial three-year term of this Agreement, ship to LAKE-RIVER for bagging a minimum quantity of [22,500 tons]. If, at the end of the three-year term, this minimum quantity shall not have been shipped, LAKE-RIVER shall invoice CARBORUNDUM at the then prevailing rates for the difference between the quantity bagged and the minimum guaranteed."

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

After the contract was signed in 1979, the demand for domestic steel, and with it the demand for Ferro Carbo, plummeted, and Carborundum failed to ship the guaranteed amount. When the contract expired late in 1982, Carborundum had shipped only 12,000 of the 22,500 tons it had guaranteed. Lake River had bagged the 12,000 tons and had billed Carborundum for this bagging, and Carborundum had paid, but by virtue of the formula in the minimum-guarantee clause Carborundum still owed Lake River $241,000-

the contract price of $533,000 if the full amount of Ferro Carbo had been shipped, minus what Carborundum had paid for the bagging of the quantity it had shipped.

When Lake River demanded payment of this amount, Carborundum refused, on the ground that the formula imposed a penalty. …

Lake River brought this suit for $241,000, which it claims as liquidated damages.

The hardest issue in the case is whether the formula in the minimum-guarantee clause imposes a penalty for breach of contract or is merely an effort to liquidate damages. Deep as the hostility to penalty clauses runs in the common law, see Loyd, *Penalties and Forfeitures,* 29 Harv.L.Rev. 117 (1915), we still might be inclined to question, if we thought ourselves free to do so, whether a modern court should refuse to enforce a penalty clause where the signator is a substantial corporation, well able to avoid improvident commitments. Penalty clauses provide an earnest of performance. The clause here enhanced Carborundum's credibility in promising to ship the minimum amount guaranteed by showing that it was willing to pay the full contract price even if it failed to ship anything. On the other side it can be pointed out that by raising the cost of a breach of contract to the contract breaker, a penalty clause increases the risk to his other creditors; increases (what is the same thing and more, because bankruptcy imposes "deadweight" social costs) the risk of bankruptcy; and could amplify the business cycle by increasing the number of bankruptcies in bad times, which is when contracts are most likely to be broken. But since little effort is made to prevent businessmen from assuming risks, these reasons are no better than makeweights.

A better argument is that a penalty clause may discourage efficient as well as inefficient breaches of contract. Suppose a breach would cost the promisee $12,000 in actual damages but would yield the promisor $20,000 in additional profits. Then there would be a net social gain from breach. After being fully compensated for his loss the promisee would be no worse off than if the contract had been performed, while the promisor would be better off by $8,000. But now suppose the contract contains a penalty clause under which the promisor if he breaks his promise must pay the promisee $25,000. The promisor will be discouraged from breaking the contract, since $25,000, the penalty, is greater than $20,000, the profits of the breach; and a transaction that would have increased value will be forgone.

On this view, since compensatory damages should be sufficient to deter inefficient breaches (that is, breaches that cost the victim more than the gain to the contract breaker), penal damages could have no effect other than to deter some efficient breaches. But this overlooks the earlier point that the willingness to agree to a penalty clause is a way of making the promisor and his promise credible and may therefore be essential to inducing some value-maximizing contracts to be made. It also overlooks the more important point that the parties (always assuming they are fully competent) will, in deciding whether to include a penalty clause in their contract, weigh the gains against the costs-costs that include the possibility of discouraging an efficient breach somewhere down the road-and will include the clause only if the benefits exceed those costs as well as all other costs.

On this view the refusal to enforce penalty clauses is (at best) paternalistic-and it seems odd that courts should display parental solicitude for large corporations. But however this may be, we must be on guard to avoid importing our own ideas of sound public policy into an area where our proper judicial role is more than usually deferential. The responsibility for making innovations in the common law of Illinois rests with the courts of Illinois, and not with the federal courts in Illinois. And like every other state, Illinois, untroubled by academic skepticism of the wisdom of refusing to enforce penalty clauses against sophisticated promisors, see, e.g., Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle*, 77 Colum.L.Rev. 554 (1977), continues steadfastly to insist on the distinction between penalties and liquidated damages. …To be valid under Illinois law a liquidation of damages must be a reasonable estimate at the time of contracting of the likely damages from breach, and the need for estimation at that time must be shown by reference to the likely difficulty of measuring the actual damages from a breach of contract after the breach occurs. If damages would be easy to determine then, or if the estimate greatly exceeds a reasonable upper estimate of what the damages are likely to be, it is a penalty.

…

Mindful that Illinois courts resolve doubtful cases in favor of classification as a penalty, we conclude that the damage formula in this case is a penalty and not a liquidation of damages, because it is designed always to assure Lake River more than its

actual damages. The formula-full contract price minus the amount already invoiced to Carborundum-is invariant to the gravity of the breach. When a contract specifies a single sum in damages for any and all breaches even though it is apparent that all are not of the same gravity, the specification is not a reasonable effort to estimate damages; and when in addition the fixed sum greatly exceeds the actual damages likely to be inflicted by a minor breach, its character as a penalty becomes unmistakable. This case is within the gravitational field of these principles even though the minimum-guarantee clause does not fix a single sum as damages.

Suppose to begin with that the breach occurs the day after Lake River buys its new bagging system for $89,000 and before Carborundum ships any Ferro Carbo. Carborundum would owe Lake River $533,000. Since Lake River would have incurred at that point a total cost of only $89,000, its net gain from the breach would be $444,000. This is more than four times the profit of $107,000 (20 percent of the contract price of $533,000) that Lake River expected to make from the contract if it had been performed: a huge windfall.

Next suppose (as actually happened here) that breach occurs when 55 percent of the Ferro Carbo has been shipped. Lake River would already have received $293,000 from Carborundum. To see what its costs then would have been (as estimated at the time of contracting), first subtract Lake River's anticipated profit on the contract of $107,000 from the total contract price of $533,000. The difference-Lake River's total cost of performance-is $426,000. Of this, $89,000 is the cost of the new bagging system, a fixed cost. The rest ($426,000-$89,000 = $337,000) presumably consists of variable costs that are roughly proportional to the amount of Ferro Carbo bagged; there is no indication of any other fixed costs. Assume, therefore, that if Lake River bagged 55 percent of the contractually agreed quantity, it incurred in doing so 55 percent of its variable costs, or $185,000. When this is added to the cost of the new bagging system, assumed for the moment to be worthless except in connection with the contract, the total cost of performance to Lake River is $274,000. Hence a breach that occurred after 55 percent of contractual performance was complete would be expected to yield Lake River a modest profit of $19,000 ($293,000-$274,000). But now add the “liquidated damages” of $241,000 that Lake River claims, and the result is a total gain from the breach of

$260,000, which is almost two and a half times the profit that Lake River expected to gain if there was no breach. And this ignores any use value or salvage value of the new bagging system, which is the property of Lake River-though admittedly it also ignores the time value of money; Lake River paid $89,000 for that system before receiving any revenue from the contract.

To complete the picture, assume that the breach had not occurred till performance was 90 percent complete. Then the "liquidated damages" clause would not be so one-sided, but it would be one-sided. Carborundum would have paid $480,000 for bagging. Against this, Lake River would have incurred its fixed cost of $89,000 plus 90 percent of its variable costs of $337,000, or $303,000. Its total costs would thus be $392,000, and its net profit $88,000. But on top of this it would be entitled to "liquidated damages" of $53,000, for a total profit of $141,000-more than 30 percent more than its expected profit of $107,000 if there was no breach.

The reason for these results is that most of the costs to Lake River of performing the contract are saved if the contract is broken, and this saving is not reflected in the damage formula. As a result, at whatever point in the life of the contract a breach occurs, the damage formula gives Lake River more than its lost profits from the breach-dramatically more if the breach occurs at the beginning of the contract; tapering off at the end, it is true. …

The fact that the damage formula is invalid does not deprive Lake River of a remedy. The parties did not contract explicitly with reference to the measure of damages if the agreed-on damage formula was invalidated, but all this means is that the victim of the breach is entitled to his common law damages. See, e.g., Restatement, Second, Contracts § 356, comment a (1981). In this case that would be the unpaid contract price of $241,000 minus the costs that Lake River saved by not having to complete the contract (the variable costs on the other 45 percent of the Ferro Carbo that it never had to bag). The case must be remanded to the district judge to fix these damages.

OLIVER V. CAMPBELL, 43 Cal.2d 298, 273 P.2d 15 (CAL. 1954.)

CARTER, Justice.

Plaintiff appeals from a judgment for defendant, administratrix of the estate of Roy Campbell, deceased, in an action for attorney's fees.

Plaintiff's cause of action was stated in a common count alleging that Roy Campbell became indebted to him in the sum of $10,000, the reasonable value of services rendered as attorney for Campbell; that no part had been paid except $450. Campbell died after the services were rendered by plaintiff. Plaintiff filed a claim against his estate for the fees which defendant rejected. Defendant in her answer denied the allegations made and as a ‘further’ defense alleged that plaintiff and Campbell entered into an ‘express written contract’ employing plaintiff as attorney for a stated fee of $750, and all work alleged to have been performed by plaintiff was performed under that contract.

According to the findings of the trial court the claim against the estate was founded on the alleged reasonable value of legal services rendered by plaintiff for Campbell in an action for separate maintenance by defendant, Campbell's wife, against Campbell and in which the latter cross complained for a divorce. Plaintiff was not counsel when the pleadings in that action were filed. He came into the case on December 16, 1949, before trial of the action. He and Campbell entered into a written contract in that date for plaintiff's representation of Campbell in the action, the contract stating that plaintiff agrees to represent Campbell in the separate maintenance and divorce action which has been set for trial in the superior court for a ‘total fee’ of $750 plus court costs and other incidentals in the sum of $100 making a total of $850. The fees were to be paid after trial. Plaintiff represented Campbell at the trial consuming 29 days and lasting until May, 1950. (Defendant's complaint for separate maintenance was changed to one for divorce.) After the trial ended the court indicated its intention to give Mrs. Campbell a divorce. But while her proposed findings were under consideration by plaintiff and the court, defendant Campbell substituted himself instead of plaintiff and thereby the representation by plaintiff of Campbell was ‘terminated.’ The findings in the divorce action were filed in May, 1951. Plaintiff's services were furnished pursuant to the contract. The reasonable value of the services was $5,000. Campbell paid $450 to plaintiff and the $100 costs.

The court concluded that plaintiff should take nothing because neither his claim against the estate nor his action was on the contract but were in quantum meruit and no

recovery could be had for the reasonable value of the services because the compensation for those services was covered by the express contract.

According to plaintiff's undisputed testimony Campbell told him after defendant had offered proposed findings in the divorce action that he was dissatisfied with plaintiff as his counsel and would discharge him and asked him if he would sign a substitution of attorneys under which Campbell would represent himself. Plaintiff replied that he recognized Campbell had a right to discharge him but that he was prepared to carry the case to conclusion; that he expected to be paid the reasonable value of his services which would be as much as defendant's counsel in the divorce action received, $9,000, to which Campbell replied he was not going to pay ‘a cent more.’ (At that time Campbell had paid $450.) Thereupon the substitution (dated January 25, 1951) was signed and Campbell took plaintiff's file in the divorce case with him.

It seems that the contract of employment contemplated that plaintiff was to continue his services and representation at least until and including final judgment in the divorce action. See Neblett v. Getty, 20 Cal.App.2d 65, 66 P.2d 473. It might thus appear that plaintiff was discharged before he had fully completed his services under the contract and the discharge prevented him from completing his performance. (That question is later discussed.)

One alleged rule of law applied by the trial court and that urged by defendant is that where there is a contract of employment for a definite term which fixes the compensation, there cannot be any recovery for the reasonable value of the services even though the employer discharges the employee repudiates the contract before the end of the term; that the only remedy of the employee is an action on the contract for the fixed compensation or damages for the breach of the contract. The trial court accepted that theory and rendered judgment for defendant because plaintiff did not state a cause of action on the contract nor for damages for its breach; it was for the reasonable value of the services performed before plaintiff's discharge. Accordingly there is no express finding on whether the discharge was wrongful or whether there was a rescission of the contract by plaintiff because of Campbell's breach of it, or whether plaintiff had substantially performed at the time of this discharge.

The rule applied is not in accord with the general contract law, the law applicable to employment contracts or employment of an attorney by a client. The general rule is stated: "that one who has been injured by a breach of contract has an election to pursue any of three remedies, to wit: 'He may treat the contract as rescinded and may recover upon a quantum meruit so far as he has performed; or he may keep the contract alive, for the benefit of both parties, being at all times ready and able to perform; or, third, he may treat the repudiation as putting an end to the contract for all purposes of performance, and sue for the profits he would have realized if he had not been prevented from performing." Alder v. Drudis, 30 Cal.2d 372, 381, 182 P.2d 195, 201; see 12 Cal.Jur.2d, Contracts, s 253; Rest. Contracts, §347. It is the same in agency or contract for services cases….

It should further be noted that under the only evidence on the subject, above mentioned, plaintiff in effect promptly notified Campbell of the rescission of the contract when he advised him that he would execute the substitution of attorneys when he was discharged by Campbell but told Campbell he would hold him for the reasonable value of the services. On the issue of the necessity of restoration or offer to restore the part payment for the services which Campbell had made, the rule applies that such restoration is not necessary where plaintiff would be entitled to it in any event. It is clear that plaintiff was entitled to receive the $450 paid to him either under the contract or for the reasonable value of his services.

The question remains, however, of the application of the foregoing rules to the instant case. Plaintiff had performed practically all of the services he was employed to perform when he was discharged. The trial was at an end. The court had indicated its intention to give judgment against Campbell and all that remained was the signing of findings and judgment. The full sum called for in the contract was payable because the trial had ended. Under these circumstances it would appear that in effect, plaintiff had completed the performance of his services and the rule would apply that: 'The remedy of restitution in money is not available to one who has fully performed his part of a contract, if the only part of the agreed exchange for such performance that has not been rendered by the defendant is a sum of money constituting a liquidated debt; but full performance does not make restitution unavailable if any part of the consideration due from the defendant in return is something other than a liquidated debt.' Rest. Contracts, § 350; see

Locke v. Duchesnay, 84 Cal.App. 448, 258 P. 418; Willett & Burr v. Alpert, 181 Cal. 652, 185 P. 976; Williston on Contracts (Rev.Ed.), §1459; Corbin on Contracts, § 1110; Civ.Code, §3302. In such cases he recovers the full contract price and no more. As we have seen, as far as pleading is concerned, however, the action may be stated as a common count other than a declaration on the special contract. Here plaintiff alleged an indebtedness on defendant's part for services performed by plaintiff of a reasonable value of $10,000 of which only $450 had been paid. While it may have been more appropriate for him to have alleged that the price of such services was the contract figure, any deficiency of the pleading is eliminated by defendant's answer setting forth that factor. Plaintiff's action can thus be said to be common count indebitatus assumpsit, and there being no dispute as to the amount called for in the contract, the services having been in effect fully performed, the court should have rendered judgment for the balance due on the contract which is conceded to be $300.

The judgment is therefore reversed and the trial court is directed to render judgment in favor of plaintiff for the sum of $300.

SCHAUER, Justice. I dissent. I agree with a great deal of the discussion in the majority opinion, and even to a larger extent with the authorities therein cited, relative to the rules of law which should govern this case but I think this court misapplies the very rules it cites.

Specifically, I think this court errs when it says ‘there being no dispute as to the amount called for in the contract, the services having been in effect fully performed, the court should have rendered judgment for the balance due on the contract which is conceded to be $300.00.’ …. Upon the record and the authorities the judgment should be reversed and the cause remanded either (a) with directions to the trial court to enter judgment for the plaintiff for $5,000 or (b) for a retrial upon all issues. I would prefer to end the litigation by adopting alternative (a) and in my view the record fully justifies that disposition of the cause. Directed to that conclusion is the succinctly stated opinion prepared by Justice Valle when the cause was before the District Court of Appeal…:

"I am of the opinion that the judgment should be reversed with directions to the superior court to render judgment for plaintiff for $5,000. The court found that the reasonable value of the service performed by plaintiff is $5,000. Plaintiff was the only witness who testified concerning his discharge by Dr. Campbell. The opinion of this court fails to state all of the testimony of plaintiff with respect to his discharge. I set it forth in toto in the margin. I think no reasonable conclusion can be drawn from the evidence other than that the discharge amounts to a clear repudiation and abrogation of the contract in its entirety, in which case plaintiff is entitled to recover the reasonable value of the service performed. The contract plaintiff made with Dr. Campbell did not limit his services to the trial of the case. Under the contract he agreed to represent the doctor until final judgment, and he told the doctor that he 'thought the case would be reversed on appeal."

Hypothetical

On October 5, 1963 plaintiff, Dave Gustafson & Company, entered into a contract with the State Highway Commission for the construction of the subbase, base and bituminous surfacing of a new public highway between Wessington Springs and Woonsocket. Plaintiff performed a total dollar amount of work in the amount of $ 530,724.14. Upon completion the new highway replaced the pre-existing portion of State Trunk Highway No. 34 between the two towns. During construction the old portion of Highway 34 remained open for travel by the public in substantially the same manner as it had been for the past five years. After the new highway was completed the old portion of the road was also left open for use as a public highway.

Plaintiff failed to complete the new highway on the date fixed. There was a delay of 67 working days for which there was no extension of time requested or granted. Therefore the state withheld $ 14,070.00 as liquidated damages from the amount due plaintiff computed according to the contract scale of daily damage for delay in construction. As this project totaled $ 530,742.14, the per diem daily damage was $ 210. This daily damage multiplied by the 67 day delay equals the sum withheld.

The pertinent contract provision reads:

"8.9 FAILURE TO COMPLETE THE WORK ON TIME:--Time is an essential element of the contract and it is important that the work be pressed vigorously to completion. [1] The cost to the Department of the administration of the contract including engineering, inspection, and supervision, will be increased as the time occupied in the work is lengthened. [2] The public is subject to detriment and inconvenience when full use cannot be made of an incomplete project.

"Should the Contractor fail to complete the work within the time agreed upon in the contract or within such extra time as may have been allowed by increases in the contract or by formally approved extensions granted by the Department there shall be deducted from any monies or amount due or that may become due the Contractor, the sum set forth in the schedule [$210 for this contract] herein, for each and every weather working day, that the work shall remain uncompleted. [3] This sum shall be considered and treated not as penalty but as fixed, agreed liquidated damage due the State from the Contractor by reason of inconvenience to the public, added cost of Engineering and supervision, and other items which have caused an expenditure of public funds resulting from his failure to complete the work within the time specified in the contract."

Dave Gustafson & Co. v. State, 83 S.D. 160, 162-163 (S.D. 1968)

SPECIFIC PERFORMANCE

CENTEX HOMES CORP. v. BOAG, 320 A.2d 194 (N.J.Super.Ch. 1974.)

GELMAN, J.S.C., Temporarily Assigned.

Plaintiff Centex Homes Corporation (Centex) is engaged in the development and construction of a luxury high-rise condominium project in the Boroughs of Cliffside Park and Fort Lee. The project when completed will consist of six 31-story buildings containing in excess of 3600 condominium apartment units, together with recreational

buildings and facilities, parking garages and other common elements associated with this form of residential development. As sponsor of the project Centex offers the condominium apartment units for sale to the public and has filed an offering plan covering such sales with the appropriate regulatory agencies of the States of New Jersey and New York.

On September 13, 1972 defendants Mr. & Mrs. Eugene Boag executed a contract for the purchase of apartment unit No. 2019 in the building under construction and known as 'Winston Towers 200.' The contract purchase price was $73,700, and prior to signing the contract defendants had given Centex a deposit in the amount of $525. At or shortly after signing the contract defendants delivered to Centex a check in the amount of $6,870 which, together with the deposit, represented approximately 10% Of the total purchase of the apartment unit. Shortly thereafter Boag was notified by his employer that he was to be transferred to the Chicago, Illinois, area. Under date of September 27, 1972 he advised Centex that he 'would be unable to complete the purchase' agreement and stopped payment on the $6,870, check. Centex deposited the check for collection approximately two weeks after receiving notice from defendant, but the check was not honored by defendants' bank. On August 8, 1973 Centex instituted this action in Chancery Division for specific performance of the purchase agreement or, in the alternative, for liquidated damages in the amount of $6,870. The matter is presently before this court on the motion of Centex for summary judgment.

Both parties acknowledge, and our research has confirmed, that no court in this State or in the United States has determined in any reported decision whether the equitable remedy of specific performance will lie for the enforcement of a contract for the sale of a condominium apartment. The closest decision on point is Silverman v. Alcoa Plaza Associates, 37 A.D.2d 166, 323 N.Y.S.2d 39 (App.Div.1971), which involved a default by a contract-purchaser of shares of stock and a proprietary lease in a cooperative apartment building. The seller, who was also the sponsor of the project, retained the deposit and sold the stock and the lease to a third party for the same purchase price. The original purchaser thereafter brought suit to recover his deposit, and on appeal the court held that the sale of shares of stock in a cooperative apartment building, even though associated with a proprietary lease, was a sale of personalty and not of an interest in real

estate. Hence, the seller was not entitled to retain the contract deposit as liquidated damages.

As distinguished from a cooperative plan of ownership such as involved in Silverman, under a condominium housing scheme each condominium apartment unit constitutes a separate parcel of real property which may be dealt with in the same manner as any real estate. Upon closing of title the apartment unit owner receives a recordable deed which confers upon him the same rights and subjects him to the same obligations as in the case of traditional forms of real estate ownership, the only difference being that the condominium owner receives in addition an undivided interest in the common elements associated with the building and assigned to each unit. See the Condominium Act, N.J.S.A. 46:8B-1 et seq.; 15 Am.Jur.2d, Condominiums and Cooperative Apartments, at 977 et seq.; Note, 77 Harv.L.Rev. 777 (1964).

Centex urges that since the subject matter of the contract is the transfer of a fee interest in real estate, the remedy of specific performance is available to enforce the agreement under principles of equity which are well-settled in this state. …

The principle underlying the specific performance remedy is equity's jurisdiction to grant relief where the damage remedy at law is inadequate. The text writers generally agree that at the time this branch of equity jurisdiction was evolving in England, the presumed uniqueness of land as well as its importance to the social order of that era led to the conclusion that damages at law could never be adequate to compensate for the breach of a contract to transfer an interest in land. Hence specific performance became a fixed remedy in this class of transactions. See 11 Williston on Contracts (3d ed. 1968) §1418A; 5A Corbin on Contracts §1143 (1964). …

While the inadequacy of the damage remedy suffices to explain the origin of the vendee's right to obtain specific performance in equity, it does not provide a rationale for the availability of the remedy at the instance of the vendor of real estate. Except upon a showing of unusual circumstances or a change in the vendor's position, such as where the vendee has entered into possession, the vendor's damages are usually measurable, his remedy at law is adequate and there is no jurisdictional basis for equitable relief. But see Restatement, Contracts §360, comment c. The early English precedents suggest that the availability of the remedy in a suit by a vendor was an outgrowth of the equitable concept

of mutuality, I.e., that equity would not specifically enforce an agreement unless the remedy was available to both parties.

No other rationale has been offered by our decisions … and specific performance has been routinely granted to vendors without further discussion of the underlying jurisdictional issue. …

Our present Supreme Court has squarely held, however, that mutuality of remedy is not an appropriate basis for granting or denying specific performance. Fleischer v. James Drug Store, 1 N.J. 138, 62 A.2d 383 (1948); see also, Restatement, Contracts s 372; 11 Williston, Contracts (3d ed. 1968), §1433. The test is whether the obligations of the contract are mutual and not whether each is entitled to precisely the same remedy in the event of a breach. …

The disappearance of the mutuality of remedy doctrine from our law dictates the conclusion that specific performance relief should no longer be automatically available to a vendor of real estate, but should be confined to those special instances where a vendor will otherwise suffer an economic injury for which his damage remedy at law will not be adequate, or where other equitable considerations require that the relief be granted. Cf. Dover Shopping Center, Inc. v. Cushman's Sons, Inc., 63 N.J.Super. 384, 394, 164 A.2d 785 (App.Div.1960). As Chancellor Vroom noted in King v. Morford, 1 N.J.Eq. 274, 281-282 (Ch.Div.1831), whether a contract should be specifically enforced is always a matter resting in the sound discretion of the court and:

"considerable caution should be used in decreeding the specific performance of agreements, and … the court is bound to see that it really does the complete justice which it aims at, and which is the ground of its jurisdiction."

Here the subject matter of the real estate transaction-a condominium apartment unit-has no unique quality but is one of hundreds of virtually identical units being offered by a developer for sale to the public. The units are sold by means of sample, in this case model apartments, in much the same manner as items of personal property are sold in the market place. The sales prices for the units are fixed in accordance with schedule filed by Centex as part of its offering plan, and the only variance as between apartments having the same floor plan (of which six plans are available) is the floor level or the bulding

location within the project. In actuality, the condominium apartment units, regardless of their realty label, share the same characteristics as personal property.

From the foregoing one must conclude that the damages sustained by a condominium sponsor resulting from the breach of the sales agreement are readily measurable and the damage remedy at law is wholly adequate. No compelling reasons have been shown by Centex for the granting of specific performance relief and its complaint is therefore dismissed as to the first count.

Centex also seeks money damages pursuant to a liquidated damage clause in its contract with the defendants. It is sufficient to note only that under the language of that clause (which was authored by Centex) liquidated damages are limited to such moneys as were paid by defendant at the time the default occurred. Since the default here consisted of the defendant's stopping payment of his check for the balance of the down-payment, Centex's liquidated damages are limited to the retention of the ‘moneys paid’ prior to that date, or the initial $525 deposit. Accordingly, the second court of the complaint for damage relief will also be dismissed.

LACLEDE GAS CO. v. AMOCO OIL CO. 522 F.2d 33 (8th Cir. 1975)

ROSS, Circuit Judge.

The Laclede Gas Company (Laclede), a Missouri corporation, brought this diversity action alleging breach of contract against the Amoco Oil Company (Amoco), a Delaware corporation. It sought relief in the form of a mandatory injunction prohibiting the continuing breach or, in the alternative, damages. The district court held a bench trial on the issues of whether there was a valid, binding contract between the parties and whether, if there was such a contract, Amoco should be enjoined from breaching it. It then ruled that the “contract is invalid due to lack of mutuality” and denied the prayer for injunctive relief. The court made no decision regarding the requested damages. Laclede

Gas Co. v. Amoco Oil Co., 385 F.Supp. 1332, 1336 (E.D.Mo.1974). This appeal followed, and we reverse the district court's judgment.….

[I]t can be seen that the contract herein is simply a so-called "requirements contract." Such contracts are routinely enforced by the courts where, as here, the needs of the purchaser are reasonably foreseeable and the time of performance is reasonably limited.

We conclude that there is mutuality of consideration within the terms of the agreement and hold that there is a valid, binding contract between the parties as to each of the developments for which supplemental letter agreements have been signed.

II.

…

Generally the determination of whether or not to order specific performance of a contract lies within the sound discretion of the trial court. Landau v. St. Louis Public Service Co., 364 Mo. 1134, 273 S.W.2d 255, 259 (1954). However, this discretion is, in fact, quite limited; and it is said that when certain equitable rules have been met and the contract is fair and plain "specific performance goes as a matter of right." Miller v. Coffeen, 365 Mo. 204, 280 S.W.2d 100, 102 (1955), quoting, Berberet v. Myers, 240 Mo. 58, 77, 144 S.W. 824, 830 (1912). (Emphasis omitted.)

With this in mind we have carefully reviewed the very complete record on appeal and conclude that the trial court should grant the injunctive relief prayed. We are satisfied that this case falls within that category in which specific performance should be ordered as a matter of right. See Miller v. Coffeen, supra, 280 S.W.2d at 102.

Amoco contends that four of the requirements for specific performance have not been met. Its claims are: (1) there is no mutuality of remedy in the contract; (2) the remedy of specific performance would be difficult for the court to administer without constant and long-continued supervision; (3) the contract is indefinite and uncertain; and (4) the remedy at law available to Laclede is adequate. The first three contentions have little or no merit and do not detain us for long.

There is simply no requirement in the law that both parties be mutually entitled to the remedy of specific performance in order that one of them be given that remedy by the court.

While a court may refuse to grant specific performance where such a decree would require constant and long-continued court supervision, this is merely a discretionary rule of decision which is frequently ignored when the public interest is involved. …Here the public interest in providing propane to the retail customers is manifest, while any supervision required will be far from onerous.

Section 370 of the Restatement of Contracts (1932) provides:

"Specific enforcement will not be decreed unless the terms of the contract are so expressed that the court can determine with reasonable certainty what is the duty of each party and the conditions under which performance is due."

We believe these criteria have been satisfied here. As discussed in part I of this opinion, … Amoco is to supply all the propane which is reasonably foreseeably required, while Laclede is to purchase the required propane from Amoco and pay the contract price therefor. The parties have disagreed over what is meant by "Wood River Area Posted Price" in the agreement, but the district court can and should determine with reasonable certainty what the parties intended by this term and should mold its decree, if necessary accordingly. Likewise, the fact that the agreement does not have a definite time of duration is not fatal since the evidence established that the last subdivision should be converted to natural gas in 10 to 15 years. This sets a reasonable time limit on performance and the district court can and should mold the final decree to reflect this testimony.

It is axiomatic that specific performance will not be ordered when the party claiming breach of contract has an adequate remedy at law. This is especially true when the contract involves personal property as distinguished from real estate.

However, in Missouri, as elsewhere, specific performance may be ordered even though personalty is involved in the "proper circumstances." Mo.Rev.Stat. § 400.2-716(1); Restatement of Contracts, supra, §361. And a remedy at law adequate to defeat

the grant of specific performance "must be as certain, prompt, complete, and efficient to attain the ends of justice as a decree of specific performance." …

[T]he evidence indicates that at the present time propane is readily available on the open market. However, this analysis ignores the fact that the contract involved in this lawsuit is for a long-term supply of propane to these subdivisions. …. Additionally, there was uncontradicted expert testimony that Laclede probably could not find another supplier of propane willing to enter into a long-term contract such as the Amoco agreement, given the uncertain future of worldwide energy supplies. And, even if Laclede could obtain supplies of propane for the affected developments through its present contracts or newly negotiated ones, it would still face considerable expense and trouble which cannot be estimated in advance in making arrangements for its distribution to the subdivisions.

Specific performance is the proper remedy in this situation, and it should be granted by the district court.

CONCLUSION

For the foregoing reasons the judgment of the district court is reversed and the cause is remanded for the fashioning of appropriate injunctive relief in the form of a decree of specific performance …

NORTHERN INDIANA PUBLIC SERVICE CO. v. CARBON COUNTY COAL CO., 799 F.2d 265 (7th Cir. 1986)

POSNER, Circuit Judge.

These appeals bring before us various facets of a dispute between Northern Indiana Public Service Company (NIPSCO), an electric utility in Indiana, and Carbon County Coal Company, a partnership that until recently owned and operated a coal mine in Wyoming. In 1978 NIPSCO and Carbon County signed a contract whereby Carbon County agreed to sell and NIPSCO to buy approximately 1.5 million tons of coal every year for 20 years, at a price of $24 a ton subject to various provisions for escalation

which by 1985 had driven the price up to $44 a ton. [When coal prices plummeted, NIPSCO chose to breach its contract and buy cheaper coal elsewhere. Carbon County Coal sued and was awarded $181 million in damages. The Court affirmed the damage award and then discussed the judge's refusal to award specific performance]

In any event the request for specific performance has no merit. Like other equitable remedies, specific performance is available only if damages are not an adequate remedy, Farnsworth, *supra,* § 12.6, and there is no reason to suppose them inadequate here. The loss to Carbon County from the breach of contract is simply the difference between (1) the contract price (as escalated over the life of the contract in accordance with the contract's escalator provisions) times quantity, and (2) the cost of mining the coal over the life of the contract. Carbon County does not even argue that $181 million is not a reasonable estimate of the present value of the difference. Its complaint is that although the money will make the owners of Carbon County whole it will do nothing for the miners who have lost their jobs because the mine is closed and the satellite businesses that have closed for the same reason. Only specific performance will help them.

But since they are not parties to the contract their losses are irrelevant. Indeed, specific performance would be improper as well as unnecessary here, because it would force the continuation of production that has become uneconomical. Cf. Farnsworth, supra, at 817-18. No one wants coal from Carbon County's mine. With the collapse of oil prices, which has depressed the price of substitute fuels as well, this coal costs far more to get out of the ground than it is worth in the market. Continuing to produce it, under compulsion of an order for specific performance, would impose costs on society greater than the benefits. NIPSCO's breach, though it gave Carbon County a right to damages, was an efficient breach in the sense that it brought to a halt a production process that was no longer cost-justified. See *Lake River Corp. v. Carborundum Co.,* 769 F.2d 1284, 1289 (7th Cir.1985). The reason why NIPSCO must pay Carbon County's loss is not that it should have continued buying coal it didn't need but that the contract assigned to NIPSCO the risk of market changes that made continued deliveries uneconomical. The judgment for damages is the method by which that risk is being fixed on NIPSCO in accordance with its undertakings.

With continued production uneconomical, it is unlikely that an order of specific performance, if made, would ever actually be implemented. If, as a finding that the breach was efficient implies, the cost of a substitute supply (whether of coal, or of electricity) to NIPSCO is less than the cost of producing coal from Carbon County's mine, NIPSCO and Carbon County can both be made better off by negotiating a cancellation of the contract and with it a dissolution of the order of specific performance. Suppose, by way of example, that Carbon County's coal costs $20 a ton to produce, that the contract price is $40, and that NIPSCO can buy coal elsewhere for $10. Then Carbon County would be making a profit of only $20 on each ton it sold to NIPSCO ($40-$20), while NIPSCO would be losing $30 on each ton it bought from Carbon County ($40-$10). Hence by offering Carbon County more than contract damages (i.e., more than Carbon County's lost profits), NIPSCO could induce Carbon County to discharge the contract and release NIPSCO to buy cheaper coal. For example, at $25, both parties would be better off than under specific performance, where Carbon County gains only $20 but NIPSCO loses $30. Probably, therefore, Carbon County is seeking specific performance in order to have bargaining leverage with NIPSCO, and we can think of no reason why the law should give it such leverage. We add that if Carbon County obtained and enforced an order for specific performance this would mean that society was spending $20 (in our hypothetical example) to produce coal that could be gotten elsewhere for $10-a waste of scarce resources.

As for possible hardships to workers and merchants in Hanna, Wyoming, where Carbon County's coal mine is located, we point out that none of these people were parties to the contract with NIPSCO or third-party beneficiaries. They have no legal interest in the contract. … Carbon County does not stand in a representative relation to the workers and businesses of Hanna, Wyoming. Treating them as real parties in interest would evade the limitations on the concept of a third-party beneficiary and would place the promisor under obligations potentially far heavier than it had thought it was accepting when it signed the contract. Indeed, if we are right that an order of specific performance would probably not be carried out-that instead NIPSCO would pay an additional sum of money to Carbon County for an agreement not to enforce the order-it becomes transparent that

granting specific performance would make NIPSCO liable in money damages for harms to nonparties to the contract, and it did not assume such liability by signing the contract. Moreover, the workers and merchants in Hanna assumed the risk that the coal mine would have to close down if it turned out to be uneconomical. The contract with NIPSCO did not guarantee that the mine would operate throughout the life of the contract but only protected the owners of Carbon County against the financial consequences to them of a breach. As Carbon County itself emphasizes in its brief, the contract was a product of the international oil cartel, which by forcing up the price of substitute fuels such as coal made costly coal-mining operations economically attractive. The OPEC cartel is not a source of vested rights to produce substitute fuels at inflated prices.

…

SO ORDERED.

AMERICAN BRANDS, INC. v. PLAYGIRL, INC., 498 F.2d 947 (2nd Cir. 1974)

MULLIGAN, Circuit Judge:

This is an appeal by the plaintiff American Brands, Inc. (American) from an order of the United States District Court, Southern District of New York, Hon. Charles L. Brieant, Jr., entered March 8, 1974, denying American's motion for a preliminary injunction seeking to enjoin the defendant, Playgirl, Inc. (Playgirl), from refusing to publish American's advertisement on the back cover of its magazine and from accepting other advertisements for its back cover. Affirmed.

American, formerly known as the American Tobacco Company, is a New Jersey corporation which is basically a manufacturer and distributor of tobacco products. Playgirl is a California corporation which commenced the publication of Playgirl Magazine in May, 1973. The magazine has a current circulation of about 2,000,000 copies, a rapid increase from its initial publication of about 600,000. Playgirl boasts that its publication is “Unconventional. Unprecedented. Unparalleled.’, and that it alone delivers the ‘young, affluent and malleable female audience for your advertising message.”

On February 13, 1974, American commenced an action against Playgirl in the Supreme Court, State of New York, County of New York, seeking a declaratory judgment as well as injunctive relief. The case was removed on February 27, 1974, to the United States District Court for the Southern District of New York, pursuant to 28 U.S.C. §§ 1441 & 1446. On March 4, 1974, American obtained an order to show cause seeking a preliminary injunction. After oral argument before Judge Brieant on March 6, 1974, the injunction was denied. Judge Brieant found that the case presented 'fair grounds for litigation. That is close to the question of probability of success.' He also held there was no showing of irreparable harm which would justify a mandatory injunction since money damages would be adequate. He determined that the equities tipped in favor of Playgirl and further indicated his willingness to provide the parties a speedy trial.

American claims that on January 26, 1973, Playgirl entered into a contract for the placement of American's advertisements on the back cover of Playgirl Magazine. Playgirl had contracted with the Carl Vann Company to solicit orders for advertisements for the new magazine. Vann negotiated the contract at issue, which reserved eight back covers of Playgirl for the advertising of Tareyton cigarettes, manufactured by American. The contract, apparently a form agreement provided by American, had two clauses specifically typed in. One, appearing on the back of the form, provided:

"YOUR ACCEPTANCE BELOW OF THIS AGREEMENT SHALL ALSO SERVE TO ACKNOWLEDGE OUR UNDERSTANDING THAT WE HAVE THE CONTINUING AND IRREVOCABLE RIGHT, AT OUT OPTION, TO BUY THE BACK COVER OF PLAYGIRL EACH AND EVERY TWELVE MONTH PERIOD, FOR EACH ISSUE OF PLAYGIRL WITHIN THAT PERIOD, FOR AS LONG A TIME AS PLAYGIRL SHALL CONTINUE TO BE PUBLISHED."

The contract also contained a clause which provided: 'We reserve a cancellation privilege as to the use of this space.' That sentence was followed by a typed-in sentence which read: 'WE HAVE THE RIGHT TO CANCEL THE SUBSEQUENT ISSUES WITHOUT PENALTY IF THE PREMIERE ISSUE IS UNSATISFACTORY TO US.' Playgirl published American's advertisements on the back cover of each of its first 11

issues commencing in June, 1973, and further agreed to accept American's advertisement for the last issue of the first publication year, May, 1974.

By letter dated September 25, 1973, Vann advised American that it was against the policy of Playgirl to afford an advertiser ‘a position of protection in perpetuity.’ Playgirl repeated its position in a letter to American dated December 3, 1973, indicating that it had elected to diversify its back cover advertisers. By letter dated December 20, 1973, Playgirl stated that this policy would be effective with the June, 1974 issue.

The standard which governs the trial court in the determination of whether or not a preliminary injunction should issue is whether or not the moving party has carried the burden of clearly demonstrating a combination of either probable success on the merits and the possibility of irreparable damage, or the existence of serious questions going to the merits and the tipping of the balance of hardships sharply in its favor.

The court below in denying injunctive relief placed its greatest emphasis on the failure of the plaintiff to establish that its injury was not compensable by an award of monetary damages. The court observed that Playgirl is not unique, that there are other magazines and other back pages, and it suggested that American's damages should be limited to the difference, if any, between the rates paid at Playgirl and those payable elsewhere. Since every magazine reaches a slightly different audience, American suggests that it would be impossible to ‘cover’ by finding a suitable replacement. A requirement that advertisers seek relief through money damages, American argues, would permit periodicals to dishonor long-term advertising contracts with impunity.

On appeal, American insists that back cover advertising space is not fungible, and that Playgirl alone and uniquely provides an advertising audience composed of young, malleable and affluent females. In proof of this proposition, American only provides us with the understandably exuberant puffing of Playgirl's vice president, which touts the periodical as standing alone among magazines for women. To further justify the granting of an injunction, American states in its brief on appeal that Playgirl has suggested no basis upon which American might calculate its loss in monetary terms. Since monetary damages cannot be calculated, American argues, an injunction is required to avoid irreparable injury. See Interphoto Corp. v. Minolta Corp., 417 F.2d 621, 622 (2d Cir. 1969). However, the burden of establishing its right to relief here is clearly upon

American (Robert W. Stark, Jr., Inc. v. New York Stock Exchange, 466 F.2d 743, 744 (2d Cir. 1972) (per curiam)), and Playgirl does not have the initial obligation of establishing that monetary damages are an appropriate remedy. While we fail to share the confidence of the court below that American's loss can be ultimately measured by the difference between advertising rates at Playgirl and those at some other comparable periodical, we do not find that American has, on the record before us, established that Playgirl is unique.

It would appear to be basic that American is obligated to mitigate its damages. If American can reasonably place its advertising on the back pages of other periodicals of comparable circulation, it would seem likely that its profits picture would be the same whether the tobacco consumers are malleable young ladies or more jaded aging males. If it had been shown that such advertising space is not readily available because of commitments to other national advertisers, American might well have established a case for equitable intervention, but the record before us is barren of any such proof. Again, American might have been able to demonstrate that Playgirl's readership is distinctly advantageous to it and that it cannot be reached by other media. However, except for Playgirl's own rodomontade, we have no documentation or proof that this is so. There is nothing in the record before us to indicate what segment of the populace is titillated by Playgirl and why in any event it is not susceptible to the lure of tobacco by American's blandishment in other and more pedestrian periodicals. The record does not indicate whether American's advertising was prepared particularly for Playgirl and its alleged audience of affluent malleables. The record contains no samples of American's advertisements and no copy of Playgirl. This reticence is perhaps explainable because of the claim of the plaintiff that Playgirl is not a magazine which everyone may find acceptable. In sum, we conclude that, on the basis of the record before the court, the trial judge did not err in holding that American had failed to establish clearly that its damages cannot be calculated and that consequently it cannot be made whole by monetary relief.

…

Finally, we note that American has failed to persuade us that, even short of probable success, it is nonetheless entitled to injunctive relief because the equities tip strongly in its favor. Dino DeLaurentiis Cinematografica, S.p.A. v. D-150, Inc., 366 F.2d

373 (2d Cir. 1966). American urges that denial of the injunctive relief sought will irreparably injure its commercial good will. However, the case upon which it relies (Dino DeLaurentiis Cinematografica, S.P.A., supra) is distinguishable. There, a new motion picture film process was to be utilized for the exhibition of a particular motion picture, 'The Bible.' It was alleged that the contract bound the producer to exclusively utilize this process in the exhibition of the film. The loss of the opportunity to launch the heavily advertised new process with the particular motion picture provided in the contract was found by this court to create public confusion, with resultant loss of credibility and good will which were not monetarily compensable. Here, of course, the relationship between American and Playgirl was not monogamous. No trade or public identification of American with Playgirl has been established. Neither is there any claim that the marketing of some new tobacco product has been frustrated by the unavailability of Playgirl's back page. On the other hand, forcing Playgirl to leave the back page blank or accepting American's material rather than that of other advertisers, who have presumably entered into arrangements with Playgirl, would obviously force losses and litigation upon the publisher.

While other issues have been raised, they need not be considered. The judgment of the court below is affirmed.

SCHLEGEL v. MOORHEAD, 170 Mont. 391, 553 P.2d 1009 (Mont. 1976)

JOHN C. HARRISON, Justice.

Plaintiff appeals from the judgment of the district court dismissing his complaint for specific performance of an option to purchase a federal oil and gas lease from the defendant.

The pertinent facts are set forth as shown by the district court findings of fact and the record. Defendant Sherman Moorhead has been the owner since 1956 of federal oil and gas lease number 073 151(a), consisting of 120 acres in Glacier County, Montana. He acquired the lease for salvage and has maintained only one producing well on the acreage. Said well has not produced sufficient revenue to pay the annual royalty. At all times pertinent hereto Moorhead employed a pumper who operated the well.

Moorhead worked in the oil fields in Glacier County from 1937 to 1964 and is familiar with oil field operations and terms. He has little experience with the business end of oil operations, and no previous experience with options. Within three years of the time of the option in dispute here, he twice attempted to sell the lease with no success. At no time relevant to this case did he make any effort to learn of oil field developments in the vicinity of his lease by making inquiries of his pumper, his attorney in the area, or the public records at the Oil and Gas Commission office in Shelby, Montana. Moorhead lived in Butte, Montana from 1964 to the time of this lawsuit.

Plaintiff Schlegal is a United States citizen who lived in Calgary, Alberta, Canada from 1952 to 1973. He has been engaged in oil fields as a roughneck, has sold real estate, and has bought and sold oil leases. He decided to leave Canada in 1973 due to his dissatisfaction with Canadian politics, and resolved to engage in the oil business in Montana.

In November 1973, Schlegel visited the Oil and Gas Commission offices in Shelby, Montana and met a geologist. The geologist recommended Township 37 N. Range 5 W as an area to review for possible lease opportunities. This township is where Moorhead's lease is located. From the public records in the Shelby office of the Oil and Gas Commission Schlegel learned that most of the acreage in that area was held by Union Oil. Union Oil declined to farm out any acreage to Schlegel. From his review of the records, Schlegel became aware of the lease held by Moorhead.

Schlegel learned from his examination of the public records at Shelby that Union Oil recently had brought in a well designated as ‘Kruger 4E13’, and that the well was capable of producing oil and gas in commercial quantities. He also learned the figures reported for the early stages of oil and gas flow, that the well was located on acreage adjoining land covered by the Moorhead lease, and that Union Oil had located another drilling site, known as ‘Kruger 5E13’, also on land adjacent to the Moorhead lease.

On a date prior to January 12, 1974, Schlegel made a telephone call to Moorhead and asked him whether he was interested in selling his lease. Moorhead replied that he was, and set a price of $5,000. Three subsequent telephone calls by Schlegel to Moorhead established further information about the lease, and set the purchase price at $5,000 provided that Moorhead give Schlegel a 90-day option to purchase for a $100

consideration. On January 18, 1974, Schlegel called Moorhead and advised him that he had prepared the option and would come to Butte to meet Moorhead on the following day to close the deal. Moorhead agreed.

On January 19, 1974, Schlegel and his wife met with Moorhead at a motel in Butte. Schlegel brought with him a form of option agreement which he had prepared. Moorhead then read over the option. There was no further discussion of the terms of the option, but in the course of conversation Moorhead asked Schlegel why he was interested in the lease and Schlegel replied that he had a general interest in the area and had become dissatisfied with the political situation in Canada. Schlegel did not then or at any time tell Moorhead of the information which Schlegel had obtained relative to the well Kruger 4E13 or the location of Kruger 5E13, both on land adjoining land covered by the Moorhead lease. The option was signed by the parties in the presence of a signing witness. Moorhead accepted from Schlegel a draft for $100 as payment of the option consideration.

Thereafter, on two occasions within the option period, Schlegel accepted and exercised the option to purchase Moorhead's lease and tendered $4,900 to Moorhead as payment therefor. Moorhead refused the tender and refused to carry out the option on both occasions.

Schlegel sued for specific performance of the option to purchase the oil and gas lease. Moorheads answered and counterclaimed for: (1) cancellation or rescission of the option on the ground of fraud; (2) damages of $5,000 for slander of title; and (3) actual damages and exemplary damages for fraud, totaling $56,000.

The district court of the ninth judicial district, sitting without a jury, Honorable B. W. Thomas presiding, concluded as a matter of law that neither plaintiff nor defendant-counterclaimants were entitled to the relief prayed for. Judgment was entered in favor of defendants against plaintiff's complaint; the complaint was dismissed; and judgment was entered in favor of plaintiffs against defendants' counterclaim. Only the plaintiff Schlegel appeals from the judgments of the district court.

The issues on appeal are:

1. Did the district court err in refusing specific performance of the option on the ground that Schlegel failed to inform Moorhead of the existence and location of the Kruger wells 4E13 and 5E13?

2. Did the district court err in refusing specific performance of the option on the ground of inadequacy of consideration?

…

We preface our discussion of the issues with a statement of the rule enunciated in Interior Securities Co. v. Campbell, 55 Mont. 459, 470, 178 P. 582, 585:

"A decree for specific performance is not granted as a matter of abstract right, but in every instance the application for such relief is addressed to the sound, legal discretion of the court. * * * The case comes within the general rule, often adverted to by this court, that in the absence of a clear showing of abuse of discretion the decision of the lower court will be affirmed."

The focus of Schlegel's assignments of error is upon the district court's finding of fact No. 25 and conclusion of law No. 3. The former reads:

25. Enforcement of the option agreement would be unjust and unreasonable as to Moorhead because of (a) the inadequacy of the consideration, and, (b) the failure of Schlegel to fully and candidly inform Moorhead of the completion of Kruger well 4E13 and the location of Kruger 5E13 when he replied to Moorhead's January 19th inquiry as to why he was interested in the lease.'

Conclusions of law No. 3 is similar, omitting the words 'fully and candidly'.

…

As to the first issue, Schlegel contends that the option transaction was at arms length and there was no duty upon him to disclose to Moorhead his knowledge gained from public records which were equally accessible to Moorhead. On the other hand, Moorhead argues that Schlegel is guilty of a multitude of frauds, a position which was

rejected by the district court. However, our task is to determine whether the district court abused its discretion in refusing specific performance, and we need not resolve the conflicting arguments of the parties concerning actual and constructive fraud and the like.

It is undisputed that Schlegel was aware of the Kruger wells on January 19, 1974, and of the fact that they had substantial production potential. It is also established that when asked ‘why’ he was interested in Moorhead's lease, Schlegel said he had a ‘general’ interest in the area. The question is not whether Schlegel's answer was fraudulent or not, but whether Moorhead's assent was obtained by the ‘misrepresentations, concealment, circumvention, or unfair practices' of Schlegel. Section 17-808(3), R.C.M.1947. This distinction is significant because under section 17-808 a court in equity has far more latitude in assessing the conduct of the parties before it than does a court determining the legal elements of fraud. As stated in Interior Securities, supra:

‘* * * To secure the desired relief (specific performance) in this instance, appellants were required to come into court with clean hands and with a cause whose ethical qualities were such as to commend it to the conscience of the chancellor. * * *’

The district court specifically found that Schlegel did not affirmatively misrepresent a lack of development in the area, and this finding is not challenged here. However, it is not necessarily inconsistent for the district court to hold that enforcement against Moorhead would be unjust and unreasonable due to Schlegel's concealment or circumvention in answer to Moorhead's question. In short, we do not find an abuse of discretion on this point.

The second issue concerns the inadequacy of the consideration. Section 17-808(1) makes this factor a defense to an action for specific performance of contract. The district court made no finding as to the specific value of the lease, and Schlegel argues that therefore it cannot properly find, as it did in finding of fact No. 24, that the ‘option price of $5,000.00 was disproportionate to the real value of the lease in the light of information available from public records on January 19, 1974.’

We cannot agree with Schlegel's contention. There is ample evidence in the record to show that the Kruger 4E13 and 5E13 wells were in close proximity to Moorhead's lease and were anticipated to be put into commercial production. Kruger

4E13 was shown to have produced substantial quantities of oil, and for the reasons appearing hereafter, it was sufficient to support the findings.

…

In view of the foregoing, we hold that the district court did not abuse its discretion by refusing to grant to Schlegel specific performance of the option to purchase Moorhead's oil and gas lease.

The judgment of the district court is affirmed.

MEYER v. BENKO, 55 Cal.App.3d 937, 127 Cal.Rptr. 846 (Cal.App. 1976)

STEPHENS, Associate Justice.

This is an action for specific performance of a contract of sale of real property, or in the alternative, damages. …

Facts

On December 28, 1972, plaintiffs and defendants executed a document entitled 'DEPOSIT RECEIPT and AGREEMENT OF SALE' (hereinafter, Deposit Receipt). Under its terms, the Deposit Receipt required plaintiffs to deposit $250 of a total of.$23,500 purchase price for a residence owned by defendants ….

…

Plaintiffs instituted this action, alleging that the aforementioned Deposit Receipt constituted an enforceable contract, and that despite the fact that the plaintiffs had performed all conditions precedent to conveyance, the defendants refused to convey the subject property. …

[Having established that the Deposit Receipt constitutes a valid enforceable contract,] we proceed to a determination of the proper remedy in this case.

The trial court found that there was inadequate consideration to justify specific performance. 'The proper time for testing the adequacy of consideration is as of the formation of the contract.' (Henderson v. Fisher, 236 Cal.App.2d 468, 474, 46 Cal.Rptr. 173, 178.) Various items of testimonial evidence were presented regarding the market value of the residence at the time the Deposit Receipt was executed. The listing real estate sales agent testified that she believed the value of the property to be 'down a little'

from the earlier listing price of $24,950. On the other hand, defendant Irene Benko testified that she believed that the residence was then worth $30,000 to her, although conceding that she was unaware of its market value. Defendant Howard Banko testified that he believed that the residence had a market value of $29,000 or $30,000 at that time. However, he also testified that he signed the Deposit Receipt at the sales price of.$23,500 in order to sell the residence more quickly. 'In determining whether consideration was fair and adequate, all circumstances surrounding the transfer of the property as they existed at that time, must be considered.' (Lundgren v. Lundgren, 245 Cal.App.2d 582, 589, 54 Cal.Rptr. 30, 34.) 'A consideration, to be adequate, need not amount to the full value of the property.' (Foley v. Cowan, 80 Cal.App.2d 70, 76, 181 P.2d 410, 413.) The test 'is not whether the (vendor) received the highest price obtainable for his property, but whether the price he received is fair and reasonable under the circumstances.' (Henderson v. Fisher, supra, 236 Cal.App.2d 468, 474, 46 Cal.Rptr. 173, 178.) Defendants' desire to quickly consummate a sale explains the difference between the sale price agreed to and the alleged full value of the property. (Williams v. Rush, 134 Cal.App. 554, 560, 25 P.2d 888.) Therefore, the trial court's finding of inadequate consideration was clearly erroneous and unsupported by the evidence adduced at the trial.

… The judgment is reversed.

DUANE SALES, INC. v. CARMEL, 394 N.Y.S.2d 307 (N.Y.A.D. 1977)

MEMORANDUM DECISION.

Appeal (1) from an order of the Supreme Court at Special Term, entered October 27, 1976, which granted plaintiff's motion for summary judgment, and (2) from the judgment entered thereon.

This action to compel specific performance of an option agreement for the purchase and sale of real property was before this court on a prior occasion. In reversing Special Term we concluded that, as a matter of law, plaintiff's complaint stated a cause of action for specific performance of the option agreement; that upon the record then before the court the matter should be considered by Special Term for summary judgment

pursuant to CPLR 3211 (subd. (c)), and we remitted the matter to Special Term for further proceedings (53 A.D.2d 988, 395 N.Y.S.2d 870).

The defendants make the additional argument on this appeal that, should the plaintiff be entitled to specific performance of the option agreement, then an accounting should be directed of the respective losses and gains during the period of litigation. Special Term did not pass upon this contention. It is clear that in decreeing specific performance equity requires not only that the contract provisions to be enforced be just and equitable, but that the consequences of specific performance likewise be just and equitable. The relief should not be granted if, under the circumstances of the case, the result of the specific enforcement of the contract would be harsh or oppressive, or result in an unconscionable advantage to the plaintiff (55 N.Y.Jur., Specific Performance, s 34, and cases cited therein).

We conclude, therefore, that an accounting should be had which should take into consideration, among other things, the following: the rents received by defendants during the period from the date of the conveyance of the title to the premises; any profits resulting to the defendants in their operation of the property; any losses sustained by the plaintiff because of the delay in conveyance of title; necessary expenses incurred by the defendants in the operation of the property, such as payments of principal and interest on the mortgage, property taxes, insurance, and minor repairs; the benefits to the plaintiff in retaining the use of the purchase money during the pendency of the litigation. As to the defendants' claim that major improvements to the property in question made during the time of their ownership should also be included in the accounting, the record is vague and unclear as to the nature of, or necessity for, such improvements. Consequently, it should be left for the determination of Special Term whether or not defendants are entitled to be compensated for such major improvements.

Judgment modified, on the law and the facts, so as to direct that an accounting should be made, and matter remitted for further proceedings not inconsistent herewith, and, as so modified, affirmed, without costs.

BEVERLY GLEN MUSIC, INC. v. WARNER COMMUNICATIONS, INC., 178 Cal.App.3d 1142, 224 Cal.Rptr. 260 (Cal.App. 2 Dist.,1986)

KINGSLEY, Acting Presiding Justice.

The plaintiff appeals from an order denying a preliminary injunction against the defendant, Warner Communications, Inc. We affirm.

FACTS

In 1982, plaintiff Beverly Glen Music, Inc. signed to a contract a then-unknown singer, Anita Baker. Ms. Baker recorded an album for Beverly Glen which was moderately successful, grossing over one million dollars. In 1984, however, Ms. Baker was offered a considerably better deal by defendant Warner Communications. As she was having some difficulties with Beverly Glen, she accepted Warner's offer and notified plaintiff that she was no longer willing to perform under the contract. Beverly Glen then sued Ms. Baker and sought to have her enjoined from performing for any other recording studio. The injunction was denied, however, as, under Civil Code section 3423, subdivision Fifth, California courts will not enjoin the breach of a personal service contract unless the service is unique in nature and the performer is guaranteed annual compensation of at least $6,000, which Ms. Baker was not.

Following this ruling, the plaintiff voluntarily dismissed the action against Ms. Baker. Plaintiff, however, then sued Warner Communications for inducing Ms. Baker to breach her contract and moved the court for an injunction against Warner to prevent it from employing her. This injunction, too, was denied, the trial court reasoning that what one was forbidden by statute to do directly, one could not accomplish through the back door. It is from this ruling that the plaintiff appeals.

DISCUSSION

From what we can tell, this is a case of first impression in California. While there are numerous cases on the general inability of an employer to enjoin his former employee from performing services somewhere else, apparently no one has previously thought of enjoining the new employer from accepting the services of the breaching employee. While we commend the plaintiff for its resourcefulness in this regard, we concur in the trial court's interpretation of the maneuver.

“It is a familiar rule that a contract to render personal services cannot be specifically enforced.” (*Foxx v. Williams* (1966) 244 Cal.App.2d 223, 235, 52 Cal.Rptr. 896.) An unwilling employee cannot be compelled to continue to provide services to his employer either by ordering specific performance of his contract, or by injunction. To do so runs afoul of the Thirteenth Amendment's prohibition against involuntary servitude. (*Poultry Producers Etc. v. Barlow* (1922) 189 Cal. 278, 288, 208 P. 93.) However, beginning with the English case of *Lumley v. Wagner* (1852) 42 Eng.Rep. 687, courts have recognized that, while they cannot directly enforce an affirmative promise (in the *Lumley* case, Miss Wagner's promise to perform at the plaintiff's opera house), they can enforce the negative promise implied therein (that the defendant would not perform for someone else that evening). Thus, while it is not possible to compel a defendant to perform his duties under a personal service contract, it is possible to prevent him from employing his talents anywhere else. The net effect is to pressure the defendant to return voluntarily to his employer by denying him the means of earning a living. Indeed, this is its only purpose, for, unless the defendant relents and honors the contract, the plaintiff gains nothing from having brought the injunction.

The California Legislature, however, did not adopt this principle when in 1872 it enacted Civil Code section 3423, subdivision Fifth, and Code of Civil Procedure section 526, subdivision 5. These sections both provided that an injunction could not be granted: “To prevent the breach of a contract the performance of which would not be specifically enforced.” In 1919, however, these sections were amended, creating an exception for: “a contract in writing for the rendition or furnishing of personal services from one to another where the minimum compensation for such service is at the rate of not less than six thousand dollars per annum and where the promised service is of a special, unique, unusual, extraordinary or intellectual character....”

The plaintiff has already unsuccessfully argued before the trial court that Ms. Baker falls within this exception. It has chosen not to appeal that judgment, and is therefore barred from questioning that determination now. The sole issue before us then is whether plaintiff-although prohibited from enjoining Ms. Baker from performing herself-can seek to enjoin all those who might employ her and prevent them from doing so, thus achieving the same effect.

We rule that plaintiff cannot. Whether plaintiff proceeds against Ms. Baker directly or against those who might employ her, the intent is the same: to deprive Ms. Baker of her livelihood and thereby pressure her to return to plaintiff's employ. Plaintiff contends that this is not an action against Ms. Baker but merely an equitable claim against Warner to deprive it of the wrongful benefits it gained when it “stole” Ms. Baker away. Thus, plaintiff contends, the equities lie not between the plaintiff and Ms. Baker, but between plaintiff and the predatory Warner Communications company. Yet if Warner's behavior has actually been predatory, plaintiff has an adequate remedy by way of damages. An injunction adds nothing to plaintiff's recovery from Warner except to coerce Ms. Baker to honor her contract. Denying someone his livelihood is a harsh remedy. The Legislature has forbidden it but for one exception. To expand this remedy so that it could be used in virtually all breaches of a personal service contract is to ignore over one hundred years of common law on this issue. We therefore decline to reverse the order.

The order is affirmed.

KARPINSKI v. INGRASCI, 28 N.Y.2d 45, 268 N.E.2d 751 (N.Y. 1971)

FULD, Chief Judge.

This appeal requires us to determine whether a covenant by a professional man not to compete with his employer is enforceable and, if it is, to what extent.

The plaintiff, Dr. Karpinski, an oral surgeon, had been carrying on his practice alone in Auburn-in Cayuga County-for many years. In 1953, he decided to expand and, since nearly all of an oral surgeon's business stems from referrals, he embarked upon a plan to ‘cultivate connections' among dentists in the four nearby Counties of Tompkins, Seneca, Cortland and Ontario. The plan was successful, and by 1962 twenty per cent of his practice consisted of treating patients referred to him by dentists located in those counties. In that year, after a number of those dentists had told him that some of their patients found it difficult to travel from their homes to Auburn, the plaintiff decided to open a second office in centrally-located Ithaca. He began looking for an assistant and, in the course of his search, met the defendant, Dr. Ingrasci, who was just completing his

training in oral surgery at the Buffalo General Hospital and was desirous of entering private practice. Dr. Ingrasci manifested an interest in becoming associated with Dr. Karpinski and, after a number of discussions, they reached an understanding; the defendant was to live in Ithaca, a locale with which he had no prior familiarity, and there work as an employee of the plaintiff.

A contract, reflecting the agreement, was signed by the defendant in June, 1962. It was for three years and, shortly after its execution, the defendant started working in the office which the plaintiff rented and fully equipped at his own expense. The provision of the contract with which we are concerned is a covenant by the defendant not to compete with the plaintiff. More particularly, it recited that the defendant

"promises and covenants that while this agreement is in effect and forever thereafter, he will never practice dentistry and/or Oral Surgery in Cayuga, Cortland, Seneca, Tompkins or Ontario counties except: (a) In association with the (plaintiff) or (b) If the (plaintiff) terminates the agreement and employs another oral surgeon".

In addition, the defendant agreed, "in consideration of the * * * terms of employment, and of the experience gained while working with" the plaintiff, to execute a $40,000 promissory note to the plaintiff, to become payable if the defendant left the plaintiff and practiced "dentistry and/or Oral Surgery" in the five enumerated counties.

When the contract expired, the two men engaged in extended discussions as to the nature of their continued association-as employer and employee or as partners. Unable to reach an accord, the defendant, in February, 1968, left the plaintiff's employ and opened his own office for the practice of oral surgery in Ithaca a week later. The dentists in the area thereupon began referring their patients to the defendant rather than to the plaintiff, and in two months the latter's practice from the Ithaca area dwindled to almost nothing and he closed the office in that city. In point of fact, the record discloses that about 90% of the defendant's present practice comes from referrals from dentists in the counties specified in the restrictive covenant, the very same dentists who had been referring patients to the plaintiff's Ithaca office when the defendant was working there.

The plaintiff, alleging a breach of the restrictive covenant, seeks not only an injunction to enforce it but also a judgment of $40,000 on the note. The Supreme Court,

after a nonjury trial, decided in favor of the plaintiff and granted him both an injunction and damages as requested. On appeal, however, the Appellate Division reversed the resulting judgment and dismissed the complaint; it was that court's view that the covenant was void and unenforceable on the ground that its restriction against the practice of both dentistry and oral surgery was impermissibly broad.

There can be no doubt that the defendant violated the terms of the covenant when he opened his own office in Ithaca. But the mere fact of breach does not, in and of itself, resolve the case. Since there are ‘powerful considerations of public policy which militate against sanctioning the loss of a man's livelihood,’ the courts will subject a covenant by an employee not to compete with his former employer to an ‘overriding limitation of ‘reasonableness“. …

Each case must, of course, depend, to a great extent, upon its own facts. It may well be that, in some instances, a restriction not to conduct a profession or a business in two counties or even in one, may exceed permissible limits. But, in the case before us, having in mind the character and size of the counties involved, the area restriction imposed is manifestly reasonable. The five small rural counties which it encompasses comprise the very area from which the plaintiff obtained his patients and in which the defendant would be in direct competition with him. Thus, the covenant's coverage coincides precisely with ‘the territory over which the practice extends', and this is proper and permissible. In brief, the plaintiff made no attempt to extend his influence beyond the area from which he drew his patients, the defendant being perfectly free to practice as he chooses outside the five specified counties.

Nor may the covenant be declared invalid because it is unlimited as to time, forever restricting the defendant from competing with the plaintiff. It is settled that such a covenant will not be stricken merely because it “contains no time limit or is expressly made unlimited as to time”. …In the present case, the defendant opened an office in Ithaca, in competition with the plaintiff, just one week after his employment had come to an end. Under the circumstances presented, we thoroughly agree with the trial judge that it is clear that nearly all of the defendant's practice was, and would be, directly attributable to his association with his former employer.

This brings us to the most troublesome part of the restriction imposed upon the defendant. By the terms of the contract, he agreed not to practice ‘dentistry and/or Oral Surgery’ in competition with the plaintiff. Since the plaintiff practices only ‘oral surgery,’ and it was for the practice of that limited type of ‘dentistry’ that he had employed the defendant, the Appellate Division concluded that the plaintiff went beyond permissible limits when he obtained from the defendant the covenant that he would not engage in any ‘dentistry’ whatsoever. The restriction, *as formulated*, is, as the Appellate Division concluded, too broad; it is not reasonable for a man to be excluded from a profession for which he has been trained when he does not compete with his former employer by a practicing it.

The plaintiff seeks to justify the breadth of the covenant by urging that, if it had restricted only the defendant's practice of oral surgery and permitted him to practice ‘dentistry’-that is, to hold himself out as a dentist generally-the defendant would have been permitted, under Education Law § 6601, subd. 3, to do all the work which an oral surgeon could. We have no sympathy with this argument; the plaintiff was not privileged to prevent the defendant from working in an area of dentistry in which he would not be in competition with him. The plaintiff would have all the protection he needs if the restriction were to be limited to the practice of oral surgery, and this poses the question as to the court's power to ‘sever’ the impermissible from the valid and uphold the covenant to the extent that it is reasonable.

Although we have found no decision in New York directly in point, cases in this court support the existence of such a power. (See, e.g., Purchasing Assoc. v. Weitz, 13 N.Y.2d 267, 272, 246 N.Y.S.2d 600, 603, Supra; Carpenter & Hughes v. De Joseph, 10 N.Y.2d 925, 224 N.Y.S.2d 9, 179 N.E.2d 854, affg. 13 A.D.2d 611, 213 N.Y.S.2d 860; Interstate Tea Co. v. Alt, 271 N.Y. 76, 80, 2 N.E.2d 51, 53, Supra.) Moreover, a number of out-of-state decisions, and they are supported by authoritative texts and commentators, explicitly recognize the court's power of severance and divisibility in order to sustain the covenant insofar as it is reasonable. As Professor Blake put it (73 Harv.L.Rev., at pp. 674-675), ‘If in balancing the equities the court decides that his (the employee's) activity would fit within the scope of a reasonable prohibition, it is apt to make use of the tool of severance, paring an unreasonable restraint down to appropriate size and enforcing it.’ In

short, to cull from the Washington Supreme Court's opinion in Wood v. May, 73 Wash.2d 307, 314, 438 P.2d 587, 591, ‘we find it just and equitable to protect appellant (employer) by injunction to the extent necessary to accomplish the basic purpose of the contract insofar as such contract is reasonable.’ Accordingly, since his practice is solely as an oral surgeon, the plaintiff gains all the injunctive protection to which he is entitled if effect be given only to that part of the covenant which prohibits the defendant from practicing oral surgery.

The question arises, however, whether injunctive relief is precluded by the fact that the defendant's promissory note for $40,000 was to become payable if he breached the agreement not to compete. We believe not. The mere inclusion in a covenant of a liquidated damages provision does not automatically bar the grant of an injunction. (See As this court wrote in the *Diamond Match Co*. case (106 N.Y., at p. 486, 13 N.E., at p. 424), “It is a question of intention, to be deduced from the whole instrument and the circumstances; and if it appear that the performance of the covenant was intended, and not merely the payment of damages in case of a breach, the covenant will be enforced.’ The covenant under consideration in this case may not reasonably be read to render ‘the liquidated damages provision * * * the sole remedy.” On the other hand, it would be grossly unfair to grant the plaintiff, in addition to an injunction, the full amount of damages ($40,000) which the parties apparently contemplated for a total breach of the covenant, since the injunction will halt any further violation. The proper approach is that takenin *Wirth* (265 N.Y. 214, 192 N.E. 297, Supra). The court, there faced with a similar situation, granted the injunction sought and, instead of awarding the amount of liquidated damages specified, remitted the matter for determination of the actual damages suffered during the period of the breach.

The hardship necessarily imposed on the defendant must be borne by him in view of the plaintiff's rightful interest in protecting the valuable practice of oral surgery which he built up over the course of many years. The defendant is, of course, privileged to practice ‘dentistry’ generally in Ithaca or continue to practice ‘oral surgery’ anywhere in the United States outside of the five small rural counties enumerated. The covenant, part of a contract carefully negotiated with no indication of fraud or overbearing on either side, must be enforced, insofar as it reasonably and validly may, according to its terms. In

sum, then, the plaintiff is entitled to an injunction barring the defendant from practicing oral surgery in the five specified counties and to damages actually suffered by him in the period during which the defendant conducted such a practice in Ithaca after leaving the plaintiff's employ.

The order appealed from should be reversed, with costs, and the case remitted to Supreme Court, Cayuga County, for further proceedings in accordance with this opinion.

HOWARD SCHULTZ & ASSOCIATES v. BRONIEC, 236 S.E.2d 265 (Ga. 1977)
HILL, Justice.

This case involves a covenant not to compete and a covenant against disclosure of confidential information. In *Rita Personnel Services v. Kot*, 229 Ga. 314, 191 S.E.2d 79 (1972), this court was called upon to adopt or reject the "blue-pencil theory of severability" as to a covenant not to compete. In deciding that issue, the court was called upon to decide whether covenants not to compete should or should not be favored, and it was decided that they should not be favored. Thus the "blue-pencil" case, as *Rita Personnel* is known here, is somewhat of a landmark in this area of Georgia law and as such may even represent a turning point. In this case we are asked to overrule *Rita Personnel* if the restriction on competition is found to be overly broad.

At the outset it is necessary to determine whether the contract under consideration here is to be treated for these covenant purposes as an employment agreement in view of the fact that it expressly declares that it creates only the relationship of independent contractor and not that of master and servant. *Rita Personnel, supra*, involved a franchise agreement which was treated as an employment agreement. We find that the agreement here under review is to be treated similarly. Having made this determination, the parties can be identified by use of the traditional labels of "employer" and "employee."

An employer sought an injunction to enforce a covenant not to compete contained in an employment agreement and to restrain the former employee from divulging confidential and privileged information received by him during his employment. After hearing evidence the trial court dismissed the complaint. The employer appeals.

On November 20, 1972, Frank D. Broniec (employee) entered into an agreement with Edward C. Aubitz by which the employee was to audit the accounts of clients of Aubitz and his principal, Howard Schultz and Associates, Inc., to determine if the clients had overpaid accounts payable because they were unaware of the availability of special discounts or allowances. The agreement contained a restrictive covenant whereby employee "will not, for a period of two years after the termination of this agreement, for any reason thereafter, engage, directly or indirectly, as principal, agent, employer, employee, or in any capacity whatsoever, in any business, activity, auditing practice, or any other related activities, in competition with the principal (Howard Schultz & Associates) or associate's (Aubitz) business within any area or areas from time to time constituting the principal's or associate's area of activity in the conduct of their respective businesses, as of the date of said termination. . . ."

The agreement also contained a paragraph concerned with confidential and privileged information which stated that employee "shall receive information and knowledge with reference to clients, customers, and other sources of income of the principal and the associate, and with reference to auditing techniques, forms, standards, and other practices of the principal and the associate in performing the services in which the principal and the associate are engaged, and that all of said knowledge and information is confidential and privileged, and . . . (employee) agrees to keep said information confidential and not reveal the same to any party. . . ."

…

1. By both constitutional and legislative provision, Georgia prohibits contracts or agreements in general restraint of trade. Const.1976, Art. III, Sec. VIII, Par. VIII, Code Ann. § 2-1409; Code Ann. §20-504. Georgia courts have consistently held that the prohibition does not impose an absolute bar against every kind of restrictive agreement. A covenant not to compete ancillary to an employment contract is enforceable only where it is strictly limited in time and territorial effect and is otherwise reasonable considering the business interest of the employer sought to be protected and the effect on the employee.

Insofar as territorial restrictions are concerned, some of them relate to the territory in which the employee was employed; others relate to the territory in which the employer

does business. The former generally will be enforced. The latter generally are unenforceable absent a showing by the employer of the legitimate business interests sought to be protected. It appears that the justification for this difference in treatment is that a court will accept as prima facie valid a covenant related to the territory where the employee was employed as a legitimate protection of the employer's investment in customer relations and good will. Thus a court will enforce an agreement prohibiting an employee from pirating his former employer's customers served by the employee, during the employment, at the employer's direct or indirect expense. Conversely, a court will not accept as prima facie valid a covenant related to the territory where the employer does business where the only justification is that the employer wants to avoid competition by the employee in that area.

In the case before us the employee was prohibited from engaging in competition within "any area or areas from time to time constituting the principal's or associate's area of activity in the conduct of their respective businesses, as of the date of said termination." This area would be, as to the employer's territory, not to mention the principal's territory, Alabama, Georgia, Florida, North Carolina, South Carolina and Tennessee. The employer has not justified this territorial restriction. It therefore stands as a bald attempt by the employer to prevent competition by the employee and is unenforceable.

2. This covenant not to compete must fall for two more reasons. This court has held on several occasions that a covenant wherein the employee agreed not to accept employment with a competitor "in any capacity" imposes a greater limitation upon the employee than is necessary for the protection of the employer and therefore is unenforceable.

A covenant not to compete is also unreasonable where the nature of the business activities in which the employee is forbidden to engage is not specified with particularity. These indefinite business activities generally are identified by reference to the employer's business; e. g., the employee agrees not to engage in or be employed by any "business similar to employer's business."

The restrictive covenant here prohibits the employee from engaging "in any capacity whatsoever, in any business, activity, auditing practice, or in any other related

activities, in competition with the principal or associate's business." We find that the covenant is unreasonable because the employee is prohibited from working in any capacity for a competitor. The covenant also fails to specify with any particularity the nature and kind of business which is or will be competitive with the employer; i. e., the covenant fails to specify with particularity the activity which the employee is prohibited from performing.

3. The employer urges us to overrule *Rita Personnel Services v. Kot*, 229 Ga. 314, 191 S.E.2d 79, supra, and adopt the "blue-pencil theory" of severability. In *Rita Personnel* this court considered the severance theory and declined to apply it. The court has consistently followed *Rita Personnel.*

The employer argues that the Restatement of Contracts, §518, approves the blue-pencil theory. However, Draft No. 12 of Restatement of the Law, Second, Contracts, §326, pp. 95-96 (March 1, 1977), approved by the American Law Institute, rejects the blue-pencil theory as contrary to the weight of recent authority. *Rita Personnel* is cited with approval.

…

According to the contract before us the employee agreed that for a period of two years he would not engage, directly or indirectly, as principal, agent, employer, employee, or in any capacity whatsoever, in any business activity, auditing practice, or any other related activity, in competition with the employer in Alabama, Georgia, Florida, North Carolina, South Carolina and Tennessee, or in competition with employer's principal wherever it may operate. The employer requests us to restrict the territory, to strike the offensive words "in any capacity" and to add words of our choosing to specify the activity forbidden to the employee.

It is these very requests which are the reason for rejecting severability of employee covenants not to compete. Employers covenant for more than is necessary, hope their employees will thereby be deterred from competing, and rely on the courts to rewrite the agreements so as to make them enforceable if their employees do compete. When courts adopt severability of covenants not to compete, employee competition will be deterred even more than it is at present by these overly broad covenants against competition. We choose to reaffirm *Rita Personnel Services v. Kot*, supra.

4. We next must consider whether the trial court erred in not issuing an injunction with reference to the employee's covenant against disclosure of confidential information. In *Durham v. Stand-By Labor, Inc.,* supra, we made it clear that a nondisclosure covenant in an employment agreement could be enforced independently from a claim under a covenant not to compete such as has been discussed above.

Also, at the outset, it is important to note that here the employer does not have a "trade secret" such as can be protected by law absent a contract provision. "A trade secret, within the rules pertaining to the rights which can be protected by injunction, is a plan, process, tool, mechanism, or compound, known only to its owner and those of his employees to whom it must be confided in order to apply it to the uses intended."

Judgment affirmed.

Hypothetical

Appellant, Sibarco Stations, Inc., entered into agreements with appellees to purchase contiguous parcels of real estate in Homestead, Pennsylvania, for the purpose of constructing a service station. The purchase of each parcel was contingent, inter alia; upon the consummation of all the purchases upon the premises being free and clear of all leases; and upon appellant's receipt of the necessary permits for construction. Nearly six months after accepting appellees' offer, but before a closing date was agreed upon, appellant informed appellees it was cancelling the agreement because it was unable to obtain the permits necessary to construct a gasoline service station.

Each of the appellees filed a complaint in equity asking for specific performance of the contracts of sale. Some of the appellees also sought money damages for loss of rental income, maintenance costs, and certain demolition costs. Appellant filed preliminary objections to each of the complaints on the ground that equity jurisdiction should not obtain because appellees sought money damages only and had a complete and adequate remedy at law.

Trachtenburg v. Sibarco Stations, Inc., 477 Pa. 517 (1978)

CONTRACT INTERPRETATION

EMPLOYMENT CONTRACT

1) In consideration of my employment by you in the capacity of manager, at a salary of at least $800 a week, effective March 5, 2009, I hereby agree that I will not, for a period of one year after termination of my employment for any reason whatsoever, be engaged in the operation of any cafeteria or food facility serving employees, guests, or students of any person or corporation who shall have been your client within the period of one year prior to the termination of my employment or with whom you may have been negotiation during my employment by you if I have participated in such negotiations directly or indirectly, or have had contact with them, directly or indirectly, in the course of my employment with you.

2) I will not, during or after the term of my employment, divulge to others, or make use of any information or knowledge relating to your business, methods, processes, techniques, or research, which shall not be generally known to the public.

3) I will not, during the term of my employment, become associated with any other business connected with the food service industry.

4) You agree to employ me for at least four weeks and not to dismiss me at any time thereafter without at least two weeks notice or two weeks severance pay in lieu thereof, except for disregard of duty, gross incompetence, fraud or dishonesty.

Questions for Employment Contract: [one for each paragraph]

Employer runs food services for his clients, who are colleges, universities, and other institutions. One of his clients is Towson University. Employer hired Employee to work as a manager for the cafeteria at Towson University.

1) Assume U.B. Bookstore had also been a client of Employer and that U.B. Bookstore terminated its relationship with Employer on May 1, 2011. Employee comes to you on December 1, 2011 and says he wants to take a new job running the cafeteria at U.B. Bookstore. When is the earliest he can work at U.B. Bookstore? [You will need to break down paragraph one into many smaller parts to answer this]

2) While working for Employer, Employee learns that students like foods with "regional names" – like "New England Pizza". When he starts his new job, can he tell people this?

3) While working at Employer, can Employee purchase 100 shares of "Trucking, Inc." – which, among other things, delivers food supplies to Employer? [Are there other facts you would need to answer this question?]

4) Assume that Employee has yet to start working for Employer. If Employee starts working tomorrow, what's the earliest he can be fired? What are the limits to the firing?

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

OPINION BY: FRIENDLY

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

The action is for breach of the warranty that goods sold shall correspond to the description. Two contracts are in suit. In the first, dated May 2, 1957, defendant, a New York sales corporation, confirmed the sale to plaintiff, a Swiss corporation, of "US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated 2 1/2-3 lbs. and 1 1/2-2 lbs. each all chicken individually wrapped in cryovac, packed in secured fiber cartons or wooden boxes, suitable for export scheduled May 10, 1957 pursuant to instructions from Penson & Co., New York."

75,000 lbs. 2 ½-3 lbs....	@$ 33.00
25,000 lbs. 1 ½-2 lbs....	@$ 36.50
per 100 lbs. FAS New York	

The second contract, also dated May 2, 1957, was identical save that only 50,000 lbs. of the heavier 'chicken' were called for, the price of the smaller birds was $ 37 per 100 lbs., and shipment was scheduled for May 30. The initial shipment under the first contract was short but the balance was shipped on May 17. When the initial shipment

arrived in Switzerland, plaintiff found, on May 28, that the 2 1/2-3 lbs. birds were not young chicken suitable for broiling and frying but stewing chicken or "fowl"; indeed, many of the cartons and bags plainly so indicated. Protests ensued. Nevertheless, shipment under the second contract was made on May 29, the 2 1/2-3 lbs. birds again being stewing chicken. Defendant stopped the transportation of these at Rotterdam. This action followed…

Since the word "chicken" standing alone is ambiguous, I turn first to see whether the contract itself offers any aid to its interpretation. Plaintiff says the 1 1/2-2 lbs. birds necessarily had to be young chicken since the older birds do not come in that size, hence the 2 1/2-3 lbs. birds must likewise be young. This is unpersuasive -- a contract for "apples" of two different sizes could be filled with different kinds of apples even though only one species came in both sizes. Defendant notes that the contract called not simply for chicken but for "US Fresh Frozen Chicken, Grade A, Government Inspected." It says the contract thereby incorporated by reference the Department of Agriculture's regulations, which favor its interpretation; I shall return to this after reviewing plaintiff's other contentions.

The first hinges on an exchange of cablegrams which preceded execution of the formal contracts. The negotiations leading up to the contracts were conducted in New York between defendant's secretary, Ernest R. Bauer, and a Mr. Stovicek, who was in New York for the Czechoslovak government at the World Trade Fair…. Plaintiff stresses that, although … cables between plaintiff and defendant, which laid the basis for the additional quantities under the first and for all of the second contract, were predominantly in German, they used the English word "chicken"; it claims this was done because it understood 'chicken' meant young chicken whereas the German word, "Huhn," included both "Brathuhn" (broilers) and "Suppenhuhn" (stewing chicken), and that defendant, whose officers were thoroughly conversant with German, should have realized this.

Whatever force this argument might otherwise have is largely drained away by Bauer's testimony that he asked Stovicek what kind of chickens were wanted, received the answer "any kind of chickens," and then, in German, asked whether the cable meant "Huhn" and received an affirmative response….

Plaintiff's next contention is that there was a definite trade usage that “chicken” meant “young chicken.” …. Plaintiff endeavored to establish such a usage by the testimony of … witnesses and certain other evidence. Strasser, resident buyer in New York for a large chain of Swiss cooperatives, testified that “on chicken I would definitely understand a broiler.” However, the force of this testimony was considerably weakened by the fact that in his own transactions the witness, a careful businessman, protected himself by using “broiler” when that was what he wanted and “fowl” when he wished older birds. …[A] witness’ consistent failure to rely on the alleged usage deprives his opinion testimony of much of its effect.

…

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

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

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

Chickens. The following are the various classes of chickens:

(a) Broiler or fryer . . .

(b) Roaster . . .

(c) Capon . . .

(d) Stag . . .

(e) Hen or stewing chicken or fowl . . .

(f) Cock or old rooster . . .

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

Defendant makes a further argument based on the impossibility of its obtaining broilers and fryers at the 33 cents price offered by plaintiff for the 2 1/2-3 lbs. birds. There is no substantial dispute that, in late April, 1957, the price for 2 1/2-3 lbs. broilers was between 35 and 37 cents per pound, and that when defendant entered into the contracts, it was well aware of this and intended to fill them by supplying fowl in these weights. It claims that plaintiff must likewise have known the market since plaintiff had reserved shipping space on April 23, three days before plaintiff's cable to Stovicek, or, at least, that Stovicek was chargeable with such knowledge. It is scarcely an answer to say, as plaintiff does in its brief, that the 33 cents price offered by the 2 1/2-3 lbs. 'chickens' was closer to the prevailing 35 cents price for broilers than to the 30 cents at which defendant procured fowl. Plaintiff must have expected defendant to make some profit -- certainly it could not have expected defendant deliberately to incur a loss.

Finally, defendant relies on conduct by the plaintiff after the first shipment had been received. On May 28 plaintiff sent two cables complaining that the larger birds in the first shipment constituted "fowl." Defendant answered with a cable refusing to recognize plaintiff's objection and announcing "We have today ready for shipment 50,000 lbs. chicken 2 1/2-3 lbs. 25,000 lbs. broilers 1 1/2-2 lbs.," these being the goods procured for shipment under the second contract, and asked immediate answer "whether we are to ship this merchandise to you and whether you will accept the merchandise." After several other cable exchanges, plaintiff replied on May 29 "Confirm again that merchandise is to be shipped since resold by us if not enough pursuant to contract chickens are shipped the missing quantity is to be shipped within ten days stop we resold to our customers pursuant to your contract chickens grade A you have to deliver us said merchandise we again state that we shall make you fully responsible for all resulting costs." Defendant argues that if plaintiff was sincere in thinking it was entitled to young chickens, plaintiff would not have allowed the shipment under the second contract to go forward, since the distinction between broilers and chickens drawn in defendant's cablegram must have made it clear that the larger birds would not be broilers. However, plaintiff answers that the cables show plaintiff was insisting on delivery of young chickens and that defendant shipped old ones at its peril. … Defendant argues that it was only when plaintiff's customers complained about this that plaintiff developed the idea that "chicken" meant "young chicken." There is little force in this in view of plaintiff's immediate and consistent protests.

When all the evidence is reviewed, it is clear that defendant believed it could comply with the contracts by delivering stewing chicken in the 2 1/2-3 lbs. size. Defendant's subjective intent would not be significant if this did not coincide with an objective meaning of "chicken." Here it did coincide with one of the dictionary meanings, with the definition in the Department of Agriculture Regulations to which the contract made at least oblique reference, with at least some usage in the trade, with the realities of the market, and with what plaintiff's spokesman had said. Plaintiff asserts it to be equally plain that plaintiff's own subjective intent was to obtain broilers and fryers; the only evidence against this is the material as to market prices and this may not have been sufficiently brought home. In any event it is unnecessary to determine that issue. For

plaintiff has the burden of showing that "chicken" was used in the narrower rather than in the broader sense, and this it has not sustained.

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

BEANSTALK GROUP, INC. v. AM GENERAL CORP., 283 F.3d 856 (7th Cir. 2002)
POSNER, Circuit Judge.

Beanstalk, which serves owners of intellectual property by negotiating licenses of their property, brought this diversity suit for breach of its contract with AM General; the substantive issues are governed by the law of Indiana. The contract, called a "representation agreement," appointed Beanstalk an agent of AM General to obtain licenses to use the latter's "HUMMER" trademark. When the contract was made in 1997, AM General was the manufacturer of the Humvee, a military vehicle that is the successor to the jeep and like the jeep is also sold in a version intended for the civilian market, under the name "Hummer."

The agreement made Beanstalk AM General's "sole and exclusive nonemployee representative" for the purpose of licensing the Hummer trademark and entitled Beanstalk to 35 percent of the "gross receipts ... received on Owner's [AM General's] behalf ... under any License Agreements" made while the representation agreement was in force. Each license agreement "shall provide for all payments thereunder to be made to Beanstalk on Owner's behalf," and Beanstalk is required to account quarterly to AM General for "all gross receipts actually received during the preceding calendar quarter under any License Agreements." …. "License agreement" is defined as "any agreement or arrangement, whether in the form of a license or otherwise, granting merchandising or other rights in the Property," which in turn is defined to mean trademarks and related rights.

The agreement was drafted by Beanstalk, but this fact has little interpretive significance since AM General is a commercially sophisticated party represented by counsel. Most courts now agree with this exception to the principle that contracts are to be construed against the party that drafted it. *Western Sling & Cable Co. v. Hamilton,* 545

So.2d 29, 31-32 (Ala.1989)….There are holdouts, illustrated by *Eastern Bus Lines, Inc. v. Board of Education,* 7 Conn.App. 581, 509 A.2d 1071, 1073-74 (1986), where the court, quoting an earlier opinion, said that "the party who actually does the writing of an instrument will presumably be guided by his own interests and goals in the transaction. He may choose shadings of expression, words more specific or more imprecise, according to the dictates of these interests." No doubt; but the other party, if commercially sophisticated and represented by counsel, will insist on clarification. Indiana has yet to take a stand on the exception, though the only case from Indiana that we can find which bears on it, *Nationwide Mutual Ins. Co. v. Neville,* 434 N.E.2d 585, 599 (Ind.App.1982), leans in favor of rejecting it. No matter; AM does not need the rule in order to prevail. We add that the rule is in practice a makeweight rather than a tie breaker.

Beanstalk set about obtaining agreements for the licensing of the Hummer trademark. In 1999, however, two years into the representation agreement with Beanstalk, AM General entered into a joint-venture agreement with General Motors under which GM would design and engineer a new version of the Hummer, would make an interest-free loan of $235 million to AM General for the construction of a factory to manufacture the new version, would promise to buy a minimum number of the new vehicles, would obtain an option to buy up to 40 percent of AM General's common stock-and would acquire the Hummer trademark. GM informed Beanstalk that it had not assumed any of AM General's obligations under the representation agreement and that it would not compensate Beanstalk for any license agreements made or renewed after the effective date of the joint-venture agreement.

Beanstalk argues that the agreement between AM General and GM, although of course not labeled a license agreement, was one because it transferred the Hummer trademark to GM and thus was an "agreement or arrangement, whether in the form of a license or otherwise, granting merchandising or other rights in the Property"; for the transfer gave GM the right, indeed the exclusive right, to merchandise the Hummer trademark, that is, the "Property." The contract thus is clear, Beanstalk argues-the joint venture was an "agreement" that "grant[ed]" GM "merchandising ... rights" in the Hummer trademark and it did not have to be "in the form of a license" because the

representation agreement says “in the form of a license *or otherwise*”-and under accepted principles of contract law we should look no further. Beanstalk wants 35 percent of so much of the consideration running from GM to AM General as represents the value of the Hummer trademark. We do not know what the consideration was, or what that value is, because no evidence has been taken-in fact, the joint-venture agreement is not even in the record, though the sketch we have just given of its terms is not contested.

Beanstalk is correct that written contracts are usually enforced in accordance with the ordinary meaning of the language used in them and without recourse to evidence, beyond the contract itself, as to what the parties meant. This presumption simplifies the litigation of contract disputes and, more important, protects contracting parties against being blindsided by evidence intended to contradict the deal that they thought they had graven in stone by using clear language. It is a strong presumption, motivated by an understandable distrust in the accuracy of litigation to reconstruct contracting parties' intentions, but it is rebuttable-here by two principles of contract interpretation that are closely related in the setting of this suit. The first is that a contract will not be interpreted literally if doing so would produce absurd results, in the sense of results that the parties, presumed to be rational persons pursuing rational ends, are very unlikely to have agreed to seek.

This is an interpretive principle, not a species of paternalism. “The letters between plaintiff and defendant were from one merchant to another. They are to be read as businessmen would read them, and only as a last resort are to be thrown out altogether as meaningless futilities.... If literalness is sheer absurdity, we are to seek some other meaning whereby reason will be instilled and absurdity avoided.” *Outlet Embroidery Co. v. Derwent Mills,* 254 N.Y. 179, 172 N.E. 462, 463 (1930) (Cardozo, C.J.). “There is a long tradition in contract law of reading contracts sensibly; contracts-certainly business contracts of the kind involved here-are not parlor games but the means of getting the world's work done.... True, parties *can* contract for preposterous terms. If contract language is crystal clear or there is independent extrinsic evidence that something silly was actually intended, a party may be held to its bargain, absent some specialized defense.”

The second principle is that a contract must be interpreted as a whole. Sentences are not isolated units of meaning, but take meaning from other sentences in the same document. The second principle thus is linguistic; the first reflects the fact that interpretation is a cultural as well as a linguistic undertaking. To interpret a contract or other document, it is not enough to have a command of the grammar, syntax, and vocabulary of the language in which the document is written. One must know something about the practical as well as the purely verbal context of the language to be interpreted. In the case of a commercial contract, one must have a general acquaintance with commercial practices. This doesn't mean that judges should have an M.B.A. or have practiced corporate or commercial law, but merely that they be alert citizens of a market-oriented society so that they can recognize absurdity in a business context. A blinkered literalism, a closing of one's eyes to the obvious, can produce nonsensical results, as this case illustrates. Beanstalk is in the business of merchandising trademarks. If, while the representation agreement was in effect, a toy company wanted to make a toy Hummer, Beanstalk was authorized to grant the toy company a license in exchange for a fee that it would split 35/65 with AM General. The joint-venture agreement was not that kind of arrangement. It was not an arrangement for the promotion of AM General's trademark. By the agreement creating the joint venture, AM General essentially transferred the Hummer business to General Motors, retaining a role limited to manufacturing, in a factory built with GM's money, a vehicle designed by, engineered by, and to be marketed by (that is the significance of the transfer of the trademark) GM. Quite apart from the option that GM also received to buy a large, doubtless controlling interest in AM General, it's as if AM General had sold its entire business, including its manufacturing assets and all its trademarks, to GM.

Beanstalk is not a business broker. It had nothing to do with the joint venture and indeed didn't even know about it until after it took place. The parties could hardly have intended that Beanstalk should get a commission if AM General decided, as in effect it did, to get out of the Hummer business. A business would not contract to pay an agent for work that the agent did not do but that the business did itself. Beanstalk and AM General must have known when they signed the representation agreement that if AM General ever sold its Hummer business, the trademark would go with it, as the purchaser would need it

in order to identify the product, while AM General would no longer have any need or use for it. Indeed, AM General would have nothing to attach the trademark to-and a trademark is an identifier, not a freestanding piece of intellectual property; hence the rule that a trademark cannot be sold in gross, that is, without the assets that create the product that it identifies. The parties would hardly have intended Beanstalk to obtain a commission on the sale of the business merely because the sale would *inevitably* include the trademark. And they would not have wanted to burden the sale with the added cost of allocating the purchase price between the trademark and the other assets involved in the sale, as Beanstalk claims they must do in order to compute the commission to which it is entitled on the joint venture. (Such allocations may be required for tax purposes. We are not told whether that was the case with the AM General-GM joint venture.)

The unreasonableness of Beanstalk's position can be seen most clearly by imagining that the joint venture had taken place the day after the representation agreement between Beanstalk and AM General went into effect. Then on Beanstalk's interpretation it would be entitled to 35 percent of the entire value of the Hummer trademark even though it had made absolutely no contribution to that value. That makes no sense; it is apparent that the definition of "License Agreement" in the representation agreement covers any agreement that has the function or character of a trademark licensing agreement even if the word "license" or a cognate term does not appear; the sale of a business is an agreement of an entirely different character. …

[It] might be argued that to disregard a contractual term, whether on the basis that interpreting it literally would yield absurd results or that other terms in the contract alter the disputed term's apparent meaning, requires evidence and thus cannot be done on a motion to dismiss. Not so. For when we said earlier that the interpretation of a contract is a cultural as well as a linguistic undertaking, we did not add that the materials of interpretation are limited to literal meanings on the one hand and trial-type evidence on the other. The cultural background that a judge brings to the decision of a contract case includes as we said a general knowledge of how the world operates, including the commercial world, and this knowledge, precisely because it is general rather than being knowledge of the specific facts of the case ("adjudicative facts"), can show that the literal

interpretation of a particular contractual term would be unsound, in which event no evidence need be taken. …AFFIRMED. [dissent omitted]

Hypothetical

What is a "cow?" This appeal comes here as an ultimate result of a dispute between plaintiffs-appellees contract buyers and defendants-appellants contract sellers of 134 "cows," over the answer to that question….

One significant fact is not in dispute. The parties entered into a written agreement as follows: "This Certifies, that Howard Shrum of Sheridan has this day bargained and sold to Heinhold Cattle Mkt., 134 head of Cows to be delivered F.O.B. cars, on or before 17 day of Sept., 1973 at $4.50 per head…."

Of all the cattle delivered, Harris refused to accept 72, as being heifers, which he claimed were not "cows" under the contract. Harris, in his deposition, further testified as follows: "Well, it's always been my thought that a cow is a female bovine that's already had a calf. Normally they're not referred to as a cow until after they've weaned their first calf. Even at that time they were often referred to as first-calf heifers."

Harris offered to take what he considered to be cows under the contract but refused the others. Shrum refused, claiming all were cows under their agreement.

The whole case revolves around what the parties intended by the use of the word "cows" in describing the subject matter of the contract. Taken by itself, it has any number of meanings: Webster's Third New International Dictionary, Unabridged: "Cow: 1 a; * * * * the mature female of wild or domestic cattle of the genus Bos or of any of the various animals the male of which is called bull * * * * b: a domestic bovine animal regardless of its sex or age *." Black's Law Dictionary, 4th Ed. 1951: "Cow. Female of bovine genus of animals. Strictly, one that has calved. Often loosely used to include heifer, or young female that has not calved. [Citing cases.]" Ballentine's Law Dictionary With Pronunciations, 2d Ed., under the word "cow," the volume states: "See * * * * heifer." "Heifer. A female calf of the bovine species, from the end of the first year until she has had a calf; a young cow. [Citing case.]"

Shrum v. Zeltwanger, 559 P.2d 1384 (Wyo. 1977)

PAROL EVIDENCE

INTERSTATE INDUSTRIAL UNIFORM RENTAL SERVICE, INC. v. F. R. LEPAGE BAKERY, INC., 413 A.2d 516 (ME. 1980)

OPINION BY: GODFREY

In September, 1972, Interstate Industrial Uniform Rental Service, Inc. (Interstate) began an action against F. R. Lepage Bakery, Inc. (Lepage) for breach of contract. Lepage counterclaimed, alleging breach by Interstate. After acceptance of a referee's report, judgment was entered for Lepage on both the complaint and counterclaim. We deny Interstate's appeal and affirm the judgment.

Before January, 1971, Lepage bought the uniforms for its route salesmen from Benoit's in Portland. Each salesman was then responsible for cleaning and maintaining the uniforms issued to him by Lepage. Some of the salesmen having expressed discontent with that arrangement, on January 26, 1971, Lepage executed a three-year written agreement with Interstate whereby Interstate agreed to supply clean uniforms of its own to Lepage's salesmen at a weekly rental to be paid by Lepage.

Under the agreement, which was on a printed form supplied by Interstate, Interstate was to provide a weekly pick-up and cleaning service and maintain the uniforms. By a handwritten insertion on the printed contract form, Interstate agreed to buy "garments of men they will service at invoice [price]". …

During negotiations, the parties discussed the Lepage uniforms that had been purchased from Benoit's. Interstate representatives were shown a sample of one of those uniforms. According to the Lepage representatives, the parties agreed before execution of the agreement that the uniforms supplied by Interstate would be of comparable quality to the Benoit uniforms. Representatives from Interstate denied any such agreement, insisting that they showed Lepage officials a sample of the Interstate uniforms, which were so obviously inferior to Benoit's in quality of fabric that Interstate would never have agreed that its new uniforms would be of comparable quality….

Testimony before the referee disclosed that during negotiations Interstate agreed to perform certain duties that were not provided for in the contract; namely, to sew route book pockets into the uniforms, affix emblems, tag the uniforms with the employees' names and locker numbers, and supply lockers for the uniforms.

After Interstate began supplying uniforms to Lepage's employees, the employees began to complain about their quality and about Interstate's service and maintenance. Officials of Lepage related the complaints to Interstate, and several meetings took place to work out the problems. Lepage's route salesmen continued to complain. Lepage officials testified that morale of the salesmen was adversely affected because other bakery route salesmen wore uniforms of higher quality. Because the problems continued after the meetings with Interstate officials, the president of Lepage terminated the contract by letter dated June 26, 1972, declaring that, effective July 1, 1972, Lepage would no longer accept the service of Interstate.

Interstate brought this action alleging that Lepage “breached” the contract by refusing to accept services after July 1, 1972. Lepage denied that it had wrongfully terminated the contract and counterclaimed, alleging that it legally terminated the agreement because Interstate had breached by not supplying uniforms of comparable quality to the Lepage uniforms and that Interstate had not properly maintained the uniforms.

After an agreement for reference was filed, the case was ordered to be heard by a referee. After hearing, the referee found that the written contract was silent as to the quality of the uniforms to be rented, that the parties agreed orally that the uniforms were to be substantially equal in quality to Lepage uniforms, and that Interstate violated the oral agreement by supplying inferior uniforms.

…

The contract set forth the following schedule to govern the cost of replacing new garments if lost or destroyed by Lepage employees, and specified the kind of fabric in the replacment garments.

Chino Shirts	3.50
Chino Pants	4.50
Coveralls	6.50
Shop Coats	5.75

Nylon-Rayon Lined Jackets	10.00
Dacron-Rayon Pants	8.00
Dacron Pants	10.00
Dacron Jackets	12.00
Liner	3.00
Dacron-Cotton Shirts	4.50
Dacron-Cotton Pants	5.75

The dollar amounts for dacron-rayon pants, dacron jackets and dacron-cotton shirts were circled in ink on the contract form. The implication is clear that the parties agreed on the fabrics shown opposite the circled amounts as the fabrics for the uniforms to be supplied under this contract.

In reaching his conclusion, the referee found the January 26 agreement to be silent on the quality of the Interstate uniforms. He appears to have found that there was a parol agreement, not merged or integrated in the January 26 writing and hence not discharged by it, that the Interstate uniforms would be substantially equal in quality to the existing Lepage uniforms; in other words, that Interstate was bound by a parol express warranty of future substantial equivalency in the quality of the two sets of uniforms. The principal question on appeal is whether the parol evidence rule should have been applied to bar reliance on that oral promissory warranty.

There was testimony by Lepage officials, which the referee apparently believed, from which he could have rationally inferred the existence of a parol agreement by Interstate that the new uniforms would be substantially equal in quality to the old. His finding that such a parol agreement existed had some support in the evidence. The question is whether he erred in giving effect to that collateral oral agreement about quality, which he had thus found to exist, in view of the fact that it created an added obligation on Interstate not provided for by the written agreement.

With respect to contracts, the parol evidence rule is carefully stated in *Restatement (Second) of Contracts* § 239 (Revised Tent. Drafts Nos. 1-7, 1973), as follows:

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

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

(3) [not here applicable]

As Comment *a* to section 239 makes clear, the parol evidence rule is not a rule of evidence but of substantive law;[1] it is not a rule of interpretation but a rule defining the proper subject matter for interpretation. In order to apply the provisions of section 239, a court must first make a determination that there is a binding integrated agreement and then must ascertain its relationship to the prior parol agreement. It is therefore necessary in this case to determine first whether the January 26 contract was an "integrated agreement" and, if so, to what extent.

Agreements and negotiations of the parties leading up to the January 26 writing may be properly considered in order to establish whether the writing was a binding integrated agreement and, if so, whether it was completely or partially integrated. *Restatement (Second) of Contracts* § 240 (Revised Tent. Drafts Nos. 1-7, 1973). From even a cursory review of the evidence, it is clear that the January 26 writing did not integrate completely all the understandings of the parties. It contained no reference, for example, to Interstate's initial duties: sewing special pockets into the uniforms, tagging the uniforms, and supplying lockers; by referring to “invoice” price, it left to future determination the exact pricing of the old Lepage uniforms that Interstate promised to buy. It is equally clear, however, that the agreement did integrate the parties' understanding on certain matters; *e.g.*, the weekly rental cost of Interstate uniforms, the type and number of garments to be issued to each employee of Lepage, the number of employees to be served, and the arrangements for handling lost and destroyed uniforms.

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[1] Often, the court seems to regard the face of the writing itself as the sole test of its completeness as an integration. The fact that this is quite unsound should not lead us to overlook the fact that the face of the document may weigh heavily on the issue of completeness of integration. It is only one of the evidential factors; and until that issue is determined, the “parol evidence rule” as it is commonly stated does not purport to exclude any testimony. 3 A. Corbin, *Contracts* § 585 at 485 (1961).

For purposes of determining the applicability of the parol evidence rule, the writing of January 26 must be classified as a binding, partially integrated agreement, and it therefore discharges prior agreements only to the extent that it is "inconsistent" with them. *Restatement (Second) of Contracts* § 239(1), set forth above.

Nothing in the language of the January 26 agreement explicitly addressed the quality of the Interstate uniforms, and the referee found that the agreement was silent on the point. However, Interstate argues that the effect of designating in the agreement the types of fabric to be used for pants, jackets and shirts was to create an inherent limitation on the quality of the Interstate uniforms in terms of their durability and resistance to wrinkling, dirt and stains, which limitation was inconsistent with any parol agreement that the uniforms would substantially equal the Benoit uniforms in quality.

In effect, Interstate contends that the January 26 agreement was not really silent with respect to the quality of the uniforms to be supplied by Interstate and hence discharged the asserted prior parol agreement. *Restatement (Second) of Contracts* § 239(1), *supra*. In the absence of any evidence of record to the contrary, we must assume that the referee, in concluding that the written agreement was “silent” with respect to the quality of the Interstate uniforms, found that the contract references to types of fabric did not merge or integrate by implication any prior oral agreement of the parties as to quality. We have no basis in fact for holding, as a matter of law, that he was wrong in doing so. We cannot say, as a matter of law, that it was impossible for uniforms of the designated fabrics to be substantially as good as the Benoit uniforms had been. Thus we cannot say that the referee erred in treating the contract designation of fabrics as not having a necessary bearing on the quality of the uniforms. At the very least, we could not hold the referee to have been wrong if he concluded that the parties themselves did not intend, merely by their designation of fabrics, to agree to a limitation on quality, especially when that designation seemed to be merely incidental to the contract arrangements for recouping the value of employees' lost or destroyed uniforms.

The present case is one of first impression in Maine. We have on the one hand a binding, partially integrated agreement, on a printed form supplied by the promisor, for successive bailments of goods and for services related to those goods, without any express warranty of quality of the goods or services and without any merger or

integration clause in the agreement; on the other, a prior promissory oral warranty of quality of the goods, going beyond any warranty that would be implied by law. ….. Professor Williston cites many sales cases in other states for the proposition that even where a writing stating the terms of a sale contains no express warranty and no merger clause, "extrinsic evidence of an oral warranty generally is excluded." 4 S. Williston, *Contracts* § 643, at 1080 (3d ed. 1961). However, he continues:

> "The trend of the decisions shows some qualification of this doctrine. The principles applicable to contracts only partially reduced to writing find frequent application, and where the writing on its face does not appear to be a complete statement of the contract or the purchase, or is a mere receipt, memorandum or order as distinguished from a written contract, or is a promissory note which states that the note is given as the price of a chattel conditionally sold, the reason for applying the parol evidence rule is lacking and extrinsic evidence of a warranty is generally admitted.
>
> "The principle thus stated is one very difficult of application, and the decisions are not easy to reconcile on their facts. It must be remembered, too, that the parol evidence rule also applies to a partial integration to the extent that it is integrated." 4 S. Williston, *supra*, at 1082-83 [footnote omitted].

…

We are influenced in our decision by the fact that the Uniform Commercial Code, title 11 of the Maine Revised Statutes, has adopted the approach to the parol evidence rule that is taken by sections 239 and 240 of the *Restatement (Second) of Contracts*. Section 2-202 of the Code provides as follows:

> "Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
>
> (1) By course of dealing or usage of trade (section 1-205) or by course of performance (section 2-208); and
>
> (2) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement."

Article 2 of the Code is not directly applicable to the present case, which involves an agreement, not for sale of goods, but for successive future bailments of goods and for services on those goods. … Though it does not involve a contract for sale of goods, the instant case is one in which the correct solution is strongly suggested by the provisions of section 2-202 of the Code, governing the relationship between written contract and prior parol agreement. No good reason appears for according the parol agreement found by the referee less effectiveness than it would have had under the Code if a contract to sell goods had been involved, the facts being otherwise similar.

It was not clearly erroneous for the referee to find on the evidence that Interstate had agreed that its uniforms would be substantially as good as the former Lepage uniforms and to decide that the written agreement was silent as to quality of the uniforms. On the facts as he found them, he was correct in treating the oral agreement about quality as surviving the integration of other agreements of the parties into the January 26 writing.

Judgment affirmed.

VAL-FORD REALTY CORP. v. J.Z.'S TOY WORLD, INC., 231 A.D.2d 434, 647 N.Y.S.2d 488 (N.Y.A.D. 1 Dept.,1996)

MEMORANDUM DECISION. Order, Supreme Court, New York County (Herman Cahn, J.), entered on or about October 26, 1995, which, insofar as appealed from, denied plaintiff's motion for summary judgment, unanimously affirmed, without costs.

Plaintiff seeks to recover rent due under a written lease executed by the corporate defendant and guaranteed by the individual defendant. Defendants admit executing these documents, but assert that their purpose was to defraud plaintiff's construction lender into advancing additional funds and were never intended by the parties to be enforceable, and that the parties are not strangers in that, among other things, the individual defendant is one of the plaintiff corporation's three directors. We agree with the motion court that this parol evidence offered by defendants raises issues of credibility inappropriate for summary judgment treatment. While parol evidenceis generally inadmissible to contradict, vary, add to, or subtract from the terms of an integrated agreement such as the

instant lease and guarantee, it is admissible to show that a " 'writing, although purporting to be a contract, is, in fact, no contract at all' " (*Greenleaf v. Lachman,* 216 A.D.2d 65, 66, 628 N.Y.S.2d 268, *lv. denied* 88 N.Y.2d 802, 645 N.Y.S.2d 445, 668 N.E.2d 416, quoting Richardson on Evidence § 606 [Prince, 10th ed.]; *see also, Paolangeli v. Cowles,* 208 A.D.2d 1174, 617 N.Y.S.2d 936). We have considered plaintiff's other arguments and find them to be without merit.

NANAKULI PAVING AND ROCK CO. v. SHELL OIL CO., INC., 664 F.2d 772 (9th Cir. 1981)

HOFFMAN,D.J.:

Appellant Nanakuli Paving and Rock Company (Nanakuli) initially filed this breach of contract action against appellee Shell Oil Company (Shell) in Hawaiian State Court in February, 1976. Nanakuli, the second largest asphaltic paving contractor in Hawaii, had bought all its asphalt requirements from 1963 to 1974 from Shell under two long-term supply contracts; its suit charged Shell with breach of the later 1969 contract. The jury returned a verdict of $220,800 for Nanakuli on its first claim, which is that Shell breached the 1969 contract in January, 1974, by failing to price protect Nanakuli on 7200 tons of asphalt at the time Shell raised the price for asphalt from $44 to $76. Nanakuli's theory is that price-protection, as a usage of the asphaltic paving trade in Hawaii, was incorporated into the 1969 agreement between the parties, as demonstrated by the routine use of price protection by suppliers to that trade, and reinforced by the way in which Shell actually performed the 1969 contract up until 1974. Price protection, appellant claims, required that Shell hold the price on the tonnage Nanakuli had already committed because Nanakuli had incorporated that price into bids put out to or contracts awarded by general contractors and government agencies. The District Judge set aside the verdict and granted Shell's motion for judgment n. o. v., which decision we vacate. We reinstate the jury verdict because we find that, viewing the evidence as a whole, there was substantial evidence to support a finding by reasonable jurors that Shell breached its contract by failing to provide protection for Nanakuli in 1974.

Nanakuli …argues all material suppliers to the asphaltic paving trade in Hawaii followed the trade usage of price protection and thus it should be assumed, under the U.C.C., that the parties intended to incorporate price protection into their 1969 agreement. This is so, Nanakuli continues, even though the written contract provided for price to be "Shell's Posted Price at time of delivery," F.O.B. Honolulu. Its proof of a usage that was incorporated into the contract is reinforced by evidence of the commercial context, which under the U.C.C. should form the background for viewing a particular contract. The full agreement must be examined in light of the close, almost symbiotic relations between Shell and Nanakuli on the island of Oahu, whereby the expansion of Shell on the island was intimately connected to the business growth of Nanakuli. The U.C.C. looks to the actual performance of a contract as the best indication of what the parties intended those terms to mean. Nanakuli points out that Shell had price protected it on the two occasions of price increases under the 1969 contract other than the 1974 increase. In 1970 and 1971 Shell extended the old price for four and three months, respectively, after an announced increase. This was done, in the words of Shell's agent in Hawaii, in order to permit Nanakuli's to "chew up" tonnage already committed at Shell's old price.

Price protection was practiced in the asphaltic paving trade by either extending the old price for a period of time after a new one went into effect or charging the old price for a specified tonnage, which represented work committed at the old price. In addition, several months' advance notice was given of price increases.

…

Shell presents three arguments for upholding the judgment n. o. v. or, on cross appeal, urging that the District Judge erred in admitting certain evidence. First, it says, the District Court should not have denied Shell's motion in limine to define trade, for purposes of trade usage evidence, as the sale and purchase of asphalt in Hawaii, rather than expanding the definition of trade to include other suppliers of materials to the asphaltic paving trade. Asphalt, its argument runs, was the subject matter of the disputed contract and the only product Shell supplied to the asphaltic paving trade. Shell protests that the judge, by expanding the definition of trade to include the other major suppliers to the asphaltic paving trade, allowed the admission of highly prejudicial evidence of

routine price protection by all suppliers of aggregate. Asphaltic concrete paving is formed by mixing paving asphalt with crushed rock, or aggregate, in a “hot-mix” plant and then pouring the mixture onto the surface to be paved. Shell's second complaint is that the two prior occasions on which it price protected Nanakuli, although representing the only other instances of price increases under the 1969 contract, constituted mere waivers of the contract's price term, not a course of performance of the contract. A course of performance of the contract, in contrast to a waiver, demonstrates how the parties understand the terms of their agreement. Shell cites two U.C.C. Comments in support of that argument: (1) that, when the meaning of acts is ambiguous, the preference is for the waiver interpretation, and (2) that one act alone does not constitute a relevant course of performance. Shell's final argument is that, even assuming its prior price protection constituted a course of performance and that the broad trade definition was correct and evidence of trade usages by aggregate suppliers was admissible, price protection could not be construed as reasonably consistent with the express price term in the contract, in which case the Code provides that the express term controls.

We hold that the judge did not abuse his discretion in defining the applicable trade, for purposes of trade usages, as the asphaltic paving trade in Hawaii, rather than the purchase and sale of asphalt alone, given the unusual, not to say unique, circumstances: the smallness of the marketplace on Oahu; the existence of only two suppliers on the island; the long and intimate connection between the two companies on Oahu, including the background of how the development of Shell's asphalt sales on Oahu was inextricably linked to Nanakuli's own expansion on the island; the knowledge of the aggregate business on the part of Shell's Hawaiian representative, Bohner; his awareness of the economics of Nanakuli's bid estimates, which included only two major materials, asphalt and aggregate; his familiarity with realities of the Hawaiian marketplace in which all government agencies refused to include escalation clauses in contract awards and thus pavers would face tremenduous losses on price increases if all their material suppliers did not routinely offer them price protection; and Shell's determination to build Nanakuli up to compete for those lucrative government contracts with the largest paver on the island, Hawaiian Bitumuls (H.B.), which was supplied by the only other asphalt company on the islands, Chevron, and which was routinely price protected on materials. We base our

holding on the reading of the Code Comments as defining trade more broadly than transaction and as binding parties not only to usages of their particular trade but also to usages of trade in general in a given locality. This latter seems an equitable application of usage evidence where the usage is almost universally practiced in a small market such as was Oahu in the 1960's before Shell signed its 1969 contract with Nanakuli. Additionally, we hold that, under the facts of this case, a jury could reasonably have found that Shell's acts on two occasions to price protect Nanakuli were not ambiguous and therefore indicated Shell's understanding of the terms of the agreement with Nanakuli rather than being a waiver by Shell of those terms.

Lastly we hold that, although the express price terms of Shell's posted price of delivery may seem, at first glance, inconsistent with a trade usage of price protection at time of increases in price, a closer reading shows that the jury could have reasonably construed price protection as consistent with the express term. We reach this holding for several reasons. First, we are persuaded by a careful reading of the U.C.C., one of whose underlying purposes is to promote flexibility in the expansion of commercial practices and which rather drastically overhauls this particular area of the law. The Code would have us look beyond the printed pages of the contract to usages and the entire commercial context of the agreement in order to reach the “true understanding” of the parties. Second, decisions of other courts in similar situations have managed to reconcile such trade usages with seemingly contradictory express terms where the prior course of dealings between the parties, trade usages, and the actual performance of the contract by the parties showed a clear intent by the parties to incorporate those usages into the agreement or to give to the express term the particular meaning provided by those usages, even at times varying the apparent meaning of the express terms. Third, the delineation by thoughtful commentators of the degree of consistency demanded between express terms and usage is that a usage should be allowed to modify the apparent agreement, as seen in the written terms, as long as it does not totally negate it. We believe the usage here falls within the limits set forth by commentators and generally followed in the better reasoned decisions. The manner in which price protection was actually practiced in Hawaii was that it only came into play at times of price increases and only for work committed prior to those increases on non-escalating contracts. Thus, it formed an exception to, rather

than a total negation of, the express price term of "Shell's Posted Price at time of delivery." Our decision is reinforced by the overwhelming nature of the evidence that price protection was routinely practiced by all suppliers in the small Oahu market of the asphaltic paving trade and therefore was known to Shell; that it was a realistic necessity to operate in that market and thus vital to Nanakuli's ability to get large government contracts and to Shell's continued business growth on Oahu; and that it therefore constituted an intended part of the agreement, as that term is broadly defined by the Code, between Shell and Nanakuli.

….

Perhaps one of the most fundamental departures of the Code from prior contract law is found in the parol evidence rule and the definition of an agreement between two parties. Under the U.C.C., an agreement goes beyond the written words on a piece of paper. " 'Agreement' means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this chapter (sections 490:1-205 and 490:2-208)." Id. § 490:1-201(3). Express terms, then, do not constitute the entire agreement, which must be sought also in evidence of usages, dealings, and performance of the contract itself. The purpose of evidence of usages, which are defined in the previous section, is to help to understand the entire agreement.

"(Usages are) a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade.... Part of the agreement of the parties ... is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding." §490:1-205, Comment 4.

Course of dealings is more important than usages of the trade, being specific usages between the two parties to the contract. "(C)ourse of dealing controls usage of trade." § 490:1-205(4). It "is a sequence of previous conduct between the parties to a particular

transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." § 490:1-205(1). Much of the evidence of prior dealings between Shell and Nanakuli in negotiating the 1963 contract and in carrying out similar earlier contracts was excluded by the court.

A commercial agreement, then, is broader than the written paper and its meaning is to be determined not just by the language used by them in the written contract but "by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing." Id., Comment 1. Performance, usages, and prior dealings are important enough to be admitted always, even for a final and complete agreement; only if they cannot be reasonably reconciled with the express terms of the contract are they not binding on the parties. "The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade." § 490:1-205(4).

Of these three, then, the most important evidence of the agreement of the parties is their actual performance of the contract. Id. The operative definition of course of performance is as follows: "Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement." § 490:2-208(1). "Course of dealing ... is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning (Section 2-208)." §490:1-205, Comment 2. The importance of evidence of course of performance is explained: "The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the 'agreement' ..." Id. s 490:2-208,

Comment 1. “Under this section a course of performance is always relevant to determine the meaning of the agreement.” Id., Comment 2.

Our study of the Code provisions and Comments, then, form the first basis of our holding that a trade usage to price protect pavers at times of price increases for work committed on nonescalating contracts could reasonably be construed as consistent with an express term of seller's posted price at delivery. Since the agreement of the parties is broader than the express terms and includes usages, which may even add terms to the agreement, and since the commercial background provided by those usages is vital to an understanding of the agreement, we follow the Code's mandate to proceed on the assumption that the parties have included those usages unless they cannot reasonably be construed as consistent with the express terms.

…

Here the evidence was overwhelming that all suppliers to the asphaltic paving trade price protected customers under the same types of circumstances. Chevron's contract with H.B. was a similar long-term supply contract between a buyer and seller with very close relations, on a form supplied by the seller, covering sales of asphalt, and setting the price at seller's posted price, with no mention of price protection…. [T]he express price term was “Shell's Posted Price at time of delivery.” A total negation of that term would be that the buyer was to set the price. It is a less than complete negation of the term that an unstated exception exists at times of price increases, at which times the old price is to be charged, for a certain period or for a specified tonnage, on work already committed at the lower price on nonescalating contracts. Such a usage forms a broad and important exception to the express term, but does not swallow it entirely. Therefore, we hold that, under these particular facts, a reasonable jury could have found that price protection was incorporated into the 1969 agreement between Nanakuli and Shell and that price protection was reasonably consistent with the express term of seller's posted price at delivery.

…

Because the jury could have found for Nanakuli on its price protection claim under either theory, we reverse the judgment of the District Court and reinstate the jury verdict for Nanakuli in the amount of $220,800, plus interest according to law.

LURIA BROS. & CO. v. PIELET BROS. SCRAP IRON & METAL, INC., 600 F.2d 103 (7th Cir. 1979)

FAIRCHILD , J.

This is a diversity action for breach of contract. Most of the events giving rise to this litigation occurred in Illinois and we accept the parties' assumption that Illinois law is applicable. The action below was tried before a jury which returned a verdict in the amount of $ 600,000, having found that a contract for the purchase of barge scrap steel existed between plaintiff, Luria Brothers & Co., Inc. (hereinafter referred to as "Luria") and defendant, Pielet Brothers Scrap Iron & Metal, Inc. (hereinafter referred to as "Pielet"), and that Luria was damaged as a consequence of Pielet's failure to deliver. Defendant appeals…We affirm.

A consideration of the issues requires a statement of the facts in some detail. Luria, in its capacity as both a broker and a dealer is in the business of buying, selling, and processing scrap metal. Pielet is in the same business. The parties had done business with each other on a number of occasions prior to the transaction giving rise to this litigation. In fact, Lawrence Bloom, who represented Pielet in this matter had formerly been employed by Luria as a scrap trader.

Most of the facts surrounding the subject transaction are not in dispute and were stipulated to at trial. In mid-September, 1973, Bloom, a vice-president of Pielet, telephoned Richard Fechheimer, a vice-president of Luria. Bloom informed Fechheimer that Pielet might offer a substantial quantity of scrap metal for sale. Bloom inquired as to whether Luria would be interested in purchasing the metal and Fechheimer said that it would be. Subsequent telephone conversations took place between Bloom and Fechheimer in which price quotations and other matters were discussed. The quantity was to be 35,000 net tons of scrap steel from old barges cut into sections measuring five feet by five feet by twenty feet. The shipment date was to be on or before December 31, 1973. The price was set at $ 42 per net ton if Luria took delivery in Houston or $ 49 if Luria took delivery in Brownsville (Texas). This transaction was unusual in two respects. First,

the amount of scrap involved was much larger than that in a typical scrap transaction. Secondly, while the type or grade of scrap was not unusual, the dimensions were. Luria intended to process the scrap for resale as "No. 1 heavy melting" scrap by reducing it to a size that would fit into a steel furnace, generally in pieces at least 1/4 inch thick and not more than 5 feet long by 18 inches wide.

…On September 24, 1973, Bloom caused to be prepared a sales confirmation relating to the scrap transaction between Pielet and Luria. The following information was typed on the confirmation form: "Quantity: Thirty-five thousand (35,000) net tons. Material: Steel barges cut 5' X 5' X 20' free of non metallics. Price: $ 42.00 per net ton F.O.B. Shipping point barge Houston, Texas or $ 49.00 per net ton delivered Brownsville, Texas. Shipment: On or before December 31, 1973. Terms: 90% Advance on receipt of surveyor's weights and bill of lading."

Bloom signed the sales confirmation and mailed the original and one copy to Forlani. The copy bore the printed words "confirmation copy." The following words are printed at the bottom of both the original and the confirmation copy of Pielet's confirmation form: "PLEASE SIGN AND RETURN THE COPY OF THIS CONFIRMATION FOR OUR FILES. FAILURE TO RETURN COPY DOES NOT VOID CONTRACT." Neither Forlani nor any officer or other employee of Luria ever signed or returned the confirmation copy to Bloom or anyone else at Pielet.

In the ordinary course of business when Luria makes a purchase of scrap, information regarding the purchase is typed or written on its own purchase confirmation form. On or about October 4, 1973, Forlani caused to be prepared a purchase confirmation containing the same terms as in Pielet's form, except with respect to the delivery date and mode of shipment. The delivery date typed on the form was by October 31, 1973 and the mode of shipment appeared to be left to the discretion of Luria. On the reverse side of this form are printed standard terms including ones referring to warranties, insurance, and taxes, as well as one stating "This order constitutes the entire contract between the parties." The original and one copy of this form are sent to the seller. These bear in red letters the words "RETURN ACCEPTANCE COPY IMMEDIATELY" in the lower right hand corner. There were no other words on this document to indicate any

condition as to the existence of a contract.

[The Court found these two writings constituted the contractual agreement of the parties, and that the first form correctly described the delivery date and mode of shipment.]

…

In an offer of proof, Bloom testified that in their first conversation in September, he told Fechheimer "I was doing business with people that I had never heard of, that they were fly-by-night people, that I was worried about shipment and if I didn't get shipment, I didn't want any big hassle, but if I got the scrap, he would get it."

….

Having found § 2-202 applicable, the next question is whether the excluded evidence contradicts or is inconsistent with the terms of the writings. Pielet argues that the offered testimony did not "contradict" but instead "explained or supplemented" the writings with "consistent additional terms." [1]For this contention, Pielet relies upon Hunt Foods & Industries, Inc. v. Doliner, 26 A.D.2d 41, 270 N.Y.S.2d 937 (1966). In reversing the trial court's summary judgment for plaintiff, the court in Hunt held that evidence of an oral condition precedent did not contradict the terms of a written stock option which was unconditional on its face. Therefore evidence of the condition precedent should not have been barred by U.C.C. § 2-202. "In a sense any oral provision which would prevent the ripening of the obligations of a writing is inconsistent with the writing. But that obviously is not the sense in which the word is used. (Citation omitted.) To be inconsistent the term must contradict or negate a term of the writing." Id. at 43, 270 N.Y.S.2d at 940. This reasoning in Hunt was followed in Michael Schiavone & Sons, Inc. v. Securalloy Co., 312 F. Supp. 801 (D.Conn.1970). In that case, the court found that parol evidence that the quantity in a sales contract was "understood to be up to 500 tons cannot be said to be inconsistent with the terms of the written contract which specified the quantity as '500

[1] Pielet cites *McCormick on Evidence* § 56 (2d ed. 1972) for the proposition that once one party has introduced part of a conversation, the other party automatically has the right to introduce the remainder of the conversation relating to the same subject. This is a general rule of evidence based on materiality and relevance. The parol evidence rule, on the other hand, is a rule of substantive law. Evidence is excluded not because it is not credible or not relevant but because of a policy favoring the reliability of written representations of the terms of a contract.

Gross Ton'" Id. at 804.

The narrow view of inconsistency espoused in these two cases has been criticized. In Snyder v. Herbert Greenbaum & Assoc., Inc., 38 Md.App. 144, 380 A.2d 618 (1977), the court held that parol evidence of a contractual right to unilateral rescission was inconsistent with a written agreement for the sale and installation of carpeting. The court defined "inconsistency" as used in § 2-202(b) as "the absence of reasonable harmony in terms of the language and respective obligations of the parties." Id. at 623 (emphasis in original) (citing U.C.C. § 1-205(4)). See also Southern Concrete v. Mableton Contractors, 407 F. Supp. 581 (N.D.Ga.1975), aff'd memo., 569 F.2d 1154 (5th Cir. 1978).

We adopt this latter view of inconsistency and reject the view expressed in Hunt. Where writings intended by the parties to be a final expression of their agreement call for an unconditional sale of goods, parol evidence that the seller's obligations are conditioned upon receiving the goods from a particular supplier is inconsistent and must be excluded. ….Judgment affirmed.

River's Edge Homeowners' Ass'n v. City of Naperville, 353 Ill.App.3d 874 (2004)

Plaintiff, River's Edge Homeowners' Association, sued defendant, City of Naperville, for a declaratory judgment that defendant's proposed bicycle path exceeded its easement rights on the River's Edge property. The trial court denied both parties' motions for summary judgment. After a bench trial, the trial court denied plaintiff's complaint for declaratory judgment. Plaintiff appeals the trial court's denial of its motion for summary judgment and the trial court's ultimate ruling for defendant after a bench trial. Because we hold that the trial court erred in denying plaintiff's motion for summary judgment, we do not reach plaintiff's appeal on the court's ultimate ruling after a bench trial. We vacate the trial court's final ruling on the bench trial and we reverse the trial court's ruling on plaintiff's motion for summary judgment.

I. FACTS

The creation of a residential townhome development in Naperville was proposed to defendant in 1972. After some negotiation, defendant approved the development, called "River's Edge," pursuant to the developers' agreement to dedicate an easement on the property to defendant. The developers and defendant entered into an agreement on March 19, 1973, and the agreement was amended on July 2, 1974. Also on July 2, 1974, the developers executed a grant of easement. The developers are not parties to this lawsuit.

The amended agreement stated, in pertinent part:
"No public parks will be required due to the private open spaces in paragraph B [of this section of the agreement] being more than adequate to meet open space requirements. There will be however, a dedicated walk easement along the river side of said property extending from the [f]ive [f]eet [w]est of the retaining wall to the center line of the river—approximately 4 acres. A 5 [foot] wide walkway constructed of 4 [inches] of Type 'B' Base and 4 [inches] of BAM meeting the requirements of the Standard Specifications for Road and Bridge Construction of the State of Illinois, dated 1973, will follow a free form path in the area commencing at the north end of said property and extending to the [s]outh limits."

The grant of easement stated:
"The [g]rantor * * * hereby declares and grants in perpetuity an easement to [defendant] and to the public in general for the purpose of ingress and egress thereto and a walkway upon, under, along and across the following described property situated in DuPage County, Illinois, and identified as a walkway easement in this plat: [description]."

Pursuant to the above-quoted documents, defendant obtained an easement, consisting of approximately four acres, on the River's Edge property. The easement is approximately 1,400 feet long, and it runs the entire length of the River's Edge property from north to south along the river front. Though the agreement required a walkway of 5 feet in width to be constructed, the developers constructed a walkway that measures, on average, 8.7 feet in width.

Defendant now seeks to reconstruct the River's Edge path and widen it to approximately 12 feet so that the path can comprise a portion of its newly proposed bicycle trail project. The new path would be a "multi-use" recreational trail, which would accommodate bicyclists and pedestrians simultaneously. On July 9, 2003, plaintiff brought a complaint seeking a declaratory judgment that defendant's project was an illegal expansion of the purpose and scope of the easement. Both parties submitted motions for summary judgment, which the trial court denied.

After a bench trial, the trial court found that the original intent of the drafters of the easement contemplated bicycle traffic and, thus, that the proposed reconstruction of the path was not an expansion of the easement for which just compensation was due plaintiff. It based its ruling on the language of the easement documents, the public use intended for the walkway, the documentary and testimonial evidence concerning the meaning of the term "walkway" at the time the easement documents were written, the fact that no signs or other restrictive measures were ever imposed upon bicycle use on the path, the actual width of the sidewalk, and the fact that the easement was given in lieu of a public park. Plaintiff timely appeals.

II. DISCUSSION

Plaintiff's first contention on appeal is that the trial court erred in denying its motion for summary judgment. We agree.

Plaintiff sought summary judgment because the easement documents unambiguously established that defendant did not have the right to create a bicycle path on its easement on the River's Edge property. Summary judgment is appropriate where the pleadings, depositions, admissions, and affidavits on file, when taken together in the light most favorable to the nonmovant, show that there is no genuine issue of material fact and that the movant is entitled to judgment as a matter of law. *Fremont Casualty Insurance Co. v. Ace–Chicago Great Dane Corp.*, 317 Ill.App.3d 67, 73 (2000). Our review of the trial court's ruling on a motion for summary judgment is *de novo. Fremont Casualty*, 317 Ill.App.3d at 73.

A court interprets an easement in the same manner it would interpret any agreement between parties. *See Smith v. Heissinger*, 319 Ill.App.3d 150 (2001) (looking at ambiguity of easement under rules of interpreting agreements). Generally, an instrument creating an easement is construed in accordance with the intention of the parties, which is ascertained from the words of the instrument and the circumstances contemporaneous to the transaction, including the state of the thing conveyed and the objective to be obtained. *McMahon v. Hines*, 298 Ill.App.3d 231, 236 (1998). However, if the language of an agreement is facially unambiguous, then the trial court interprets the contract as a matter of law without the use of extrinsic evidence. *Air Safety, Inc. v. Teachers Realty Corp.*, 185 Ill.2d 457, 462 (1999)An agreement signed by the parties thereto speaks for itself, and the intention with which it was executed must be determined from the language used in the agreement, without resort to extrinsic evidence. *Air Safety*, 185 Ill.2d at 462.

In applying this "four corners rule," a court initially looks to the language of the agreement alone. *Air Safety*, 185 Ill.2d at 462. If the language is unambiguous, then the trial court interprets the agreement without resort to parol evidence. However, if the court finds that the language of the contract is susceptible to more than one meaning, then an ambiguity is present, and parol evidence may be admitted to aid the trier of fact in resolving the ambiguity. . *Air Safety*, 185 Ill.2d at 462-63. Whether language of an agreement is ambiguous and requires additional evidence for interpretation is a question of law *Schnuck Markets, Inc. v. Soffer*, 213 Ill.App.3d 957, 976 (1991)), subject to de novo review, *Smith*, 319 Ill.App.3d at 153.

We note that the above-described four corners rule has been questioned in several Illinois Appellate Court cases by the introduction of the "provisional admission" approach to contract interpretation (also referred to as the "extrinsic ambiguity" approach). See *Air Safety*, 185 Ill.2d at 463.

"Under the provisional admission approach, although the language of a contract is facially unambiguous, a party may still proffer parol evidence to the trial judge for the purpose of showing that an ambiguity exists which can be found only by looking beyond the clear language of the contract. [Citation.] Under this method, an extrinsic ambiguity exists 'when someone who knows the context of the contract would know if the contract

actually means something other than what it seems to mean.' [Citation.] Consequently, if after 'provisionally' reviewing the parol evidence, the trial judge finds than an 'extrinsic ambiguity' is present, then the parol evidence is admitted to aid the trier of fact in resolving the ambiguity. [Citation.]" *Air Safety*, 185 Ill.2d at 462.

The supreme court has not squarely addressed the validity of the provisional admission approach in Illinois. In *Air Safety*, 185 Ill.2d at 462, it noted that the appellate court has applied the approach in a variety of cases, but it declined to rule on the issue. Instead, the Supreme Court held that the explicit integration clause in the contract it was interpreting forestalled application of the provisional admission approach *Air Safety*, 185 Ill.2d at 462. The easement documents in the current case do not contain such an integration clause. Therefore, we must determine whether to apply the four corners approach or the provisional admission approach.

There are, of course, competing policy arguments to support either approach. In favor of the four corners approach, the supreme court has stated:

"When parties sign a memorandum expressing all the terms essential to a complete agreement they are to be protected against the doubtful veracity of the interested witnesses and the uncertain memory of disinterested witnesses concerning the terms of their agreement, and the only way in which they can be so protected is by holding each of them conclusively bound by all the terms of the agreement as expressed in writing. All conversations and parol agreements between the parties prior to the written agreement are so merged therein that they can not be given in evidence for the purpose of changing the contract or showing an intention or understanding different from that expressed in the written agreement." *Armstrong Paint & Varnish Works v. Continental Can Co*., 301 Ill. 102, 106 (1921) (applying the four corners rule to initial determinations of integration and ambiguity of a contract).

On the other hand, other courts have advocated the provisional admission approach:

"The 'four corners' test represents a mechanical approach to a difficult problem and possesses two flaws in that it assumes a precision of language which cannot exist and further that it places a trial judge in the uncomfortable position of determining the true intent of the parties in a transaction to which he is far removed both in time and

circumstance…. [The provisional approach rule] will permit the trial judge to determine with greater certainty whether in fact an ambiguity does exist or whether the parties were at one in their understanding of the language used." *URS Corp. v. Ash*, 101 Ill.App.3d 229, 234–35 (1981).

Given that much of the parol evidence used to establish ambiguity in the current case centered around the evolution of terminology used to describe sidewalks, bike paths, and multi-use paths from the 1970s to the current day, this case would seem to offer a tempting opportunity to invoke the provisional admission approach. However, the supreme court's decision in *Armstrong Paint Works*, which declared the four corners rule, has never been reversed or modified. The supreme court in *Air Safety* may have "suggested" that it would later adopt the provisional approach rule but suggestions and hints do not establish precedent. The holding in *Armstrong Paint Works* remains binding precedent upon this court. Accordingly, we employ the four corners approach.

Before undertaking our review, we note that defendant proposes both to widen the walkway on the easement and to use the easement as part of a bicycle path. Plaintiff argues only that the easement should be restricted to use as a walkway. Therefore, we will review the easement documents to determine if the proposed use of the easement as a bicycle path would impermissibly expand the easement, and we will not consider whether a widening of the path on the easement would be permissible.

Our *de novo* review of the easement documents reveals no facial ambiguities. The agreement between the parties states that the easement is to be a "walk easement." The easement grant itself states that the easement was "identified as a walkway easement in this plat." The dictionary definition of the word "walkway" is "a passageway used or intended for walking." Webster's Third New International Dictionary 2572 (1993). Neither term contemplates the use of bicycles on the easement path. The faces of the documents themselves admit no ambiguity, and, therefore, under the four corners rule, we may not consider parol evidence in interpreting the documents (or in determining whether they are ambiguous). We hold that the easement granted to defendant was limited on its face to use by pedestrian traffic.

In *Lien v. Loraus*, 403 N.W.2d 286, 289 (Minn.Ct.App.1987), the court considered an easement which provided for a "pedestrian walkway" to a lake. The

plaintiffs in *Lien* sought to build a dock on the lake pursuant to their easement. *Lien*, 403 N.W.2d 287 The court stated that the easement was ambiguous as to whether it included a right to build a dock, and the court turned to parol evidence to resolve that question. *Lien*, 403 N.W.2d 289. However, the court stated that the term "pedestrian" unambiguously limited the mode of travel over the easement to foot traffic. *Lien*, 403 N.W.2d 289. Likewise, here, the terms "walkway" and "walk easement" unambiguously limit the mode of passage over the easement to pedestrian travel….

We hold that the trial court should have granted summary judgment in favor of plaintiff and declared that defendant's proposed use of the easement property constitutes an expansion of the purpose of the original easement without just compensation.

Vacated in part and reversed in part; judgment entered.

PACIFIC GAS & ELEC. CO. v. G. W. THOMAS DRAYAGE & RIGGING CO.
69 Cal.2d 33, 442 P.2d 641 (Cal. 1968)
TRAYNOR, Chief Justice.

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

In 1960 defendant entered into a contract with plaintiff to furnish the labor and equipment necessary to remove and replace the upper metal cover of plaintiff's steam turbine. Defendant agreed to perform the work 'at (its) own risk and expense' and to 'indemnify' plaintiff 'against all loss, damage, expense and liability resulting from * * * injury to property, arising out of or in any way connected with the performance of this contract.' Defendant also agreed to procure not less than $50,000 insurance to cover liability for injury to property. …

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

Defendant offered to prove by admissions of plaintiff's agents, by defendant's conduct under similar contracts entered into with plaintiff, and by other proof that in the

indemnity clause the parties meant to cover injury to property of third parties only and not to plaintiff's property. Although the trial court observed that the language used was 'the classic language for a third party indemnity provision' and that 'one could very easily conclude that * * * its whole intendment is to indemnify third parties,' it nevertheless held that the 'plain language' of the agreement also required defendant to indemnify plaintiff for injuries to plaintiff's property. Having determined that the contract had a plain meaning, the court refused to admit any extrinsic evidence that would contradict its interpretation.

When a court interprets a contract on this basis, it determines the meaning of the instrument in accordance with the '* * * extrinsic evidence of the judge's own linguistic education and experience.' (3 Corbin on Contracts (1960 ed.) (1964 Supp. s 579, p. 225, fn. 56).) The exclusion of testimony that might contradict the linguistic background of the judge reflects a judicial belief in the possibility of perfect verbal expression. (9 Wigmore on Evidence (3d ed. 1940) s 2461, p. 187.) This belief is a remnant of a primitive faith in the inherent potency[1] and inherent meaning of words.[2]

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

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

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

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

Some courts have expressed the opinion that contractual obligations are created by the mere use of certain words, whether or not there was any intention to incur such obligations.[3] Under this view, contractual obligations flow, not from the intention of the parties but from the fact that they used certain magic words. Evidence of the parties' intention therefore becomes irrelevant.

In this state, however, the intention of the parties as expressed in the contract is the source of contractual rights and duties.[4] A court must ascertain and give effect to this intention by determining what the parties meant by the words they used. Accordingly, the exclusion of relevant, extrinsic evidence to explain the meaning of a written instrument could be justified only if it were feasible to determine the meaning the parties gave to the words from the instrument alone.

If words had absolute and constant referents, it might be possible to discover contractual intention in the words themselves and in the manner in which they were arranged. Words, however, do not have absolute and constant referents. "A word is a symbol of thought but has no arbitrary and fixed meaning like a symbol of algebra or chemistry, * * *." (Pearson v. State Social Welfare Board (1960) 54 Cal.2d 184, 195, 5 Cal.Rptr. 553, 559, 353 P.2d 33, 39.) The meaning of particular words or groups of words varies with the "* * * verbal context and surrounding circumstances and purposes in view of the linguistic education and experience of their users and their hearers or readers (not excluding judges). * * * A word has no meaning apart from these factors; much less does it have an objectivemeaning, one true meaning." (Corbin, The Interpretation of Words and the Parol Evidence Rule (1965) 50 Cornell L.Q. 161, 187.) Accordingly, the meaning of a writing "* * * can only be found by interpretation in the light of all the circumstances that reveal the sense in which the writer used the words. The exclusion of parol evidence regarding such circumstances merely because the words do not appear ambiguous to the

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[3]"A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent." (Hotchkiss v. National City Bank of New York (S.D.N.Y. 1911) 200 F. 287, 293. See also C. H. Pope & Co. v. Bibb Mfg. Co. (2d Cir. 1923) 290 F. 586, 587; see 4 Williston on Contracts (3d ed. 1961) § 612, pp. 577-578, § 613, p. 583.)

[4] "A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." (Civ. Code, § 1636; see also Code Civ. Proc., § 1859; Universal Sales Corp. v. California Press Mfg. Co. (1942) 20 Cal.2d 751, 760 [128 P.2d 665]; Lemm v. Stillwater Land & Cattle Co. (1933) 217 Cal. 474, 480 [19 P.2d 785].)

reader can easily lead to the attribution to a written instrument of a meaning that was never intended. (Citations omitted.)" (Universal Sales Corp. v. Cal. Press Mfg. Co., supra, 20 Cal.2d 751, 776, 128 P.2d 665, 679 (concurring opinion); see also, e.g., Garden State Plaza Corp. v. S. S. Kresge Co. (1963) 78 N.J.Super. 485, 189 A.2d 448, 454; Hurst v. W. J. Lake & Co. (1932) 141 Or. 306, 310, 16 P.2d 627, 629, 89 A.L.R. 1222; 3 Corbin on Contracts (1960 ed.) s 579, pp. 412-431; Ogden and Richards, The Meaning of Meaning, op. cit. 15; Ullmann, The Principles of Semantics, supra, 61; McBaine, The Rule Against Disturbing Plain Meaning of Writings (1943) 31 Cal.L.Rev. 145.)

Although extrinsic evidence is not admissible to add to, detract from, or vary the terms of a written contract, these terms must first be determined before it can be decided whether or not extrinsic evidence is being offered for a prohibited purpose. The fact that the terms of an instrument appear clear to a judge does not preclude the possibility that the parties chose the language of the instrument to express different terms. That possibility is not limited to contracts whose terms have acquired a particular meaning by trade usage,[5] but exists whenever the parties' understanding of the words used may have differed from the judge's understanding.

Accordingly, rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties.[6] Such evidence includes testimony as to the "circumstances surrounding the making of the agreement * * * including the object, nature and subject matter of the writing * * *" so that the court can "place itself in the same situation in which the parties found themselves at the time of

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[5]Extrinsic evidence of trade usage or custom has been admitted to show that the term "United Kingdom" in a motion picture distribution contract included Ireland (Ermolieff v. R.K.O. Radio Pictures, Inc. (1942) 19 Cal.2d 543, 549-552 [122 P.2d 3]); that the word "ton" in a lease meant a long ton or 2,240 pounds and not the statutory ton of 2,000 pounds (Higgins v. California Petroleum etc. Co. (1898) 120 Cal. 629, 630-632 [52 P. 1080]); that the word "stubble" in a lease included not only stumps left in the ground but everything "left on the ground after the harvest time" (Callahan v. Stanley (1881) 57 Cal. 476, 477-479); that the term "north" in a contract dividing mining claims indicated a boundary line running along the "magnetic and not the true meridian" (Jenny Lind Co. v. Bower (1858) 11 Cal. 194, 197-199) and that a form contract for purchase and sale was actually an agency contract. (Body-Steffner Co. v. Flotill Products (1944) 63 Cal.App.2d 555, 558-562 [147 P.2d 84]).

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

contracting." (Universal Sales Corp. v. Cal. Press Mfg. Co., supra, 20 Cal.2d 751, 761, 128 P.2d 665, 671; Lemm v. Stillwater Land & Cattle Co., supra, 217 Cal. 474, 480-481, 19 P.2d 785.) If the court decides, after considering this evidence, that the language of a contract, in the light of all the circumstances, is "fairly susceptible of either one of the two interpretations contended for * * *." (Balfour v. Fresno C. & I. Co. (1895) 109 Cal. 221, 225, 44 P. 876, 877; extrinsic evidence relevant to prove either of such meanings is admissible.[7]

In the present case the court erroneously refused to consider extrinsic evidence offered to show that the indemnity clause in the contract was not intended to cover injuries to plaintiff's property. Although that evidence was not necessary to show that the indemnity clause was reasonably susceptible of the meaning contended for by defendant, it was nevertheless relevant and admissible on that issue. Moreover, since that clause was reasonably susceptible of that meaning, the offered evidence was also admissible to prove that the clause had that meaning and did not cover injuries to plaintiff's property.[8]

Accordingly, the judgment must be reversed.

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[7] Extrinsic evidence has often been admitted in such cases on the stated ground that the contract was ambiguous. This statement of the rule is harmless if it is kept in mind that the ambiguity may be exposed by extrinsic evidence that reveals more than one possible meaning.

[8] The court's exclusion of extrinsic evidence in this case would be error even under a rule that excluded such evidence when the instrument appeared to the court to be clear and unambiguous on its face. The controversy centers on the meaning of the word "indemnify" and the phrase "all loss, damage, expense and liability." The trial court's recognition of the language as typical of a third party indemnity clause and the double sense in which the word "indemnify" is used in statutes and defined in dictionaries demonstrate the existence of an ambiguity…

Plaintiff's assertion that the use of the word "all" to modify "loss, damage, expense and liability" dictates an all inclusive interpretation is not persuasive. If the word "indemnify" encompasses only third-party claims, the word "all" simply refers to all such claims. The use of the words "loss," "damage," and "expense" in addition to the word "liability" is likewise inconclusive. These words do not imply an agreement to reimburse for injury to an indemnitee's property since they are commonly inserted in third-party indemnity clauses, to enable an indemnitee who settles a claim to recover from his indemnitor without proving his liability. …

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

RAFFLES v. WICHELHAUS, 2 Hurl. & C. 906 (Court of Exchequer 1864)

[Note: Most of this case is presented in the words of the barristers arguing the case; the judges' comments are in brackets and the court's opinion is "per curium"]

Declaration -- For that it was agreed between the plaintiff and the defendants, to wit, at Liverpool, that the plaintiff should sell to the defendants, and the defendants buy of the plaintiff, certain goods, to wit, 125 bales of Surat cotton, guarantied middling fair merchant's Dhollorah, to arrive ex "Peerless" from Bombay; and that the cotton should be taken from the quay, and that the defendants would pay the plaintiff for the same at a certain rate, to wit, at the rate of 17¼d. per pound, within a certain time then agreed upon after the arrival of the said goods in England. -- Averments; that the said goods did arrive by the said ship from Bombay in England, to wit, Liverpool, and the plaintiff was then and there ready and willing and offered to deliver the said goods to the defendants, &c. Breach: that the defendants refused to accept the said goods or pay the plaintiff for them.

Plea--- That the said ship mentioned in the said agreement was meant and intended by the defendants to be the ship called the "Peerless," which sailed from Bombay, to wit, in October; and that the plaintiff was not ready and willing and did not offer to deliver to the defendants any bales of cotton which arrived by the last-mentioned ship, but instead thereof was only ready and willing and offered to deliver to the defendants 125 bales of Surat cotton which arrived by another and different ship, which was also called the "Peerless," and which sailed from Bombay, to wit, in December.

Demurrer and joinder therein. Milward, [barrister representing the plaintiff] in support of the demurrer.--- The contract was for the sale of a number of bales of cotton of a particular description, which the plaintiff was ready to deliver. It is immaterial by what ship the cotton was to arrive, so that it was a ship called the "Peerless." The words "to arrive ex 'Peerless,'" only mean that if the vessel is lost on the voyage, the contract is to be at an end. [Pollock C.B. -- It would be a question for the jury whether both parties meant the same ship called the "Peerless."] That would be so if the contract was for the sale of a ship called the "Peerless;" but it is for the sale of cotton on board a ship of that name. [Pollock, C.B. -- The defendant only bought that cotton which was to arrive by a

particular ship. It may as well be said, that if there is a contract for the purchase of certain goods in warehouse A., that is satisfied by the delivery of goods of the same description in warehouse B.] In that case there would be goods in both warehouses; here it does not appear that the plaintiff had any goods on board the other "Peerless." [Martin, B.--- It is imposing on the defendant a contract different from that which he entered into. Pollock, C.B.-- It is like a contract for the purchase of wine coming from a particular estate in France or Spain, where there are two estates of that name.] The defendant has no right to contradict by parol evidence a written contract good upon the face of it. He does not impute misrepresentation or fraud, but only says that he fancied the ship was a different one. Intention is of no avail, unless stated at the time of the contract. [Pollock, C.B. -- One vessel sailed in October and the other in December.] The time of sailing is no part of the contract.

Mellish (Cohen with him)(barristers representing the defendant), in support of the plea.--- There is nothing on the face of the contract to show that any particular ship called the "Peerless" was meant; but the moment it appears that two ships called the "Peerless" were about to sail from Bombay there is a latent ambiguity, and parol evidence may be given for the purpose of showing that the defendant meant one "Peerless" and the plaintiff another. That being so, there was no consensus ad idem [agreement on the same thing], and therefore no binding contract. He was then stopped by the Court.

Per Curiam. There must be judgement for the defendants.

COLFAX ENVELOPE CORP. V. LOCAL NO. 458-3M, 20 F.3d 750, 752 (7th Cir. Ill. 1994)

POSNER, *Chief Judge.* This appeal in a suit over a collective bargaining agreement presents a fundamental issue of contract law, that of drawing the line between an ambiguous contract, requiring interpretation, and a contract that, because it cannot be said to represent the agreement of the parties at all, cannot be interpreted, can only be rescinded and the parties left to go their own ways. Colfax, the plaintiff, is a manufacturer of envelopes. It does some printing of its envelopes, and the seventeen employees who do

the printing are represented by the defendant union. Colfax has two printing presses. One prints 78-inch-wide sheets in four colors. The other prints 78-inch-wide sheets in five colors, but most of the time Colfax prints only four-color sheets on it.

Colfax has so few printing employees that it does not bother to participate in the collective bargaining negotiations between the union and the Chicago Lithographers Association, an association for collective bargaining of the other Chicago printing companies whose employees are represented by this union. Instead, whenever the union and the CLA sign a new collective bargaining agreement, the union sends Colfax a summary of the changes that the new agreement has made in the old one. If Colfax is content with the changes, the union sends it a copy of the complete new agreement, which Colfax signs and returns. If Colfax doesn't like the terms negotiated by the CLA, it is free to do its own bargaining with the union.

The collective bargaining agreements specify minimum manning requirements for each type of press used by the printers. The agreement in force between 1987 and 1991 fixed those minima as three men for four-color presses printing sheets 45 to 50 inches wide and four men for four-color presses printing sheets wider than 50 inches. Five-color presses printing sheets more than 55 inches wide required five men unless only four colors were printed, in which event only four men were required. The upshot was that under these agreements, all of which Colfax had signed, Colfax had to man each of its presses (which were 78-inch presses) with four men except on the rare occasions when it printed five-color sheets on its second press, and then it had to add a man.

In 1991 the union negotiated a new agreement with the CLA and sent a summary of the changes to Colfax. The letter enclosing the summary asked Colfax to indicate whether it agreed to the terms in the summary. (This may have been a departure from past practice, in which Colfax signed the complete agreement rather than the summary, but if so neither party makes anything of it.) In a section on manning requirements, the summary lists "4C 60c inches Press - 3 Men" and "5C 78 inches Press - 4 Men." Believing (in part because union members who claimed to be familiar with the new agreement had told Colfax that Colfax would really like the changes in it) that this meant that all presses operated as four-color presses would now require only three men to man

them, Colfax's president and majority shareholder, Charles Patten, signed the union's letter, indicating acceptance of the terms in the summary. Later a copy of the actual agreement arrived, but it contained a crucial typo, which supported Patten's understanding of the summary. When a corrected copy of the agreement finally arrived, the manning requirements stated in it were different from what Patten had understood from the summary. Four-color presses between 45 and 60 inches required three men, but all four-color presses over 60 inches required four men. The changes had not benefited Colfax at all, and because it was under competitive pressure, it would have liked to negotiate better terms. Patten refused to sign the agreement but the union took the position that Colfax was bound to it by its acceptance of the summary.

Colfax brought this suit under section 301 of the Taft-Hartley Act, 29 U.S.C. ß 185, for a declaration that it has no collective bargaining contract with the union because the parties never agreed on an essential term--the manning requirements for Colfax's printing presses. The union counterclaimed for an order to arbitrate. The union's position was that Colfax had accepted the new agreement, which requires arbitration of all disputes "arising out of the application or interpretation of this contract." The district judge granted summary judgment for the union, concluding that the reference to the new manning requirement for a four-color 60-inch press in the summary of changes that Colfax had accepted referred unambiguously to 60-inch presses and had no application to any other presses, such as Colfax's 78-inch presses. Colfax has appealed.

One way to describe the issue that divides the parties is that they disagree about the meaning of the term "4C 60 inches Press - 3 Men." Colfax believes that it means four-color presses printing sheets 60 inches and over, while the union believes that it means four-color presses 60 inches and under (down to 45 inches). Remember that the previous agreement had allowed the use of three-man crews on four-color presses between 45 and 50 inches. The union interprets the change as extending the upper bound of the three-man range to 60 inches. Ordinarily a dispute over the meaning of a contractual term is, if the contract contains an arbitration clause, for the arbitrator to decide. But sometimes the difference between the parties goes so deep that it is impossible to say that they ever agreed--that they even *have* a contract that a court or arbitrator might interpret. In the

famous though enigmatic and possibly misunderstood case of *Raffles v. Wichelhaus*, 2 H. & C. 906, 159 Eng. Rep. 375 (Ex. 1864), the parties made a contract for the delivery of a shipment of cotton from Bombay to England on the ship *Peerless.* Unbeknownst to either party, there were two ships of that name sailing from Bombay on different dates. One party thought the contract referred to one of the ships, and the other to the other. The court held that there was no contract; there had been no "meeting of the minds." See generally A.W. Brian Simpson, "Contracts for Cotton to Arrive: The Case of the Two Ships *Peerless,"* 11 *Cardozo L. Rev.* 287 (1989).

The premise--that a "meeting of the minds" is required for a binding contract--obviously is strained. 2 E. Allan Farnsworth, *Contracts* ß 7.9, at p. 251 (1990). Most contract disputes arise because the parties did not foresee and provide for some contingency that has now materialized--so there was no meeting of minds on the matter at issue--yet such disputes are treated as disputes over contractual meaning, not as grounds for rescinding the contract and thus putting the parties back where they were before they signed it. So a literal meeting of the minds is not required for an enforceable contract, which is fortunate, since courts are not renowned as mind readers. Let us set the concept to one side, therefore, and ask how (else) to explain *Raffles v. Wichelhaus* and cases like it. It seems to us as it has to other courts that a contract ought to be terminable without liability and the parties thus allowed to go their own ways when there is "no sensible basis for choosing between conflicting understandings" of the contractual language, as the court said in an American Raffles-like case, *Oswald v. Allen*, 417 F.2d 43, 45 (2d Cir. 1969), quoting William F. Young, Jr., "Equivocation in the Making of Agreements," 64 *Colum. L. Rev.* 619, 647 (1964). In Oswald the misunderstanding arose because the parties did not speak the same language (literally). In *Balistreri v. Nevada Livestock Production Credit Association,* 214 Cal. App. 3d 635, 262 Cal. Rptr. 862 (Cal. App. 1989), the parents of an aspiring farmer thought they had pledged property they owned in Sebastopol to secure a loan to their son, and indeed the lender's cover letter described the property as "your Sebastopol residence." But the actual deed of trust listed the parents' home in Petaluma as the collateral. The court held that there had been no meeting of the minds.

Raffles and *Oswald* were cases in which neither party was blameable for the mistake; *Balistreri* a case in which both were equally blameable, the parents for having failed to read the deed of trust, the lender for having drafted a misleading cover letter. It is all the same. *Restatement (Second) of Contracts* ßß 20(1)(a), (b) (1981). If neither party can be assigned the greater blame for the misunderstanding, there is no nonarbitrary basis for deciding which party's understanding to enforce, so the parties are allowed to abandon the contract without liability. *Neel v. Lang*, 236 Mass. 61, 127 N.E. 512 (Mass. 1920); *Konic International Corp. v. Spokane Computer Services, Inc.*, 109 Idaho 527, 708 P.2d 932, 934 (Idaho App. 1985). These are not cases in which one party's understanding is more reasonable than the other's. Compare *Restatement, supra,* ß 20(2)(b). If rescission were permitted in that kind of case, the enforcement of every contract would be at the mercy of a jury, which might be persuaded that one of the parties had genuinely held an idiosyncratic idea of its meaning, so that there had been, in fact, no meeting of the minds. Cf. Young, *supra,* at 646. Inter-subjectivity is not the test of an enforceable contract.

The clearest cases for rescission on the ground that there was "no meeting of the minds" (or, better, that there was a "latent ambiguity" in the sense that neither party knew that the contract was ambiguous) are ones in which an offer is garbled in transmission. The cases we have cited are all of that character, if "transmission" is broadly construed. *Vickery v. Ritchie,* 202 Mass. 247, 88 N.E. 835 (Mass. 1909), provides a further illustration. A landowner and a contractor signed what they believed to be duplicate copies of a contract for the construction of a Turkish bath house. Because of a fraud by the architect for which neither the contractor nor the landowner could be blamed, the copy signed by the landowner stated the price as $ 23,000 and the copy signed by the contractor stated it as $ 34,000. Through no fault of their own, the parties had signed different contracts. Or consider *Konic International Corp. v. Spokane Computer Services, Inc., supra.* The seller quoted a price of "fifty-six twenty," which the buyer thought meant $ 56.20. In fact the seller had meant $ 5,620. In both cases rescission was permitted, the first being a case in which neither party was at fault, the second one in which both were equally at fault, being careless in their utterance and interpretation, respectively, of an ambiguous oral formula.

Our case is superficially similar. The actual terms of the 1991 agreement were muddied in the summary that the union gave Colfax and that Colfax signed, making it possible that the parties had different understandings. The difference between this case and the others is that Colfax, unlike the hapless promisors in the cases we have cited, should have realized that the contract was unclear. The buyer in *Konic* thought--really thought--that he was being quoted a price of $56.20, and no doubt fell off his stool when he discovered that the price was a hundred times greater than he thought. But the expression "4C 60 inches Press" does not on its face speak to the minimum manning requirement for a 4C 78' Press. The union's interpretation, that the phrase merely extended the upper bound of the old range for three-man four-color presses from 50 to 60 inches, may or may not be correct. The fact that the union restated and clarified the interpretation in the corrected agreement that it sent Colfax is not decisive on the question, because it is the summary rather than the corrected full agreement that is the contract between these parties. But Colfax, if reasonable, could not have doubted from reading the summary that interpretations of the kind that the union and the district judge later placed upon it would be entirely plausible. Colfax had a right to *hope* that its interpretation would prevail but it had no right to accept the offer constituted by the summary on the premise that either its interpretation was correct or it could walk away from the contract. "Heads I win, tails you lose," is not the spirit that animates the principle that latent ambiguity is a ground for rescission of a contract.

It is common for contracting parties to agree--that is, to *signify* agreement--to a term to which each party attaches a different meaning. It is just a gamble on a favorable interpretation by the authorized tribunal should a dispute arise. Parties often prefer to gamble in this way rather than to take the time to try to iron out all their possible disagreements, most of which may never have any consequence. Colfax gambled on persuading an arbitrator that the reference in the summary to the fourcolor 60-inch press meant what Colfax believes it means. The union gambled on the arbitrator's adopting the meaning that the union later made clear in the full agreement--but, to repeat, if there is a contract it is (the parties agree) the summary, read in light of the collective bargaining agreement that was being modified, that is the contract between these parties.

When parties agree to a patently ambiguous term, they submit to have any dispute over it resolved by interpretation. That is what courts and arbitrators are *for* in contract cases--to resolve interpretive questions founded on ambiguity. It is when parties agree to terms that reasonably appear to each of them to be unequivocal but are not, cases like that of the ship *Peerless* where the ambiguity is buried, that the possibility of rescission on grounds of mutual misunderstanding, or, the term we prefer, latent ambiguity, arises. A reasonable person in Colfax's position would have realized that its interpretation of the term "4C 60 inches Press - 3 Men" might not coincide with that of the other party or of the tribunal to which a dispute over the meaning of the term would be submitted. It threw the dice, and lost, and that is the end of the case. It cannot gamble on a favorable interpretation and, if that fails, repudiate the contract with no liability. Cf. *Prudential Ins. Co. v. Miller Brewing Co.,* 789 F.2d 1269, 1278 (7th Cir. 1986)….

We thus affirm the district judge's decision, but point out that her conclusion that the disputed term unequivocally bears the meaning that she assigned to it (which incidentally is not identical to the union's interpretation, for she thought it a point-'inch presses, period--while the union thought it a range-'inch presses and down) does not bind the arbitrator. His is the responsibility, subject to the excruciatingly limited right of judicial review of arbitral decisions, to interpret the agreement. It will therefore be open to Colfax to argue to the arbitrator that, under a proper interpretation of the contract, there really was no meeting of the minds over the manning requirements and therefore that the contract should be rescinded after all. The only essential point at this stage of the litigation is that whether or not there was (as we believe, without meaning to bind the arbitrator) such a meeting of minds, there was sufficient mutual understanding to create an enforceable contract to submit the issue to arbitration.

Hypothetical

Plaintiff, the lessee of certain premises operated as an automobile service station in the Town of Eastchester, brings this action for a permanent injunction to restrain defendant, the lessor, from terminating a "franchise" or "distributorship" agreement….

The retail dealer contract and lease each provide in paragraph two thereof that the original term of the agreements shall be for three years and is automatically renewable for

successive three year periods "provided that it shall terminate at the end of any current period (original or renewal) by notice from either party to the other, given not less than 90 days prior to such termination". Said paragraph also gives the defendant the right to cancel the agreements on 30 days' notice during the first 12 months of the agreements.

On April 25, 1969, defendant's district manager notified plaintiff by certified mail that defendant elected to terminate the lease agreement because a "further renewal of the lease would be inadvisable." Plaintiff thereafter learned that defendant's proposed reason for termination is its desire to convert the property into a diagnostic and repair service center.

Plaintiff [claims that he] has arbitrarily been singled out and denied a franchise renewal while it is the custom of the gasoline service industry to renew franchise agreements unless the franchisee has failed in a material respect to adhere to the contract provisions. Consequently, plaintiff contends, it was the intention of the parties when the contracts were executed to renew the franchise ad infinitum unless plaintiff gave defendant cause for acting otherwise.

Div. of Triple T Serv. v. Mobil Oil Corp., 60 Misc. 2d 720, 731 (N.Y. Sup. Ct. 1969)

CONDITIONS v PROMISES

AUDETTE v. L'UNION ST. JOSEPH 178 Mass. 113, 59 N.E. 668 (Mass. 1901)
LORING, J.

Action by Malvina Audette, administratrix of the estate of Louis Audette, deceased, against L'Union St. Joseph. From a judgment in favor of defendant, plaintiff appeals. Affirmed.

A by-law of the defendant association provided that no sick member should receive any benefits before producing a sworn certificate of a physician. The physician who attended plaintiff's intestate in his last sickness refused to give a sworn certificate because of conscientious scruples against making an oath.

…

This case comes within the rule that where one engages for the act of a stranger he must procure the act to be done, and the refusal of the stranger, without the interference of the other party, is no excuse. That rule has been applied in this commonwealth to the obligation of a person, insured under a fire insurance policy, to furnish to the fire insurance company a certificate, under the hand and seal of a magistrate, notary public, or commissioner of deeds, stating that he has examined the circumstances attending the loss, knows the character and circumstances of the assured, and believes that the assured has, without fraud, sustained loss on the property insured to the amount certified. Johnson v. Insurance Co., 112 Mass. 49. In that case it was held that the plaintiff was not excused from producing such certificate by showing that he applied to two magistrates for such a certificate in vain, and used his best efforts to procure it, accompanied by proof of the facts which were to be certified to.

…

This action, therefore, was prematurely brought; but the plaintiff, on producing a sworn certificate, unless there is some objection to it not now disclosed, can bring a new writ, and recover the sick benefits now sued for.

Judgment for the defendant affirmed.

GENERAL CREDIT CORP. v. IMPERIAL CAS. & INDEM. CO., 167 Neb. 833, 95 N.W.2d 145 (Neb. 1959)

SIMMONS, Chief Justice.

Plaintiff, as a lienholder, brought this action to recover the amount allegedly due it for damages sustained to two automobiles. The action is on a policy of insurance issued by the defendant to the Service Trucking Company. There was a loss payable clause attached to the policy as follows: "Loss or damage, if any, under the policy shall be payable as interest may appear to General Credit Corp. Hastings, Nebraska and this insurance as to the interest of the Bailment Lessor, Conditional Vendor or Mortgagee or Assignee of Bailment Lessor, Conditional Vendor or Mortgagee (herein called the Lienholder) shall not be invalidated by any act or neglect of the Lessee, Mortgagor or Owner of the within described automobile nor by any change in the title or ownership of the property; provided, however, that the conversion, embezzlement or secretion by the Lessee, Mortgagor or Purchaser in possession of the property insured under a bailment lease, conditional sale, mortgage or other encumbrance is not covered under such policy, unless specifically insured against and premium paid therefor; and provided, also, that in case the Lessee, Mortgagor or Owner shall neglect to pay any premium due under such policy the Lienholder shall, on demand, pay the same."

To the policy was also attached two separate endorsements covering two automobiles and providing that loss should be paid to the insured and the plaintiff as their interests may appear. The premium for the insurance on each automobile was separately stated as $86. The total premium on the policy was stated as $6,701.43. Plaintiff alleged collision damage to the two automobiles totaling $2,016.44, alleging that its insurable interest exceeded the amount of the damages sustained.

Defendant answered admitting the issuing of the policy and the insurance involved, and that the limit of liability for each loss is the reasonable cost of repairs less $50 or the actual value of the automobile less $50, whichever is lower.

Defendant further alleged that there is due it the sum of $1,786.86 unpaid premium; that pursuant to the clause above quoted it had made demand on the plaintiff for that amount and

plaintiff had refused to pay it; and that there was due the defendant from the plaintiff the sum of $1,786.86 to which it is entitled to judgment or to have that sum deducted from any amount the plaintiff may be entitled to recover from the defendant. So stated it appears that defendant seeks to recover the unpaid premium on the principal policy, i. e., it is a claim for the payment of a premium.

The cause was tried on a stipulation of facts. It was stipulated that the reasonable cost of repairs to the two automobiles less deductible amount was $1,839.20, that being less than the actual cash value at the time of the losses; and that plaintiff's insurable interest was in excess of that amount.

It was also stipulated that the policy and endorsements were in full force and effect at the time of loss.

We construe the stipulation to mean that plaintiff, as against the defendant, was entitled to recover $1,839.20.

The facts as to defendant's claim against the plaintiff were also stipulated. There was an unpaid premium due on the policy of $1,786.86 which includes $45.92 on the vehicles in which plaintiff had an insurable interest and $1,740.94 on certain vehicles in which plaintiff had no insurable interest. It was further stipulated that ‘after the said losses had occurred and the policy had been canceled’ the defendant had demanded the sum of $1,786.86 from the plaintiff.

A jury was waived. The trial court awarded plaintiff judgment for $1,839.20 with interest and costs. It denied recovery to the defendant.

Defendant appeals.

As stated by defendant the appeal here presents primarily the question of whether the language in the loss payable clause ‘provided, also, that in case the Lessee, Mortgagor or Owner shall neglect to pay any premium due under such policy the Lienholder shall, on demand, pay the same’ is a condition or a covenant.

We conclude that it is a condition and affirm the judgment of the trial court.

In 44 C.J.S. Insurance § 356(d), p. 1335, the status of the decisions on the matter is stated as follows: ‘There is a conflict of authority on the question whether or not a mortgagee is liable for premiums on a policy containing a clause, usually referred to as a standard mortgage clause, declaring that the policy shall not be invalidated as to the mortgagee's interest by any

act or neglect of the mortgagor, ‘provided’ in case the mortgagor shall neglect to pay any premium the mortgagee shall, on demand, pay it. Some authorities have held that such clause embodies a contract or covenant on the part of the mortgagee to pay the premium on failure of the mortgagor to pay it. Other authorities have held that such clause, or a similar one, imports a condition merely, and not a covenant, and that the mortgagee is not liable for the premium, if he does not continue the policy, * * *.” …

In Restatement, Contracts, § 260, p. 373, it is stated: ‘If in an agreement words that state that an act is to be performed purport to be the words of the person who is to do the act, the words are interpreted, unless a contrary intention has been manifested, as a promise by that person to perform the act. If the words purport to be those of a party who is not to do the act they are interpreted, unless a contrary intention has been manifested, as limiting the promise of that party by making performance of the act a condition.’ In the comment it is said: ‘b. If a contract is clearly unilateral as is the case with many if not most policies of insurance, the answer to the question to whom must the language be attributed admits of no doubt. In such a contract only one party speaks, and that is the covenantor or promisor. Any clause, therefore, in a policy of insurance, requiring any act to be done by the insured, will make that act a condition of the covenant or promise of insurance.’

A discussion citing the above statement in Restatement is made by Williston in his work on contracts. 3 Williston on Contracts (Rev.Ed.), § 672, p. 1930. He states: ‘The matter has been well expressed by Professor Langdell: ‘Moreover, the words of such a clause will have, in fact, a different meaning, according to the party who uses them. If they are used in a contract by the party who is to do the act, they plainly import that he binds himself to do it; while, if they are used by the party for whose benefit the act is to be done, they fairly mean that he will require it to be done, i. e., that his own obligation shall be conditional upon its being done. How then shall it be ascertained to whom the language of such a clause is to be imputed? If the contract be clearly unilateral (e. g., a policy of insurance), of course the answer to this question admits of no doubt. In such a contract only one party speaks, and that is the covenantor or promisor. Any clause, therefore, in a policy of insurance, requiring any act to be done by the insured, will be a condition of the covenant or promise of insurance, though its language may more naturally import a covenant or promise by the insured.’'

It is stated in 14 Appleman, Insurance Law and Practice, § 7842, p. 39, that: ‘One of the most puzzling results reached by the courts arises in connection with the type of mortgage clause which has been variously termed the ‘standard’, ‘New York’, or ‘union’ clause. It will be recalled from the previous discussion that this clause gives great rights to the mortgagee and protects him under circumstances where the mortgagor would receive no indemnification. However, in return for that special protection, the mortgagee is to pay upon demand, if the mortgagor defaults, such premiums as may be due. This would seem to be clear in itself, to be fair, based upon a proper consideration, and to be an agreement of the mortgagee arising through his request of the loss payable clause, acceptance of the policy, or silent acquiescence. However, the vast majority of courts have reached the somewhat surprising conclusion that such agreement to pay is not a covenant on the part of the mortgagee to pay premiums which can be enforced by the insurer, but is merely a condition to his right to recover the insurance proceeds. Mortgagees are not to be blamed for striving to achieve this result, as it places them in the enviable position of being able to harvest a crop without first sowing seed.”…

It is stated in Restatement, Contracts, § 236, p. 328, that: ‘Where words or other manifestations of intention bear more than one reasonable meaning an interpretation is preferred which operates more strongly against the party from whom they proceed, unless their use by him is prescribed by law.’ This language is in accord with our decisions.

Commenting on the rule, the Restatement says: ‘This rule finds frequent application in regard to policies of insurance, which are ordinarily prepared solely by the insurance company, and therefore, the words of the policies are construed most strongly against it.’ Restatement, Contracts, § 236, p. 330.

We conclude then that the clause here involved is a condition and that the condition requires the plaintiff to pay the premium on the insurance involved from and after the date of the demand if plaintiff desires to keep the insurance in force. Such a conclusion is in accord with the authorities above cited that construe this language to be a condition.

It being stipulated here that the insurance was in full force and effect when the losses involved occurred and that the demand of the defendant to pay the premium was not made until after the losses had occurred and the policy had been canceled, it must necessarily follow that plaintiff is entitled to judgment for the loss proven and is not required to pay the premium demanded.

…

Defendant in its statement of questions involved advises us that the issue here is: Is this clause a condition or a covenant?

We have examined the authorities and determined that it is a condition.

Affirmed.

NEW YORK BRONZE POWDER CO., INC. v. BENJAMIN ACQUISITION CORP., 351 Md. 8, 716 A.2d 230 (Md.,1998)

MARVIN H. SMITH, Judge (retired), Specially Assigned.

This case presents the problem of whether a provision in a contract is a condition or a promise or both. The Court of Special Appeals in an unreported opinion reversed a trial court judgment and construed as a condition precedent a provision in a non-negotiable note/contract requiring surrender of the note in order to receive payment.

The facts relevant to this decision may be briefly stated.

New York Bronze Powder Company, Inc. (New York Bronze) entered into an agreement dated March 15, 1990, with Benjamin Acquisition Corporation (Benjamin) under which Benjamin agreed to purchase from New York Bronze the assets of a business then known as Benjamin F. Rich Company (Rich) for $4.5 million, together with the assumption of certain of Rich's liabilities. Closing was to take place on April 30, 1990. Shortly prior to the closing, Benjamin expressed its concerns to New York Bronze over the valuation of certain assets. The matter was resolved by an April 30, 1990 modification of the purchase agreement (Amendment No. 1). Under Amendment No. 1 $350,000 of the $4.5 million purchase price was deferred, and Benjamin executed a non-negotiable note to New York Bronze for $350,000. Under Section 3 of Amendment No. 1 Benjamin undertook, at its expense, to have prepared a balance sheet of Rich accompanied by the opinion of a specifically named accounting firm, and Benjamin promised to use its best efforts to cause that audited balance sheet to be delivered to New York Bronze no later than June 14, 1990. To the extent that the audited balance sheet reflected a net worth of Rich that was less than $4.5 million, Benjamin

was entitled under Section 3 of the note to a dollar for dollar credit against the $350,000 deferred purchase price.

As matters unfolded following the April 30, 1990 closing under the modified asset purchase agreement, the accounting firm specified in Amendment No. 1 never opined on the audited balance sheet, and apparently never completed its audit.

Benjamin never made or tendered any cash payment on the note. In October 1993 New York Bronze sued Benjamin in the Circuit Court for Montgomery County alleging non-payment of the note and breach of the modified asset purchase agreement. After a bench trial the court entered judgment for $350,000 in favor of New York Bronze.

Benjamin appealed to the Court of Special Appeals, raising three issues, but that court found it necessary to address only one. That issue is whether the portion of Section 4.2 of the note, italicized below, should be construed as a condition precedent to payment. That section provides:

> "4.2 Payments. Payments of any portion of the principal of this Note shall be made by check drawn on a United States commercial bank and shall be mailed by registered mail, return receipt requested, on or prior to the date on which such payment is due, to the Noteholder at the address set forth in the Purchase Agreement. If the date on which any payment hereunder is due is not a Business Day, then such payment shall be due on the next succeeding Business Day. *The Noteholder shall be required to surrender this Note for cancellation upon the maturity or prepayment in full of this Note in order to receive payment."* (Emphasis added).

Section 4.4 of the note provides that it "SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK."

The Court of Special Appeals held that, under New York law, the italicized language created a condition, the non-occurrence of which extinguished Benjamin's obligation to pay the $350,000 or any part thereof. New York Bronze then petitioned this Court for the writ of certiorari, which was granted.

The factual foundation for Benjamin's position that the "condition" was not fulfilled lies in the testimony of New York Bronze's chief financial officer. When New York Bronze attempted to introduce *not* the note but a *copy* of the note, the following colloquy took place:

Q. [Counsel for New York Bronze]: Can you identify Exhibit No. 3?

A. This would be the Benjamin Acquisition subordinated promissory note [due] July 30, 1991 for $350,000.

(The document referred to was marked for identification as Plaintiff's Exhibit 3.)

....

Q. Was anything paid on that note?

A. No, nothing has been received.

Q. Is that a true and accurate copy of the original?

A. It appears to be, yes.

[Counsel for New York Bronze]: Your Honor, I would move Exhibit No. 3 into evidence[.]

The Court: Any objection?

[Counsel for Benjamin]: Yes, Your Honor. *I have a bit of a problem with this exhibit to the extent Plaintiff is suing on a note and exhibiting the copy as opposed to the original.* It causes me a great deal of concern.

The Court: Okay. Can you establish foundation as to the location of the original?

....

Q. [Counsel for New York Bronze]: Do you have the original note?

A. No, I don't.

Q. Have you sold the original note?

A. No, I have not.

Q. Has it been encumbered by anyone? Have you encumbered the original note?

A. I just want to say where the original note is.

Q. Where is it?

A. Because I am not sure about the word encumbered. Perpetual Savings Bank was the lender at the time. They had an interest in all the assets. They kept the original documents.

Q. Is that a true and accurate copy of the original note?

A. Yes.

[Counsel for New York Bronze]: I would move No. 3 into evidence.

The Court: Any further objection?

[Counsel for Benjamin]: Yes, Your Honor. That still raises a question. *Now they are suing us on a note they are not even holding.*

The Court: Well, I will receive this over objection. I think a foundation has been laid.

(Emphasis added).

…

The Court of Special Appeals held that New York Bronze was not entitled to the principal amount of the note, or any part thereof, because it had not surrendered the original note to Benjamin. In reaching that result, the Court of Special Appeals reasoned:

> "New York and Maryland law are congruent on the point that words in a contract (or note) are to be given their ordinary meaning. *Slatt v. Slatt*, [64 N.Y.2d 966, 488 N.Y.S.2d 645] 477 N.E.2d 1099, 1100, *motion for reargument denied*, [65 N.Y.2d 785, 492 N.Y.S.2d 1026] 482 N.E.2d 568 (N.Y.1985). The New York courts have defined a condition precedent as "an act or event, other than a lapse of time, which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises." *Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co.*, [86 N.Y.2d 685, 636 N.Y.S.2d 734] 660 N.E.2d 415, 418 (N.Y.1995)
>
> "The language in § 4.2 of the note clearly fits that definition. The noteholder is required to surrender the note for cancellation "in order to receive payment." Unquestionably, that requirement does qualify the duty to pay. *See Gilpin v. Savage*, 94 N.E. 656 (N.Y.1911) (requirement of presentment of negotiable instrument construed as condition precedent); *Laurel Race Course v. Regal Constr.*, 274 Md. 142 [333 A.2d 319] (1975) (where payment under contract due only upon issuance of certificate by architect, production of certificate is condition precedent to liability)."

The dominant element in this case is that the note is non-negotiable. The form of the note was an exhibit to Amendment No. 1 to the asset purchase agreement, and the note's provisions concerning set off implement the provisions of Amendment No. 1 concerning the audit. The asset purchase agreement, as amended, is one integrated contract that includes the note. Under these circumstances the controlling issue is whether the last sentence of Section 4.2 of the note is to be construed as a promise on the part of New York Bronze to surrender the note for cancellation, for an unsubstantial breach of which Benjamin would not be excused from performance, or whether the last sentence is a condition precedent to enforcement of Benjamin's promise to pay.

The most recent decision of the Court of Appeals of New York dealing with conditions in contracts is *Oppenheimer & Co., Inc. v. Oppenheim, Appel, Dixon & Co.,* 86 N.Y.2d 685, 636 N.Y.S.2d 734, 660 N.E.2d 415 (1995). In that case there was an agreement concerning a proposed sublease. The sublessee had furnished the sublessor plans for construction of a telephone communications linkage system on the premises, and the sublessor obligated itself to obtain the underlying landlord's written consent to that work and to deliver that written consent by a specified date. On the specified date the sublessor telephoned the sublessee, advising that the underlying landlord had consented. The sublessee refused to sign the proposed sublease. The issue before the Court of Appeals of New York was whether the requirement for the sublessor to obtain written consent was a covenant, in which event non-performance would be subject to the doctrine of substantial performance, or whether that doctrine had no application because the provision was a condition. *Id.* at 735, 636 N.Y.S.2d 734, 660 N.E.2d at 416.

The agreement in *Oppenheimer* stated that if the sublessee "had not received the prime landlord's written consent by the agreed date, both the agreement and the sublease were to be deemed 'null and void and of no further force and effect,' and neither party was to have 'any rights against nor obligations to the other.' " Another provision of the agreement stated that "the parties 'agree not to execute and exchange the Sublease unless and until ... the conditions set forth in [the paragraph requiring, *inter alia,* written consent] are timely satisfied.' " *Id.* The court held that this language created a condition. *Id.* at 737, 636 N.Y.S.2d 734, 660 N.E.2d at 418.

The court in *Oppenheimer* gave guidance for interpreting whether a provision is a condition:

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

In addition to illustrating language that undoubtedly creates a condition, *Oppenheimer* evidences that the Court of Appeals of New York will look to Restatement (Second) of Contracts § 227 (1981) (Restatement) for the preferred interpretation of language argued to

create a condition, as well as to Restatement § 229, dealing with excusing the non-occurrence of a condition. *See Oppenheimer*, 636 N.Y.S.2d at 737, 660 N.E.2d at 418; *see also Merritt Hill Vineyards, Inc. v. Windy Heights Vineyard, Inc.*, 61 N.Y.2d 106, 113, 472 N.Y.S.2d 592, 597, 460 N.E.2d 1077, 1082 (1984) (citing to Restatement § 225, "Effects of the Non-Occurrence of a Condition"). Here, the applicable section of the Restatement is § 227(2). In the language of that subsection, the duty to be performed is Benjamin's duty to pay the note, so that Benjamin is the "obligor;" New York Bronze is the "obligee;" and the asserted condition is the surrender of the note. Benjamin's position necessarily is that, as of the time of contract formation, surrender of the note was an event within the control of New York Bronze.

Where the above recited factors are present, the preferred interpretation is set forth in Restatement § 227(2), which reads:

"Unless the contract is of a type under which only one party generally undertakes duties, when it is doubtful whether

(a) a duty is imposed on an obligee that an event occur, or

(b) the event is made a condition of the obligor's duty, or

(c) the event is made a condition of the obligor's duty and a duty is imposed on the obligee that the event occur, the first interpretation is preferred if the event is within the obligee's control.

Comment *d* states the rationale for the preferred interpretation as follows:

> "The rule in Subsection (2) states a preference for an interpretation that merely imposes a duty on the obligee to do the act and does not make the doing of the act a condition of the obligor's duty. The preferred interpretation avoids the harsh results that might otherwise result from the non-occurrence of a condition and still gives adequate protection to the obligor under the rules ... relating to performances to be exchanged under an exchange of promises. Under those rules ... the obligee's failure to perform his duty has, if it is material, the effect of the non-occurrence of a condition of the obligor's duty. Unless the agreement makes it clear that the event is required as a condition, it is fairer to apply these more flexible rules. The obligor will, in any case, have a remedy for breach."

Turning to the interpretation of the last sentence of Section 4.2 of the note we conclude, for the reasons hereinafter set forth, that it is “doubtful” that the parties intended to create a condition. Benjamin's interpretation rests entirely on the language “in order to receive payment.” Neither in the context of the contract as a whole, nor within the terms themselves, is the creation of a condition so clear that it overcomes the preference for interpretation of the language as a covenant.

The introductory paragraph of the non-negotiable note contains the promise to pay $350,000 and expresses that that promise is “[s]ubject to Sections 2 and 3 below.” The former deals with subordination and the latter is the agreement concerning set offs. Had the parties intended the promise to be subject to a condition found in Section 4.2, careful drafting would have included Section 4.2 in the introduction of the note.

Section 4.2 of the note specifies how and when payments “shall be made ... and shall be mailed.” This is the language of covenants. No one could seriously maintain that, if Benjamin, in some immaterial fashion, did not comply with the provisions describing the payment checks and their mailing, then a payment received by New York Bronze could be kept by it without crediting the payment against the obligation. The principal clause of the last sentence in Section 4.2 (“The Noteholder shall be required to surrender this Note for cancellation ....”) similarly is the language of covenant. Thus, under Benjamin's position, the language, “in order to receive payment,” must produce a substantially different legal result than do the other provisions of Section 4.2.

Under the New York cases, it would seem that more explicit language than that used is required in order to achieve that result. For example, the interpretation would be much more clear if the critical clause of the last sentence of Section 4.2 read: “and upon failure to surrender this Note [Benjamin's] obligation to pay any outstanding balance will terminate,” or “be extinguished.” Instead, the note uses the language, “in order to receive payment.” The primary meaning of the verb “to receive” is “to take possession or delivery of,” as of a gift or of a letter. Webster's Third New International Dictionary 1984 (1976). In the context of the last sentence of Section 4.2, “receive” carries a passive connotation as to the role of New York Bronze while the active role would be that of Benjamin in tendering payment in full of any outstanding balance. Interpreting Section 4.2 as promises to exchange performances is a far cry from interpreting it to provide that the failure to surrender the note causes New York

Bronze to lose all rights to take an active role and enforce collection on the note through legal proceedings.

The obvious purpose of the last sentence of Section 4.2 is to protect Benjamin from the risk that the note will fall into the hands of a third party who will in some way force Benjamin to pay twice. If the critical language is interpreted as part of a covenant by New York Bronze, then Benjamin theoretically had a number of options to remedy the breach. Benjamin could take the position that the breach was substantial, thus excusing Benjamin from performance, but that result is not the situation here, as we explain below. Benjamin could demand and possibly obtain from New York Bronze proof satisfactory to Benjamin that Benjamin would not be required to pay twice. Benjamin could claim as damages for the breach the cost of a bond protecting it against double payment. Although the note is non-interest bearing, Benjamin could have utilized the breach by New York Bronze to oppose a claim for the discretionary allowance of interest on any unpaid and overdue balance on the note for the period from maturity until judgment. Further, if after having paid New York Bronze in full a third party claimed against Benjamin on the note, Benjamin could obtain damages from New York Bronze measured by the cost of defending the claim of the third party and demonstrating that payment had been made in full.

Whatever the effect of the critical language might be in an agreement involving a negotiable note, Benjamin's risk of being required to pay twice is *de minimis* in the instant matter because the note is non-negotiable. If we assume that Benjamin paid the full $350,000 without a surrender of the note, an assignee of New York Bronze could not be a holder in due course. That assignee would take the note subject to the defense of payment by Benjamin to New York Bronze.

Under these circumstances it is unlikely that the parties intended to create a condition entitling Benjamin to keep up to $200,000 of assets without paying the agreed consideration. Thus, we apply the preferred construction and hold that the last sentence of Section 4.2 of the note creates a covenant or contractual duty on the part of New York Bronze to surrender the note.

JUDGMENT REVERSED. CASE REMANDED TO THE COURT OF SPECIAL APPEALS FOR FURTHER PROCEEDINGS NOT INCONSISTENT WITH THIS OPINION.

THOS. J. DYER CO. v. BISHOP INTERN. ENGINEERING CO., 303 F.2d 655 (6th Cir. 1962)

SHACKELFORD MILLER, JR., Chief Judge.

Appellee, The Thos. J., Dyer Company, a subcontractor on the project hereinafter referred to, brought this action against the appellant, Bishop International Engineering Company, hereinafter referred to as Engineering Company, the general contractor, to recover the sum of $134,684.53 for materials and labor furnished by it in the construction of the project. The appellant, General Insurance Company of America, was also made a defendant as surety on the 'Owner's Protective Bond,' executed by the Engineering Company as principal.

The following facts were stipulated by the parties. Appellee is an Ohio corporation engaged in the plumbing contracting business. The Engineering Company is a partnership engaged in the general contracting business. On or about August 19, 1958, the Engineering Company entered into a written contract with The Kentucky Jockey Club, Inc., hereinafter referred to as the Jockey Club, by the terms of which it agreed to provide labor and materials required in connection with the construction of a portion of a Horse Racing Plant, known as Latonia Race Track, upon premises belonging to the Jockey Club, situated in Boone County, Kentucky. That portion of the construction project covered by the contract was described as 'Phase One.'

On or about April 27, 1959, the appellee entered into a written subcontract with the Engineering Company, by the provisions of which it agreed to provide materials for and to install certain plumbing and utilities required in connection with the completion of the construction work to be performed by the Engineering Company, pursuant to its contract with the Jockey Club, for which it was to receive the sum of $115,000.00. Paragraph 3 of this subcontract reads as follows:

> "3. The total price to be paid to Subcontractor shall be $115,000.00 lawful money of the United States, no part of which shall be due until five (5) days after Owner shall have paid Contractor therefor, provided however, that not more than ..... per cent (90%) thereof shall be due until thirty-five (35) days after the entire work to be performed and completed under said contract shall have been completed to the satisfaction of Owners, and provided further that Contractor may retain sufficient moneys to fully pay and discharge any and all liens, stop-notices, attachments, garnishments and executions. Nothing herein is to be construed as preventing

> Contractorfrom paying to the Subcontractor all or any part of said price at any time hereafter as an advance or otherwise."

The Engineering Company has provided all of the labor and material and has done all things necessary for the completion of the work required of it under the contract of August 19, 1958, and has received payment of the sum of $2,236,908.95, specified by the contract as the consideration to be paid to it for the work to be performed by it thereunder.

From time to time following the execution of the contract of August 19, 1958, the Engineering Company was called upon by the Jockey Club to provide labor, services and materials for the completion of various items of construction relating to the above mentioned Horse Racing Plant which had not been included within Phase One of the construction program of the Jockey Club. The Engineering Company has received compensation for certain portions of such additional labor, services and materials provided by it at the request of the Jockey Club but has not yet received payment for all of it.

Appellee has provided all the labor and materials and has done all things necessary for the completion of the work required of it under the subcontract, change orders, proposals and acceptances. Appellee completed its work as required on or before August 1, 1959, and the completed project was accepted by the owners on or about August 28, 1959.

The Engineering Company has not been paid by the Jockey Club for any work performed or material supplied by the appellee, other than that required pursuant to the terms of the original contract, dated August 19, 1958, between the Engineering Company and the Jockey Club.

The Engineering Company has paid to appellee for work performed and materials provided under the subcontract, changes orders, proposals and acceptances the sum of $119,133.06. After the payment of $119,133.06 there remained a balance due from the Engineering Company to the appellee of $108,519.11.

Under date of August 19, 1958, the appellant General Insurance Company of America executed a bond to the Jockey Club in the face amount of $2,086,908.75, upon which the Engineering Company was the princiapl.

On December 4 , 1959, the Jockey Club filed in the United States District Court for the Western District of Kentucky, Louisville Division, a proceeding for its reorganization under Chapter X of the Federal Bankruptcy Act. That proceeding is still pending.

The Engineering Company in its defense to the action contends that by the provisions of paragraph 3 of its subcontract with the appellee no payment was due thereunder to the appellee until five days after the Jockey Club, owner of the construction project to which the contract related, had made payment to the Engineering Company; that the Jockey Club has paid to it on account of the work performed and the materials furnished by the appellee certain payments, all of which have been paid by the Engineering Company to the appellee; and that because it has not received any further payment from the Jockey Club, now being reorganized in bankruptcy, it has no obligation to make further payment to the appellee.

Following the filing of the stipulation of facts, the District Judge made findings of fact and conclusions of law, sustained appellee's motion for summary judgment, and entered judgment for the appellee in the principal amount of $108,519.11, together with $9,224.12 as interest due to the date of the judgment.

…

The parties devote considerable time to the question of whether paragraph 3 in appellee's subcontract is an enforceable provision of the contract, appellant contending that it is enforceable and appellee contending that it is not. We think this argument misconceives the real issue in the case. It appears to be settled law that contract provisions making certain obligations conditional or contingent upon the happening of a certain event are valid and enforceable. But the question remains whether the contract provision relied upon creates such a conditional or contingent obligation. This presents a question of construction interpretation of the contract provision, not a question of its validity.

In construing the contract sued on in this case, the first question is whether paragraph 3 of the subcontract of April 27, 1959, is applicable not only to the original subcontract but also to the several supplemental contracts between the parties for work additional to that covered by the original subcontract.

Appellee argues in support of the judgment that paragraph 3 in the subcontract of April 27, 1959, was applicable only to the labor and material covered by that instrument, and the subsequent agreements for additional work by it, which work was not contemplated in the

original general contract, or in the initial subcontract, constitute separate contracts which do not contain the provisions of paragraph 3. It contends that the defense relied upon under paragraph 3 of the initial subcontract is not applicable to the work performed under the supplemental contracts. This contention appears to be in accord with the general rule. Canister Co. v. Wood & Selick, 73 F.2d 312, 314, C.A.3rd; 17 C.J.S. Contracts §§ 331-336. The subsequent letter proposals and acceptances do not expressly state that they are subject to the provisions of the initial subcontract and each one contains the elements necessary to constitute a separate, independent contract. However, the fundamental question is one of intention to be determined from the language of the parties, the subject matter of the agreement and in the light of all the surrounding circumstances.

We think it is clear that the two change orders of May 25, 1959, and June 9, 1959, are to be considered as part of the original subcontract, to which they specifically refer . …

Accordingly, we come to the crucial issue in the case, namely, whether, as contended by the appellant, paragraph 3 of the subcontract is to be construed as a conditional promise to pay, enforceable only when and if the condition precedent has taken place, which in the present case has not occurred, or, as contended by the appellee, it is to be construed as an unconditional promise to pay with the time of payment being postponed until the happening of a certain event, or for a reasonable period of time if it develops that such event does not take place.

Numerous decisions from various courts are cited by the parties in support of their respective contentions. We think that these cases state the basic rule and are examples of its application under the facts of the particular case being considered. For example, in Kentucky, where the contract herein involved was to be performed, the Court of Appeals of Kentucky held in Fox v. Buckingham, supra, 228 Ky. 176, 180-181, 14 S.W.2d 421, that the promise to pay was a conditional one, enforceable only when the condition precedent has taken place. In Mock v. Trustees of First Baptist Church of Newport, 252 Ky. 243, 67 S.W.2d 9, 94 A.L.R. 716, the same Court had before it the case of an architect who had been employed to prepare plans and specifications for a Sunday school building, the construction of which was indefinitely suspended because of unexpected construction costs and the church's financial limitations. In a suit by the architect for the unpaid balance of his fee the Trustees of the church contended that he had agreed to wait for the unpaid balance until such time as the

church in its judgment and discretion was financially able and deemed it advisable to erect and complete the building. The Court held that such a promise to pay was not conditional upon the completion of the building, but should be construed to mean that payment was to be made within a reasonable time. In Ohio, where the contract herein involved was made, it appears that the Court of Appeals of Ohio has held in North Market Association, Inc. v. Case, 99 Ohio App. 187, 132 N.E.2d 122, that a promise to pay 'if and when funds are available' was conditional and did not impose any obligation to pay until funds were available, which ruling was followed by the Court of Common Pleas of Highland County, Ohio, in Smith v. Shoemaker, 162 N.E.2d 237. On the other hand, the Supreme Court of Ohio has held, in Lewis v. Tipton, supra, 10 Ohio St. 88, that a promise to pay 'when I can make it convenient' created an obligation to pay after a reasonable period of time. The Court said that it was conceded that the intention of the parties to a contract can not prevail if directly contrary to the plain sense of the words employed, but when the intention is sufficiently apparent, effect should be given to that intent though some violence be thereby done to the words. It pointed out that if the Court accepted the construction claimed by the maker of the note, the maker might never find it convenient to pay which would lead to results certainly not contemplated by the parties. The Court of Appeals of Kentucky in making its ruling in Mock v. Trustees of First Baptist Church of Newport, 252 Ky. 243, quoted with approval from section 2100 of Page on Contracts as follows:

"The time of performance is sometimes made to depend upon the doing of some specified act other than that which the parties to the contract agree to do or it is made to depend upon the happening of some event which the parties to the contract do not covenant to cause to happen. The tendency of the courts is to hold that unless the contract shows clearly that such an action is an express condition, the provision with reference to such act is inserted in order to fix the time of performance, but not to make the doing of such act or the happening of such event a condition precedent. If this is the intention of the parties, the fact that such act is not performed or that such event does not happen, does not discharge the contract, and the act which the parties agree to do upon the performance of such act or upon the happening of such event, is to be performed in at least a reasonable time. This principle has been applied to a promise to pay when the maker has finished a church then building; or to pay when a certain

dispute is settled; or ‘as soon as the crop can be sold or the money raised from any other source.”

As pointed out in that statement of the basic rule, it is the intention of the parties which is the controlling factor in each particular case.

It is, of course, basic in the construction business for the general contractor on a construction project of any magnitude to expect to be paid in full by the owner for the labor and material he puts into the project. He would not remain long in business unless such was his intention and such intention was accomplished. That is a fundamental concept of doing business with another. The solvency of the owner is a credit risk necessarily incurred by the general contractor, but various legal and contractual provisions, such as mechanics' liens and installment payments, are used to reduce this to a minimum. These evidence the intention of the parties that the contractor be paid even though the owner may ultimately become insolvent. This expectation and intention of being paid is even more pronounced in the case of a subcontractor whose contract is with the general contractor, not with the owner. In addition to his mechanic's lien, he is primarily interested in the solvency of the general contractor with whom he has contracted. He looks to him for payment. Normally and legally, the insolvency of the owner will not defeat the claim of the subcontractor against the general contractor. Accordingly, in order to transfer this normal credit risk incurred by the general contractor from the general contractor to the subcontractor, the contract between the general contractor and subcontractor should contain an express condition clearly showing that to be the intention of the parties. Section 2100, Page on Contracts, supra.

In the case before us we see no reason why the usual credit risk of the owner's insolvency assumed by the general contractor should be transferred from the general contractor to the subcontractor. It seems clear to us under the facts of this case that it was the intention of the parties that the subcontractor would be paid by the general contractor for the labor and materials put into the project. We believe that to be the normal construction of the relationship between the parties. If such was not the intention of the parties it could have been so expressed in unequivocal terms dealing with the possible insolvency of the owner. Paragraph 3 of the subcontract does not refer to the possible insolvency of the owner. On the other hand, it deals with the amount, time and method of payment, which are essential provisions in every construction contract, without regard to possible insolvency. In our opinion, paragraph 3 of

the subcontract is a reasonable provision designed to postpone payment for a reasonable period of time after the work was completed, during which the general contractor would be afforded the opportunity of procuring from the owner the funds necessary to pay the subcontractor. Stewart v. Herron, 77 Ohio St. 130, 149, 82 N.E. 956. To construe it as requiring the subcontractor to wait to be paid for an indefinite period of time until the general contractor has been paid by the owner, which may never occur, is to give to it an unreasonable construction which the parties did not intend at the time the subcontract was entered into.

The judgment is affirmed.

J.J. SHANE, INC. v. AETNA CAS. & SUR. CO., 723 So.2d 302 (Fla.App.Dist.,1998)

GREEN, Judge.

On this appeal, the plaintiff/subcontractor appeals from an adverse final judgment and order taxing attorney's fees and costs entered pursuant to a jury verdict in favor of the general contractor. We reverse and remand with instructions that this case be dismissed without prejudice as being prematurely filed.

Appellant, J.J. Shane, Inc. ("Shane") was a subcontractor to the general contractor, appellee Recchi America, Inc. ("Recchi") during the construction of the Omni extension of the "People Mover" in downtown Miami. The construction project is owned by Metropolitan Dade County. Shane instituted this breach of contract action when Recchi failed to make complete payment for Shane's work on this project. The center of this dispute involves the interpretation of the following payment provision of the written subcontract between the parties:

"Article XIII Method of Payment

a) Subcontractor is relying upon the financial responsibility of Owner in performing the Work. It is understood by Subcontractor that payment for the work is to be made from funds received from Owner by Contractor in respect to the Work."

Recchi maintains that under this provision, its obligation to pay Shane is clearly conditioned upon its receipt of payment from the county/owner. Since it is undisputed herein that Recchi has not been paid for the project by the county/owner and indeed is itself currently embroiled in litigation for such payment, Recchi maintains that its contractual obligation to pay Shane has not yet arisen. Shane, on the other hand, asserts that this payment provision is ambiguous and, as such, must be construed to require Recchi's payment within a reasonable period of time.

In most subcontract agreements, payment by the owner to the contractor ordinarily is not intended to be a condition precedent to the contractor's duty to pay the subcontractor "because small subcontractors, who must have payment for their work in order to remain in business, will not ordinarily assume the risk of the owner's failure to pay the general contractor." *Peacock Constr. Co., Inc. v. Modern Air Conditioning, Inc.,* 353 So.2d 840, 842 (Fla.1977). However, the *Peacock* court recognized that subcontract agreements such as the one before us, may contain valid payment provisions which shift the risk of payment failure by the owner from the general contractor to the subcontractor. "But in order to make such a shift the contract must unambiguously express that intention." *Peacock,* 353 So.2d at 842-43.

Here, we find the subject payment provision to plainly and unambiguously make payment by the county/owner a condition precedent to payment by the general contractor to the subcontractor herein, rather than simply fixing a reasonable time for payment as contended by the subcontractor. Thus, where the owner's non-payment to the general contractor is undisputed, this cause for payment by the subcontractor was prematurely filed. *See Robert F. Wilson, Inc. v. Post-Tensioned Structures, Inc.,* 522 So.2d 79, 80 (Fla. 3d DCA 1988). Accordingly, we reverse the final judgment and the order awarding fees and costs with directions that this case be dismissed without prejudice.

HICKS v. BUSH, 10 N.Y.2d 488, 180 N.E.2d 425 (N.Y. 1962)

FULD, Judge.

In this action for specific performance of a written agreement, we granted the plaintiff leave to appeal to consider whether the parol evidence rule was violated by the

receipt of testimony tending to establish that the parties had orally agreed that the legal effectiveness of the written agreement should be subject to a stated condition precedent.

On July 10, 1956, the plaintiff Frederick Hicks, together with defendant Michael Congero and one Jack McGee, executed a written agreement with the individual defendants, members of defendant Clinton G. Bush Company, whereby the parties were to merge their various corporate interests into a single ‘holding’ company in order to achieve more efficient operation and greater financial strength. The document recited, among other things, that the plaintiff would subscribe for some 425,000 shares of stock in the new holding corporation, known as Bush-Hicks Enterprises, Inc., and that the defendants comprising the Bush Company would subscribe for more than a million shares. The other parties to the agreement were to subscribe for a total of less than 50,000 shares. The principal consideration for the subscription was the transfer to the holding company of stock in the operating corporations which the several parties owned.

The written agreement provided expressly that the subscriptions for the stock in Bush-Hicks Enterprises were to be made ‘within five days after the date of this Agreement’ and that, ‘If within twenty-five days after the date hereof Bush-Hicks shall have failed to accept any of said subscriptions delivered to it * * * then and in any such event the obligations of all of the parties hereto shall be terminated and cancelled.’ The subscriptions were promptly made and accepted and, although the plaintiff turned over the stock of his corporations, the defendants did not transfer the stock of their companies to Bush-Hicks Enterprises. In consequence, the plaintiff never received the Bush-Hicks stock as provided in the agreement and the merger never eventuated.

Alleging a breach of contract, the plaintiff brought this suit for specific performance and for an accounting. In their answer, the defendants urged, as an affirmative defense, that the written agreement was executed ‘upon a parol condition’ that it ‘was not to operate’ as a contract and that the contemplated merger was not ‘to become effective’ until so-called ‘equity expansion funds', amounting to $672,500, were first procured. And, to support that allegation, the defendants upon the trial offered evidence of such an oral understanding. The court admitted the evidence, over the plaintiff's objection that it varied and contradicted the terms of the writing, and, finding that the oral condition asserted had actually been agreed on by the parties, rendered judgment in favor of the defendants.

A reading of the record unquestionably supports the decision of the courts below that the parties, having concluded that $672,500 was essential to successful operation of the proposed merger, agreed that the entire merger deal was to be subject to the condition precedent that that sum be raised. Thus, one witness, the president of the defendant Bush Company, declared that everyone 'understood' that the writing was not to become operative as a binding contract until the specified equity expansion funds were obtained. Indeed, his expressive and colorful testimony leaves no doubt as to the nature of the agreement arrived at: 'I used the Chinese slang phrase of 'No tickie, no shirtie.' Let's get signed so we would be ready. I said, 'You all know what that means, that if we do not get the funds, this document (the written agreement) does not become operative * * *.' * * * There is only one understanding, verbal understanding that we have had. That speaks of 'Get the money or no deal.''

The expansion capital of $672,500, which the parties hoped would be procured by December 31, 1956, was never raised.

The applicable law is clear, the relevant principles settled. Parol testimony is admissible to prove a condition precedent to the legal effectiveness of a written agreement (see Saltzman v. Barson, 239 N.Y. 332, 337, 146 N.E. 618, 619; Grannis v. Stevens, 216 N.Y. 583, 587, 111 N.E. 263, 265; Reynolds v. Robinson, 110 N.Y. 654, 18 N.E. 127; see, also, 4 Williston, Contracts (3d ed., 1961), s 634, p. 1021; 3 Corbin, Contracts (1960 ed.), s 589, p. 530 et seq.), if the condition does not contradict the express terms of such written agreement. (See Fadex Foreign Trading Corp. v. Crown Steel Corp., 297 N.Y. 903, 79 N.E.2d 739, see, also, Restatement, Contracts, §241.) A certain disparity is inevitable, of course, whenever a written promise is, by oral agreement of the parties, made conditional upon an event not expressed in the writing. Quite obviously, though, the parol evidence rule does not bar proof of every orally established condition precedent, but only of those which in a real sense contradict the terms of the written agreement. (See, e. g., Illustration to Restatement, Contracts, § 241.) Upon the present appeal, our problem is to determine whether there is such a contradiction.

The *Fadex* case (297 N.Y. 903, 79 N.E.2d 739, supra) is illustrative. The plaintiff, seeking damages for nondelivery of certain goods, relied upon written agreements which specifically provided that the goods were 'Ready now' and that the time of delivery was to be 'Prompt' and 'Within 4 to 6 weeks, if possible earlier'. Despite these express recitals, plus the further explicit notation that no oral arrangement or modification was to be binding upon the

parties, the defendant sought to show a contemporaneous oral agreement that the sales were conditioned upon its ability to obtain the goods within a month. In connection with a motion for partial summary judgment, this court decided that an oral condition precedent to the formation of a contract could be established when not contradictory of the written agreement itself, but concluded that the condition attempted to be proved by the defendant Crown Steel Corporation would, if ruled operative, actually annul the express terms of the writing.

The present case differs materially from Fadex. There is here no direct or explicit contradiction between the oral condition and the writing; in fact, the parol agreement deals with a matter on which the written agreement, as in some of the cases cited (10 N.Y.2d p. 491, 225 N.Y.S.2d 36, 180 N.E.2d 427, supra), is silent. The plaintiff, however contends, that, since the written agreement provides in terms that the obligations of the parties were to be terminated if the merged corporation failed to accept any of their stock subscriptions within 25 days, the additional oral condition that the writing 'was (not) to become operative' and that the merger was 'not to become effective' until the expansion funds had been raised is irreconcilable with the written agreement.

As already indicated, and analysis confirms it, the two conditions may stand side by side. The oral requirement that the writing was not to take effect as a contract until the equity expansion funds were obtained is simply a further condition a condition added to that requiring the acceptance of stock subscriptions within 25 days and not one which is contradictory. If both provisions had been contained in the written agreement, it is clear that the defendants would not have been under immediate legal duty to transfer the stock in their companies to Bush-Hicks Enterprises until both conditions had been fulfilled and satisfied. And it is equally clear that evidence of an oral condition is not to be excluded as contradictory or 'inconsistent' merely because the written agreement contains other conditions precedent. As the Supreme Court Wrote in the Hartford Fire Ins. Co. case (187 U.S. 467, 474, 23 S.Ct. 189, 192,), "If an instrument containing an absolute promise to pay may be conditionally delivered, it is difficult to perceive any good reason why an instrument containing a promise to pay upon a contingency may not likewise be conditionally delivered."

In short, the parties in the case before us intended that their respective rights and duties with respect to the contemplated transfers of stock in the operating companies to the holding company be subject to two conditions, each independent of the other the acceptance of the

stock subscription within a specified period and the procuring of expansion funds of $672,500. As the courts below found, the parties did not contemplate performance of the written agreement until such funds were first received. In other words, it was their desire and understanding that the merger was to be one of proposal only and that, even though the formal preliminary steps were to be taken, the writing was not to become operative as a contract or the merger effective until $672,500 was raised. It is certainly not improbable that parties contracting in these circumstances would make the asserted oral agreement; the condition precedent at hand is the sort of condition which parties would not be inclined to incorporate into a written agreement intended for public consumption. The challenged evidence was, therefore, admissible and, since there was ample proof attesting to the making of the oral agreement, the trial court was fully warranted in holding that no operative or binding contract ever came into existence.

The judgment appealed from should be affirmed, with costs.

EDMUND J. FLYNN CO. v. SCHLOSSER, 265 A.2d 599 (D.C.App. 1970)

QUINN, Associate Judge, Retired.

This appeal arises out of an agreement to purchase a cooperative apartment. Appellee was the prospective purchaser and appellant the agent of the seller. Appellee attempted to revoke her 'offer' before the time for performance. At trial, by stipulation of both parties, the issues were reduced to one legal question: What effect was to be given a condition contained in the written sales agreement? As stated by the trial court, the question was: 'Is it a condition precedent to the existence of a binding contract to purchase the apartment or a condition precedent to the obligation immediately to perform the contract?' The relevant portion of the agreement is as follows:

> "It is understood that Purchaser must be approved by the board of directors of the Cooperative, and the time hereinabove specified for full settlement shall be extended for the time necessary to receive the decision of said board of directors, provided said decision shall not have been received by said time appointed for settlement.
>
> "This entire agreement is conditioned upon Purchaser's being approved for occupancy by the board of directors of the Cooperative, as hereinbefore set forth, and the accompanying application for such approval, executed by both Seller and Purchaser, is hereby made a part hereof as fully as though written herein. It is agreed by the parties hereto that the Agent shall promptly submit said application to the said board of directors. In the event approval of the Purchaser shall be denied by the said board of directors, then, and in such event, the entire aforesaid deposit shall be returned to Purchaser promptly, and without any deduction therefrom whatsoever, and this agreement shall thereafter be of no further force or effect."

The sole question on this appeal is likewise the legal effect of this condition. The trial court found that the language in the writing was a condition procedent to the existence of a binding contract, and that the appellee was thus free to revoke her offer. We cannot agree.

The term 'condition precedent' has led to much confusion in the law. Most of this confusion arises out of the so-called 'dual usage' of the term; i. e., condition to the existence of a contract or condition to the duty to perform. In the case at bar, we are directly faced with the single issue of which use of the term is applicable.

When is a condition precedent a prerequisite to the existence of a contract? There is authority for the proposition that this use of the term is a common, often applied, and well established legal principle. An analysis of the case law, however, shows two specific areas where this use of the term has had a consistent application: (1) Where because of a 'conditional acceptance' to an offer no mutual assent occurs and thus no contract arises, and (2) where the effect of a contract is conditional on its validation by some 'superior' or 'higher' authority, reflecting a limited power in an agent to bind a principal. The latter area consists almost entirely of cases in which a government or one of its agencies is one party to the contract.

Much of the confusion in this area of the law can be attributed to the somewhat unfortunate use of the term 'condition prededent' when addressing the issue of the formation

of a contract. The issue really is not whether a ‘condition’ must occur before a contract comes into existence but whether the parties have mutually assented or agreed to make a binding contract. If there is such mutual assent, agreed on conditions clearly affect only the duty to perform. If no mutual agreement is ever reached, there is no contract. The ‘condition precedent’ to the formation or existence of a contract is thus the mutual assent or agreement of the parties.

The initial issue in this case is: Did the parties mutually agree to the purchase and sale of this cooperative apartment? By their own written agreement, which is the entire evidence before us as to this question, the only possible answer is in the affirmative.[1] Thus, both parties are bound by the agreement and neither has the power to unilaterally revoke.

As stated previously, the other area where the existence of a contract has been held to be conditioned involves approval by an authority higher than one of the contracting parties. Most of these cases involve that area of the law dealing with government contracts. District of Columbia v. Singleton, D.C.Mun.App., 81 A.2d 335 (1951), aff'd, 91 U.S.App.D.C. 91, 198 F.2d 945 (1952), is such a case in this jurisdiction. There it was held that ‘the statute here involved should * * * be construed to make a contract over the specified limit, which lacks the Commissioners' approval, unenforceable against the District but binding on the other party.’ 81 A.2d at 337. We hold that the special rules embodied in government contracts law which cover approval by an authorized agent of the sovereign are not applicable in this case between private litigants.

The trial court, however, relied on the case of Detroit Football Co. v. Robinson, 186 F.Supp. 933 (E.D.La.1960), where a government contract was not involved. There the court held that the endorsement of the commissioner of the National Football League was a condition precedent to the formation of a contract between the parties. The agreement had been reduced to writing and the condition read: ‘This agreement shall become valid and binding upon each party hereto only when, as and if it shall be approved by the Commissioner.’ 186 F.Supp. at 935. Appellant urges that, as the language in the contract

[1] We are not here faced with the problem of the admissibility of parol evidence to show that no contract was ever entered into. See Northeast Motor Co. v. Neal, supra note 6. Nor are we faced with the problem of the admissibility of parol evidence to show a failure of a condition precedent to the duty to perform under the contract, no such evidence having been introduced in this case.

before us is virtually the same, the above law should be applied to this case. We do not agree for the following reasons.

First, the circumstances and background of the Robinson case, the pre-merger 'war' for talent between the National Football League and the American Football League, were quite foreign to the usual background in most contract cases. Second, and certainly not unrelated, the legal principles which eventually evolved from the premerger cases were not based on contract law but on principles of equity. Both reasons are most persuasive for not following the 'contract rule' set out in the Robinson case.

Thus, we hold that the parties to the contract mutually agreed on the purchase and sale of this cooperative apartment. The condition, approval by the board of directors of the cooperative, was also a result of the mutual agreement. Neither party was obligated to perform until the happending of the condition, but neither party could rightfully revoke or withdraw in the meantime. Both parties were bound by the agreement. As this was the only issue presented both on appeal and at trial, the case is

Reversed with instructions to enter judgment for appellant.

Hypothetical

Plaintiff-appellants sued to recover for losses to their 1973 tobacco crop due to alleged rain damage. The crops were insured by defendant-appellee, Federal Crop Insurance Corporation (FCIC), an agency of the United States which issued three policies to the Howards, insuring their tobacco crops, to be grown on six farms, against weather damage and other hazards.

The Howards (plaintiffs) established production of tobacco on their acreage, and have alleged that their 1973 crop was extensively damaged by heavy rains, resulting in a gross loss to the three plaintiffs in excess of $35,000. The plaintiffs harvested and sold the depleted crop and timely filed notice and proof of loss with FCIC, but, prior to inspection by the adjuster for FCIC, the Howards had either plowed or disked under the tobacco fields in question to prepare the same for sowing a cover crop of rye to preserve the soil. When the FCIC adjuster later inspected the fields, he found the stalks had been largely obscured or obliterated by plowing or disking and denied the claims, apparently on the ground that the plaintiffs had

violated a portion of the policy which provides that the stalks on any acreage with respect to which a loss is claimed shall not be destroyed until the corporation makes an inspection.

There is no question but that apparently after notice of loss was given to defendant, but before inspection by the adjuster, plaintiffs plowed under the tobacco stalks and sowed some of the land with a cover crop, rye. The question is whether, under paragraph 5(f) of the tobacco endorsement to the policy of insurance, the act of plowing under the tobacco stalks forfeits the coverage of the policy. Paragraph 5 of the tobacco endorsement is entitled Claims. Pertinent to this case are subparagraphs 5(b) and 5(f), which are as follows:

5(b) *It shall be a condition precedent* to the payment of any loss that the insured establish the production of the insured crop on a unit and that such loss has been directly caused by one or more of the hazards insured against during the insurance period for the crop year for which the loss is claimed, and furnish any other information regarding the manner and extent of loss as may be required by the Corporation. (Emphasis added)

5(f) The tobacco stalks on any acreage of tobacco of types 11a, 11b, 12, 13, or 14 with respect to which a loss is *claimed shall not be destroyed until the Corporation makes an inspection.* (Emphasis added)

Howard v. Federal Crop Ins. Corp., 540 F.2d 695 (4th Cir. 1976)

CONSTRUCTIVE CONDITIONS

STEWART v. NEWBURY, 220 N.Y. 379, 115 N.E. 984 (N.Y. 1917)
CRANE, J.

The defendants are partners in the pipe fitting business under the name of Newbury Manufacturing Company. The plaintiff is a contractor and builder residing at Tuxedo, N. Y.

The parties had the following correspondence about the erection for the defendants of a concrete mill building at Monroe, N. Y.:

"Alexander Stewart,

"Tuxedo, N. Y., July 18, 1911.

"Newbury Mfg. Company, Monroe, N. Y.-Gentlemen: With reference to the proposed work on the new foundry building I had hoped to be able to get up and see you this afternoon, but find that impossible and am, in consequence, sending you these prices, which I trust you will find satisfactory.

"I will agree to do all excavation work required at sixty-five ($.65) cents per cubic yard.

"I will put in the concrete work, furnishing labor and forms only, at two and 05-100 ($2.05) dollars per cubic yard.

"I will furnish labor to put in reenforcing at four ($4.00) dollars per ton.

"I will furnish labor only to set all window and door frames, window sash and doors, including the setting of hardware for one hundred twelve ($112) dollars. As alternative I would be willing to do any or all of the above work for cost plus 10 per cent., furnishing you with first class mechanics and giving the work considerable of my personal time.

"Hoping to hear favorably from you in this regard, I am,

"Respectfully yours,

"[Signed] Alexander Stewart.

[This letter was followed by a letter from Newbury]

"Monroe, N. Y., July 22, 1911.

"Alexander Stewart, Tuxedo Park, N. Y.-

"Dear Sir: Confirming the telephone conversation of this morning we accept your bid of July the 18th to do the concrete work on our new building. We trust that you will be able to get at this the early part of next week.

"Yours truly,

"The Newbury Mfg. Co.,

"H. A. Newbury."

Nothing was said in writing about the time or manner of payment. The plaintiff, however, claims that after sending his letter, and before receiving that of the defendant, he had a telephone communication with Mr. Newbury and said: ‘I will expect my payments in the usual manner,’ and Newbury said, ‘All right, we have got the money to pay for the building.’ This conversation over the telephone was denied by the defendants. The custom, the plaintiff testified, was to pay 85 per cent. every 30 days or at the end of each month, 15 per cent. being retained till the work was completed.

In July the plaintiff commenced work and continued until September 29th, at which time he had progressed with the construction as far as the first floor. He then sent a bill for the work done up to that date for $896.35. The defendants refused to pay the bill and work was discontinued. The plaintiff claims that the defendants refused to permit him to perform the rest of his contract, they insisting that the work already done was not in accordance with the specifications. The defendants claimed upon the trial that the plaintiff voluntarily abandoned the work after their refusal to pay his bill.

On October 5, 1911, the defendants wrote the plaintiff a letter containing the following:

“Notwithstanding you promised to let us know on Monday whether you would complete the job or throw up the contract, you have not up to this time advised us of your intention. * * * Under the circumstances, we are compelled to accept your action as being an abandonment of your contract and of every effort upon your part to complete your work on our building. As you know, the bill which you sent us and which we declined to pay is not correct, either in items or amount, nor is there anything due you under our contract as we understand it until you have completed your work on our building.”

To this letter the plaintiff replied the following day. In it he makes no reference to the telephone communication agreeing, as he testified, to make ‘the usual payments,’ but does say this:

“There is nothing in our agreement which says that I shall wait until the job is completed before any payment is due, nor can this be reasonably implied. * * * As to having given you positive date as to when I should let you know what I proposed doing, I did not do

so; on the contrary, I told you that I would not tell you positively what I would do until I had visited the job, and I promised that I would do this at my earliest convenience and up to the present time I have been unable to get up there."

The defendant Herbert Newbury testified that the plaintiff 'ran away and left the whole thing.' And the defendant F. A. Newbury testified that he was told by Mr. Stewart's man that Stewart was going to abandon the job; that he thereupon telephoned Mr. Stewart, who replied that he would let him know about it the next day, but did not.

In this action, which is brought to recover the amount of the bill presented, as the agreed price and $95.68 damages for breach of contract, the plaintiff had a verdict for the amount stated in the bill, but not for the other damages claimed, and the judgment entered thereon has been affirmed by the Appellate Division.

The appeal to us is upon exceptions to the judge's charge. The court charged the jury as follows:

"Plaintiff says that he was excused from completely performing the contract by the defendants' unreasonable failure to pay him for the work he had done during the months of August and September. * * * Was it understood that the payments were to be made monthly? If it was not so understood, the defendant's only obligation was to make payments at reasonable periods, in view of the character of the work, the amount of work being done, and the value of it. In other words, if there was no agreement between the parties respecting the payments, the defendants' obligation was to make payments at reasonable times. * * * But whether there was such an agreement or not, you may consider whether it was reasonable or unreasonable for him to exact a payment at that time and in that amount."

The court further said, in reply to a request to charge:

"I will say in that connection, if there was no agreement respecting the time of payment, and if there was no custom that was understood by both parties, and with respect to which they made the contract, then the plaintiff was entitled to payments at reasonable times."

The defendants' counsel thereupon made the following request, which was refused:

"I ask your honor to instruct the jury that, if the circumstances existed as your honor stated in your last instruction, then the plaintiff was not entitled to any payment until the contract was completed."

The jury was plainly told that if there were no agreement as to payments, yet the plaintiff would be entitled to part payment at reasonable times as the work progressed, and if such payments were refused he could abandon the work and recover the amount due for the work performed.

This is not the law. Counsel for the plaintiff omits to call our attention to any authority sustaining such a proposition and our search reveals none. In fact, the law is very well settled to the contrary. This was an entire contract. Ming v. Corbin, 142 N. Y. 334, 340, 341, 37 N. E. 105. Where a contract is made to perform work and no agreement is made as to payment, the work must be substantially performed before payment can be demanded.

…The judgment should be reversed, and a new trial ordered; costs to abide the event.

MONROE ST. PROPERTIES, INC. v. CARPENTER, 407 F.2d 379 (9th Cir. 1969)
HUFSTEDLER, Circuit Judge:

Appellant, Monroe Street Properties, Inc. ('Monroe'), appeals from a judgment in favor of the defendant Carpenter entered after Carpenter's motion for a summary judgment was granted. Carpenter is a party in his capacity as a trustee for Western Equities, Inc. ('Western'). Federal jurisdiction is based upon diversity of citizenship.

Monroe's action is for claimed breach of a written contract between Monroe and Western in which Western agreed to buy from Monroe ten insured first mortgages and notes having a face value of $1,250,000 in exchange for $1,000,000 worth of Western's common stock. The District Court granted summary judgment on the ground that the uncontroverted facts showed that Monroe neither performed nor tendered performance on its side and, therefore, Western was not in breach of contract. Monroe contends that there was a genuine issue of material fact

within the meaning of Rule 56 of the Federal Rules of Civil Procedure: Could Monroe have performed its agreement by delivering clear insured title to the first mortgages during the life of the contract? We reject Monroe's contention and affirm the judgment.

The following facts are undisputed. On March 27, 1962, Western submitted its written offer to Monroe to buy the ten first mortgages and notes. Monroe promptly accepted the offer. Western's offer was expressly subject to ‘verification by Union Title Company that the ten first mortgages * * * are valid first mortgages.’ The offer further provided that Monroe would secure a policy of title insurance at its expense, would take the Western stock ‘as investment stock without plans for redistribution,’ and would execute voting proxies for the stock in favor of the Executive Committee of Western for three years. Western agreed to have the stock listed on the American Stock Exchange and to seek with due diligence registration of the stock with the Securities and Exchange Commission.

Pursuant to the contract the parties opened an escrow with Union Title Company on March 30, 1962. The escrow agreement provided that the terms and conditions of the agreement were to be complied with ‘on or before the date upon which (Western) stock has been listed on the American Stock Exchange, and delivered to Union Title Company.’ The Western stock was listed on the American Stock Exchange sometime before June 29, 1962, although the precise date of the listing is not clearly stated in the affidavits filed in connection with the motion for summary judgment. Monroe never deposited into escrow ten valid first mortgages or the policy of title, and Western never deposited its stock. Monroe did deposit the mortgage instruments in the escrow, but a preliminary title report received by Western on May 7, 1962, revealed that the properties subject to the ten mortgages were also subject to heavy prior encumbrances. After Monroe deposited those instruments in escrow, Monroe sent a demand to Western to deposit the stock. Western did not comply with the demand. Nothing further was done by either of the parties to perform the agreement and Monroe brought this action in October 1966.

According to the facts presented by Monroe in its own affidavits, which are uncontradicted in this respect by Western's affidavits, the only means by which Monroe could have delivered clear title to the first mortgages and could have obtained the policy of title insurance was to hypothecate Western stock to raise the money to pay off the prior

encumbrances. Monroe had no ability or means to perform its part of the agreement unless Western deposited its stock in escrow before Monroe performed.

The District Court correctly decided that Monroe never made an adequate tender of its own performance. Monroe's duty to deposit the insured first mortgages and Western's duty to deposit its stock were concurrent conditions. Neither party could place the other in breach for failure to perform without a tender of its own performance. 'Tender' as used in this connection means "a readiness and willingness to perform in case of the concurrent performance by the other party, with present ability to do so, and notice to the other party of such readiness." (6 Williston, contracts (3d ed. 1962) § 833, p. 105.) Monroe's offer to perform its concurrent condition upon condition that Western perform first was not an adequate tender and could not be relied upon by Monroe to place Western in breach of contract.

The judgment is affirmed.

JACOB & YOUNGS v. KENT, 130 N.E. 933 (N.Y. 1921)

[note: This is the same case you read earlier; this time, however, I included the Court's discussions of conditions and duties]

CARDOZO, J.

The plaintiff built a country residence for the defendant at a cost of upwards of $77,000, and now sues to recover a balance of $3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that--

"All wrought-iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture."

The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value, and in cost as the brand stated in the contract-that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture. Spence v. Ham, 163 N. Y. 220, 57 N. E. 412, 51 L. R. A. 238; Woodward v. Fuller, 80 N. Y. 312; Glacius v. Black, 67 N. Y. 563, 566; Bowen v. Kimbell, 203 Mass. 364, 370, 89 N. E. 542, 133 Am. St. Rep. 302. The distinction is akin to that between dependent and independent promises, or between promises and conditions. Anson on Contracts (Corbin's Ed.) § 367; 2 Williston on Contracts, § 842. Some promises are so plainly independent that they can never ***242** by fair construction be conditions of one another. Rosenthal Paper Co. v. Nat. Folding Box & Paper Co., 226 N. Y. 313, 123 N. E. 766; Bogardus v. N. Y. Life Ins. Co., 101 N. Y. 328, 4 N. E. 522. Others are so plainly dependent that they must always be conditions. Others, though dependent and thus conditions when there

is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant. 2 Williston on Contracts, §§ 841, 842; Eastern Forge Co. v. Corbin, 182 Mass. 590, 592, 66 N. E. 419; Robinson v. Mollett, L. R., 7 Eng. & Ir. App. 802, 814; Miller v. Benjamin, 142 N. Y. 613, 37 N. E. 631. Considerations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another. The simple and the uniform will call for different remedies from the multifarious and the intricate. The margin of departure within the range of normal expectation upon a sale of common chattels will vary from the margin to be expected upon a contract for the construction of a mansion or a 'skyscraper.' There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason in the implication of a like condition when the subject-matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.

Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier. The decisions in this state commit us to the liberal view, which is making its way, nowadays, in jurisdictions slow to welcome it. Dakin & Co. v. Lee, 1916, 1 K. B. 566, 579. Where the line is to be drawn between the important and the trivial cannot be settled by a formula. 'In the nature of the case precise boundaries are impossible.' 2 Williston on Contracts, § 841. The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose

of the contract. Crouch v. Gutmann, 134 N. Y. 45, 51, 31 N. E. 271, 30 Am. St. Rep. 608. There is no general license to install whatever, in the builder's judgment, may be regarded as 'just as good.' Easthampton L. & C. Co., Ltd., v. Worthington, 186 N. Y. 407, 412, 79 N. E. 323. The question is one of degree, to be answered, if there is doubt, by the triers of the facts (Crouch v. Gutmann; Woodward v. Fuller, supra), and, if the inferences are certain, by the judges of the law (Easthampton L. & C. Co., Ltd., v. Worthington, supra). We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfillment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression. Schultze v. Goodstein, 180 N. Y. 248, 251, 73 N. E. 21; Desmond-Dunne Co. v. Friedman-Doscher Co., 162 N. Y. 486, 490, 56 N. E. 995. For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong. Spence v. Ham, supra.

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure. Spence v. Ham, supra. The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a

foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. 'There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable.' Handy v. Bliss, 204 Mass. 513, 519, 90 N. E. 864, 134 Am. St. Rep. 673. Cf. Foeller v. Heintz, 137 Wis. 169, 178, 118 N. W. 543, 24 L. R. A. (N. S.) 321; Oberlies v. Bullinger, 132 N. Y. 598, 601, 30 N. E. 999; 2 Williston on Contracts, § 805, p. 1541. The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

McLAUGHLIN, J.

I dissent. The plaintiff did not perform its contract. Its failure to do so was either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing, nor did it make any proof of the cost of compliance, where compliance was possible….

I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had, complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages

caused by such omissions. Woodward v. Fuller, 80 N. Y. 312; Nolan v. Whitney, 88 N. Y. 648. But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor that any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either 'nominal or nothing.' Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been 'just as good, better, or done just as well.' He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed. The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application.

HISCOCK, C. J., and HOGAN and CRANE, JJ., concur with CARDOZO, J.
POUND and ANDREWS, JJ., concur with McLAUGHLIN, J.

K & G CONST. CO. v. HARRIS, 223 Md. 305, 164 A.2d 451 (Md. 1960)

PRESCOTT, Judge.

Feeling aggrieved by the action of the trial judge of the Circuit Court for Prince George's County, sitting without a jury, in finding a judgment against it in favor of a subcontractor, the appellant, the general contractor on a construction project, appealed.

The principal question presented is: Does a contractor, damaged by a subcontractor's failure to perform a portion of his work in a workmanlike manner, have a right, under the circumstances of this case, to withhold, in partial satisfaction of said damages, an installment payment, which, under the terms of the contract, was due the subcontractor, unless the negligent performance of his work excused its payment?

The appeal is presented on a case stated in accordance with Maryland Rule 826 g.

The statement, in relevant part, is as follows:

"* * * K & G Construction Company, Inc. (hereinafter called Contractor), plaintiff and counter-defendant in the Circuit Court and appellant herein, was owner and general contractor of a housing subdivision project being constructed (herein called Project). Harris and Brooks (hereinafter called Subcontractor), defendants and counter-plaintiffs in the Circuit Court and appellees herein, entered into a contract with Contractor to do excavating and earth-moving work on the Project. Pertinent parts of the contract are set forth below:

"Section 3. The Subcontractor agrees to complete the several portions and the whole of the work herein sublet by the time or times following:

"(a) Without delay, as called for by the Contractor.

"(b) It is expressly agreed that time is of the essence of this contract, and that the Contractor will have the right to terminate this contract and employ a substitute to perform the work in the event of delay on the part of Subcontractor, and Subcontractor agrees to indemnify the Contractor for any loss sustained thereby, provided, however, that nothing in this paragraph shall be construed to deprive Contractor of any rights or remedies it would otherwise have as to damage for delay.

"Section 4. (b) Progress payments will be made each month during the performance of the work. Subcontractor will submit to Contractor, by the 25th of each month, a requisition for work performed during the preceding month. Contractor will pay these requisitions, less a retainer equal to ten per cent (10%), by the 10th of the months in which such requisitions are received.

"(c) No payments will be made under this contract until the insurance requirements of Sec. 9 hereof have been complied with.

"Section 5. The Contractor agrees--

"(1) That no claim for services rendered or materials furnished by the Contractor to the Subcontractor shall be valid unless written notice thereof is given by the Contractor to the Subcontractor during the first ten days of the calendar month following that in which the claim originated.

* * *

"Section 8. * * * All work shall be performed in a workmanlike manner, and in accordance with the best practices.

"Section 9. Subcontractor agrees to carry, during the progress of the work, * * * liability insurance against * * * property damage, in such amounts and with such companies as may be satisfactory to Contractor and shall provide Contractor with certificates showing the same to be in force."

While in the course of his employment by the Subcontractor on the Project, a bulldozer operator drove his machine too close to Contractor's house while grading the yard, causing the immediate collapse of a wall and other damage to the house. The resulting damage to contractor's house was $3,400.00. Subcontractor had complied with the insurance provision (Sec. 9) of the aforesaid contract. Subcontractor reported said damages to their liability insurance carrier. The Subcontractor and its insurance carrier refused to repair damage or compensate Contractor for damage to the house, claiming that there was no liability on the part of the Subcontractor.

"Subcontractor performed work under the contract during July, 1958, for which it submitted a requisition by the 25th of July, as required by the contract, for work done prior to the 25th of July, payable under the terms of the contract by Contractor on or before August 10, 1958. Contractor was current as to payments due under all preceding monthly requisitions from Subcontractor. The aforesaid bulldozer accident damaging Contractor's house occurred on August 9, 1958. Contractor refused to pay Subcontractor's requisition due on August 10, 1958, because the bulldozer damage to Contractor's house had not been repaired or paid for. Subcontractor continued to work on the project until the 12th of September, 1958, at which time they discontinued working on the project because of Contractor's refusal to pay the said work requisition and notified Contractor by registered letters of their position and willingness to return to the job, but only upon payment. At that time, September 12, 1958, the value of the work completed by Subcontractor on the project for which they had not been paid was $1,484.50.

"* * * Contractor filed suit against the Subcontractor in two counts: (1), for the aforesaid bulldozer damage to Contractor's house, alleging negligence of the Subcontractor's bulldozer operator, and (2) for the $450.00 costs above the contract price in having another excavating subcontractor complete the uncompleted work in the contract. Subcontractor filed a counter-claim for recovery of work of the value of $1,484.50 for which they had not received payment and for loss of anticipated profits on uncompleted portion of work in the amount of $1,340.00. By agreement of the parties, the first count of Contractor's claim, i. e., for aforesaid bulldozer damage to Contractor's house, was submitted to jury who found in favor of Contractor in the amount of $3,400.00. Following the finding by the jury, the second count of the Contractor's claim and the counter-claims of the Subcontractor, by agreement of the parties, were

submitted to the Court for determination, without jury. All of the facts recited herein above were stipulated to by the parties to the Court. Circuit Court Judge Fletcher found for counter-plaintiff Subcontractor in the amount of $2,824.50 from which Contractor has entered this appeal."

The $3.400 judgment has been paid.

It is immediately apparent that our decision turns upon the respective rights and liabilities of the parties under that portion of their contract whereby the subcontractor agreed to do the excavating and earth-moving work in 'a workmanlike manner, and in accordance with the best practices,' with time being of the essence of the contract, and the contractor agreed to make progress payments therefor on the 10th day of the months following the performance of the work by the subcontractor. The subcontractor contends, of course, that when the contractor failed to make the payment due on August 10, 1958, he breached his contract and thereby released him (the subcontractor) from any further obligation to perform. The contractor, on the other hand, argues that the failure of the subcontractor to perform his work in a workmanlike manner constituted a material breach of the contract, which justified his refusal to make the August 10 payment; and, as there was no breach on his part, the subcontractor had no right to cease performance on September 12, and his refusal to continue work on the project constituted another breach, which rendered him liable to the contractor for damages. The vital question, more tersely stated, remains: Did the contractor have a right, under the circumstances, to refuse to make the progress payment due on August 10, 1958?

The answer involves interesting and important principles of contract law. Promises and counter-promises made by the respective parties to a contract have certain relations to one another, which determine many of the rights and liabilities of the parties. Broadly speaking, they are (1) independent of each other, or (2) mutually dependent, one upon the other. They are independent of each other if the parties intend that *performance* by each of them is in no way conditioned upon *performance* by the other. 5 Page, The Law of Contracts, ¶ 2971. In other words, the parties exchange promises for promises, not the *performance* of promises for the *performance* of promises. 3 Williston, Contracts (Rev. Ed.), ¶813, n. 6. A failure to perform an independent promise does not excuse non-performance on the part of the adversary party, but each is required to perform his promise, and, if one does not perform, he

is liable to the adversary party for such non-performance. (Of course, if litigation ensues questions of set-off or recoupment frequently arise.) Promises are mutually dependent if the parties intend *performance* by one to be conditioned upon *performance* by the other, and, if they be mutually dependent, they may be (a) precedent, i. e., a promise that is to be performed before a corresponding promise on the part of the adversary party is to be performed, (b) subsequent, i. e., a corresponding promise that is not to be performed until the other party to the contract has performed a precedent covenant, or (c) concurrent, i. e., promises that are to be performed at the same time by each of the parties, who are respectively bound to perform each. Page, op. cit., ¶¶ 2941, 2951, 2961.

In the early days, it was settled law that covenants and mutual promises in a contract were *prima facie* independent, and that they were to be so construed in the absence of language in the contract clearly showing that they were intended to be dependent. Williston, op. cit., ¶816; Page, op. cit., ¶¶2944, 2945. In the case of Kingston v. Preston, 2 Doug. 689, decided in 1774, Lord Mansfield, contrary to three centuries of opposing precedents, changed the rule, and decided that performance of one covenant might be dependent on prior performance of another, although the contract contained no express condition to that effect. Page, op. cit., ¶2946; Williston, op. cit., ¶817. The modern rule, which seems to be of almost universal application, is that there is a presumption that mutual promises in a contract are dependent and are to be so regarded, whenever possible. Page, op. cit., ¶2946; Restatement, Contracts, ¶ 266. Cf. Williston, op. cit., ¶812.

Considering the presumption that promises and counter-promises are dependent and the statement of the case, we have no hesitation in holding that the promise and counter-promise under consideration here were mutually dependent, that is to say, the parties intended performance by one to be conditioned on performance by the other; and the subcontractor's promise was, by the explicit wording of the contract, precedent to the promise of payment, monthly, by the contractor. In Shapiro Engineering Corp. v. Francis O. Day Co., 215 Md. 373, 380, we stated that it is the general rule that where a total price for work is fixed by a contract, the work is not rendered divisible by progress payments. It would, indeed present an unusual situation if we were to hold that a building contractor, who has obtained someone to do work for him and has agreed to pay each month for the work performed in the previous month, has to continue the monthly payments, irrespective of the degree of skill and care displayed in the

performance of work, and his only recourse is by way of suit for ill-performance. If this were the law, it is conceivable, in fact, probable, that many contractors would become insolvent before they were able to complete their contracts. As was stated by the Court in Measures Brothers Ltd. v. Measures, : ‘Covenants are to be construed as dependent or independent according to the intention of the parties and the good sense of the case.’

We hold that when the subcontractor's employee negligently damaged the contractor's wall, this constituted a breach of the subcontractor's promise to perform his work in a ‘workmanlike manner, and in accordance with the best practices.’ And there can be little doubt that the breach was material: the damage to the wall amounted to more than double the payment due on August 10. Speed v. Bailey, 153 Md. 655, 661, 662, 139 A. 534. 3A Corbin, Contracts, § 708, says: ‘The failure of a contractor's [in our case, the subcontractor's] performance to constitute ‘substantial’ performance may justify the owner [in our case, the contractor] in refusing to make a progress payment * * *. * * * If the refusal to pay an installment is justified on the owner's [contractor's] part, the contractor [subcontractor] is not justified in abandoning work by reason of that refusal. His abandonment of the work will itself be a wrongful repudiation that goes to the essence, even if the defects in performance did not.' See also Restatement, Contracts, §274. Professor Corbin, in § 954, states further: ‘The unexcused failure of a contractor to render a promised performance when it is due is always a breach of contract * * *. Such failure may be of such great importance as to constitute what has been called herein a ‘total’ breach. * * *. For a failure of performance constituting such a ‘total’ breach, an action for remedies that are appropriate thereto is at once maintainable. Yet the injured party is not required to bring such action. He has the option of treating the non-performance as a ‘partial’ breach only * * *.'

In permitting the subcontractor to proceed with work on the project after August 9, the contractor, obviously, treated the breach by the subcontractor as a partial one. As the promises were mutually dependent and the subcontractor had made a material breach in his performance, this justified the contractor in refusing to make the August 10 payment; hence, as the contractor was not in default, the subcontractor again breached the contract when he, on September 12, discontinued work on the project, which rendered him liable (by the express terms of the contract) to the contractor for his increased cost in having the excavating done-a stipulated amount of $450. Cf. Keystone Engineering Corp. v. Sutter, 196 Md. 620, 628.

The appellees … contend that the contractor had no right to refuse the August 10 payment, because the subcontractor had furnished the insurance against property damage, as called for in the contract. There is little, or no, merit in this suggestion. The subcontractor and his insurance company denied liability. The furnishing of the insurance by him did not constitute a license to perform his work in a careless, negligence, or unworkmanlike manner; and its acceptance by the contractor did not preclude his assertion of a claim for unworkmanlike performance directly against the subcontractor.

Judgment against the appellant reversed; and judgment entered in favor of the appellant against the appellees for $450, the appellees to pay the costs.

WALKER & CO. v. HARRISON, 347 Mich. 630, 81 N.W.2d 352 (Mich. 1957)

SMITH, Justice.

This is a suit on a written contract. The defendants are in the dry-cleaning business. Walker & Company, plaintiff, sells, rents, and services advertising signs and billboards. These parties entered into an agreement pertaining to a sign. The agreement is in writing and is termed a 'rental agreement.' It specifies in part that:

"The lessor agrees to construct and install, at its own cost, one 18′9″ high x 8′8″ wide pylon type d.f. neon sign with electric clock and flashing lamps * * *. The lessor agrees to and does hereby lease or rent unto the said lessee the said SIGN for the term, use and rental and under the conditions, hereinafter set out, and the lessee agrees to pay said rental * * *.

"(a) The term of this lease shall be 36 months * * *.

"(b) The rental to be paid by lessee shall be $148.50 per month for each and every calendar month during the term of this lease; * * *.

"(d) Maintenance. Lessor at its expense agrees to maintain and service the sign together with such equipment as supplied and installed by the lessor to operate in conjunction with said sign under the terms of this lease; this service is to include cleaning and repainting of sign in original color scheme as often as deemed necessary by lessor to keep sign in first class advertising condition and make all necessary repairs to sign and equipment installed by lessor. * * *."

At the ‘expiration of this agreement,’ it was also provided, ‘title to this sign reverts to lessee.’ This clause is in addition to the printed form of agreement and was apparently added as a result of defendants' concern over title, they having expressed a desire ‘to buy for cash’ and the salesman, at one time, having ‘quoted a cash price.'

The sign was completed and installed in the latter part of July, 1953. The first billing of the monthly payment of $148.50 was made August 1, 1953, with payment thereof by defendants on September 3, 1953. This first payment was also the last. Shortly after the sign was installed, someone hit it with a tomato. Rust, also, was visible on the chrome, complained defendants, and in its corners were ‘little spider cobwebs.’ In addition, there were ‘some children's sayings written down in here.’ Defendant Herbert Harrison called Walker for the maintenance he believed himself entitled to under subparagraph (d) above. It was not forthcoming. He called again and again. ‘I was getting, you might say, sorer and sorer. * * * Occasionally, when I started calling up, I would walk around where the tomato was and get mad again. Then I would call up on the phone again.’ Finally, on October 8, 1953, plaintiff not having responded to his repeated calls, he telegraphed Walker that:

“You Have Continually Voided Our Rental Contract By Not Maintaining Signs As Agreed As We No Longer Have A Contract With You Do Not Expect Any Further Remuneration.”

Walker's reply was in the form of a letter. After first pointing out that ‘your telegram does not make any specific allegations as to what the failure of maintenance comprises,’ and stating that ‘We certainly would appreciate your furnishing us with such information,’ the letter makes reference to a prior collateral controversy between the parties, ‘wondering if this refusal on our part prompted your attempt to void our rental contract,’ and concludes as follows:

"We would like to call your attention to paragraph G[1] in our rental contract, which covers procedures in the event of a Breach of Agreement. In the event that you carry out your threat to make no future monthly payments in accordance with the agreement, it is our intention to enforce the conditions outlined under paragraph G through the proper legal channels. We call to your attention that your monthly rental payments are due in advance at our office not later than the 10th day of each current month. You are now approximately 30 days in arrears on your September payment. Unless we receive both the September and October payments by October 25th, this entire matter will be placed in the hands of our attorney for collection in accordance with paragraph G which stipulates that the entire amount is forthwith due and payable.'

No additional payments were made and Walker sued in assumpsit for the entire balance due under the contract, $5,197.50, invoking paragraph (g) of the agreement. Defendants filed answer and claim of recoupment, asserting that plaintiff's failure to perform certain maintenance services constituted a prior material breach of the agreement, thus justifying their repudiation of the contract and grounding their claim for damages. The case was tried to the court without a jury and resulted in a judgment for the plaintiff. The case is before us on a general appeal.

Defendants urge upon us again and again, in various forms, the proposition that Walker's failure to service the sign, in response to repeated requests, constituted a material

[1] "(g) Breach of agreement. Lessee shall be deemed to have breached this agreement by default in payment of any installment of the rental herein provided for; abandonment of the sign or vacating premises where the sign is located; termination or transfer of lessee's interest in the premises by insolvency, appointment of a receiver for lessee's business; filing of a voluntary or involuntary petition in bankruptcy with respect to lessee or the violation of any of the other terms or conditions hereof. In the event of such default, the lessor may, upon notice to the lessee, which notice shall conclusively be deemed sufficient if mailed or delivered to the premises where the sign was or is located, take possession of the sign and declare the balance of the rental herein provided for to be forthwith due and payable, and lessee hereby agrees to pay such balance upon any such contingencies. Lessor may terminate this lease and without notice, remove and repossess said sign and recover from the lessee such amounts as may be unpaid for the remaining unexpired term of this agreement. Time is of the essence of this lease with respect to the payment of rentals herein provided for. Should lessee after lessor has declared the balance of rentals due and payable, pay the full amount of rental herein provided, he shall then be entitled to the use of the sign, under all the terms and provisions hereof, for the balance of the term of this lease. No waiver by either party hereto of the nonperformance of any term, condition or obligation hereof shall be a waiver of any subsequent breach of, or failure to perform the same, or any other term, condition or obligation hereof. It is understood and agreed that the sign is especially constructed for the lessee and for use at the premises now occupied by the lessee for the term herein provided; that it is of no value unless so used and that it is a material consideration to the lessor in entering into this agreement that the lessee shall continue to use the sign for the period of time provided herein and for the payment of the full rental for such term."

breach of the contract and justified repudiation by them. Their legal proposition is undoubtedly correct. Repudiation is one of the weapons available to an injured party in event the other contractor has committed a material breach. But the injured party's determination that there has been a material breach, justifying his own repudiation, is fraught with peril, for should such determination, as viewed by a later court in the calm of its contemplation, be unwarranted, the repudiator himself will have been guilty of material breach and himself have become the aggressor, not an innocent victim.

What is our criterion for determining whether or not a breach of contract is so fatal to the undertaking of the parties that it is to be classed as 'material'? There is no single touchstone. Many factors are involved. They are well stated in section 275 of Restatement of the Law of Contracts in the following terms:

"In determining the materiality of a failure fully to perform a promise the following circumstances are influential:

"(a) The extent to which the injured party will obtain the substantial benefit which he could have reasonably anticipated;

"(b) The extent to which the injured party may be adequately compensated in damages for lack of complete performance;

"(c) The extent to which the party failing to perform has already partly performed or made preparations for performance;

"(d) The greater or less hardship on the party failing to perform in terminating the contract;

"(e) The wilful, negligent or innocent behavior of the party failing to perform;

"(f) The greater or less uncertainty that the party failing to perform will perform the remainder of the contract."

We will not set forth in detail the testimony offered concerning the need for servicing. Granting that Walker's delay (about a week after defendant Herbert Harrison sent his telegram of repudiation Walker sent out a crew and took care of things) in rendering the service requested was irritating, we are constrained to agree with the trial court that it was not of such materiality as to justify repudiation of the contract, and we are particularly mindful of the lack

of preponderant evidence contrary to his determination. Jones v. Eastern Michigan Motorbuses, 287 Mich. 619, 283 N.W. 710. The trial court, on this phase of the case, held as follows:

"Now Mr. Harrison phoned in, so he testified, a number of times. He isn't sure of the dates but he sets the first call at about the 7th of August and he complained then of the tomato and of some rust and some cobwebs. The tomato, according to the testimony, was up on the clock; that would be outside of his reach, without a stepladder or something. The cobwebs are within easy reach of Mr. Harrison and so would the rust be. I think that Mr. Bueche's argument that these were not materially a breach would clearly be true as to the cobwebs and I really can't believe in the face of all the testimony that there was a great deal of rust seven days after the installation of this sign. And that really brings it down to the tomato. And, of course, when a tomato has been splashed all over your clock, you don't like it. But he says he kept calling their attention to it, although the rain probably washed some of the tomato off. But the stain remained, and they didn't come. I really can't find that that was such a material breach of the contract as to justify rescission. I really don't think so."

Nor, we conclude, do we. There was no valid ground for defendants' repudiation and their failure thereafter to comply with the terms of the contract was itself a material breach, entitling Walker, upon this record, to judgment.

…

Affirmed. Costs to appellee.

Hypothetical

Loehmann's, Inc. petitions us to review a court of appeals opinion dealing with grounds for termination of a long-term commercial lease. In 1978, Loehmann's became the anchor tenant in the Lincoln View Plaza Shopping Center by entering into a twenty-year lease with Foundation's predecessor in interest. Loehmann's had an option to renew for two five-year terms. The lease therefore was potentially of thirty years' duration, expiring in 2008. Loehmann's was to operate a retail clothing store, part of its nationwide chain. Loehmann's

total annual payments to Foundation were to be approximately $ 50,000 ($ 45,000 annual rent plus approximately $ 5,000 for common area charges).

The lease also contained a section describing “Conditions of Default.” If Loehmann's failed “to pay any installment of minimum annual rental or additional rental or other charges [and did not cure] within ten (10) days after receipt . . . of notice of such neglect or failure,” Foundation could “prior to the removal of such Condition of Default," elect to terminate the lease. The lease stipulated that “with respect to . . . [Loehmann's] obligation to pay rent, taxes and other charges . . . [or] in any case where either party . . . is required to do any act, the time for the performance thereof shall be of the essence.”

On February 23, 1987, an employee [Beemiller] of Foundation's local managing agent sent Loehmann's the year-end statement for common area charges for the lease year ending January 31, 1987. The balance due was $ 3,566.44. Believing that Foundation had miscalculated its proration of the total square footage of the complex, a Loehmann’s employee sent an inquiry to on March 18, 1987. Beemiller responded explaining the bill.

On April 10, 1987, Timothy Richardson, another Foundation employee sent a demand letter to Loehmann's which stated: “We have not yet received your payment in the amount of $ 3,566.44. We must reinstate time of the essence of your lease and insist that this amount be paid within ten days from the date of this letter.”

Loehmann's received Richardson's letter in the Phoenix store on April 13, 1987. Because the local store was not responsible for paying rent or other charges, the letter was forwarded to the their main office. Loehmann's main office received the letter on Friday, April 17, 1987. Loehmann's general counsel, Marvin Gardner, was not in his office that Friday, which Loehmann's notes was Good Friday. When he returned to work on Monday April 20, 1987, he sent the notice to the accounting department. A senior staff accountant marked the letter "REC'D 4-20-87." On Friday April 24, 1987 a check was issued. and mailed the next day, April 25.

On Tuesday April 28, 1987, Foundation filed a complaint in superior court seeking termination of the lease, immediate possession of the leased premises, and payment of the accrued common area charges. A day later, April 29, Foundation received Loehmann's check in Phoenix.

Foundation Dev. Corp. v. Loehmann's, 163 Ariz. 438, 440-441 (Ariz. 1990)

UCC CONDITIONS

BARTUS v. RICCARDI, 55 Misc.2d 3, 284 N.Y.S.2d 222 (N.Y.City Ct. 1967)
HAROLD H. HYMES, Judge.

The plaintiff is a franchised representative of Acousticon, a manufacturer of hearing aids. On January 15, 1966, the defendant signed a contract to purchase a Model A-660 Acousticon hearing aid from the plaintiff. The defendant specified Model A-660 because he had been tested at a hearing aid clinic and had been informed that the best hearing aid for his condition was this Acousticon model. An ear mold was fitted to the defendant and the plaintiff ordered Model A-660 from Acousticon.

On February 2, 1966, in response to a call from the plaintiff the defendant went to the plaintiff's office for his hearing aid. At that time he was informed that Model A-660 had been modified and improved, and that it was now called Model A-665. This newer model had been delivered by Acousticon for the defendant's use. The defendant denies that he understood this was a different model number. The hearing aid was fitted to the defendant. The defendant complained about the noise, but was assured by the plaintiff that he would get used to it.

The defendant tried out the new hearing aid for the next few days for a total use of 15 hours. He went back to the hearing clinic, where he was informed that the hearing aid was not the model that he had been advised to buy. On February 8, 1966, he returned to the plaintiff's office complaining that the hearing aid gave him a headache, and that it was not the model he had ordered. He returned the hearing aid to the plaintiff, for which he received a receipt. At that time the plaintiff offered to get Model A-660 for the defendant. The defendant neither consented to nor refused the offer. No mention was made by either party about canceling the contract, and the receipt given by the plaintiff contained no notation or indication that the plaintiff considered the contract canceled or rescinded.

The plaintiff immediately informed Acousticon of the defendant's complaint. By letter dated February 14, 1966, Acousticon writing directly to the defendant, informed him that Model A-665 was an improved version of model A-660, and that they would either replace the model that had been delivered to him or would obtain Model A-660 for him. He was asked

to advise the plaintiff immediately of his decision so that they could effect a prompt exchange. After receiving this letter the defendant decided that he did not want any hearing aid from the plaintiff, and he refused to accept the tender of a replacement, whether it be Model A-665 or A-660.

The plaintiff is suing for the balance due on the contract. Although he had made a down payment of $80.00, the defendant made no claim for repayment of his down payment until the case was ready to go to trial. The plaintiff objected to the counterclaim as being untimely. There is nothing in the pleadings to show that such a claim had been previously made by the defendant and, therefore, the court will not consider any counterclaim in this matter.

The question before the court is whether or not the plaintiff, having delivered a model which admittedly is not in exact conformity with the contract, can nevertheless recover in view of his subsequent tender of the model that did meet the terms of the contract.

The defendant contends that since there was an improper delivery of goods, the buyer has the right to reject the same under Sections 2-601 and 2-602(2)(c) of the Uniform Commercial Code. He further contends that even if the defendant had accepted delivery he may, under Section 2-608(1)(b) of the U.C.C., revoke his acceptance of the goods because ‘his acceptance was reasonably induced * * * by the seller's assurances.’ He also relies on Section 2-711, claiming that he may recover not only the down payment but also consequential damages.

The defendant, however, has neglected to take into account Section 2-508 of the Uniform Commercial Code which has added a new dimension to the concept of strict performance. This section permits a seller to cure a non-conforming delivery under certain circumstances. Subparagraph (1) of this section enacts into statutory law what had been New York case law. This permits a seller to cure a non-conforming delivery before the expiration of the contract time by notifying the buyer of his intention to so cure and by making a delivery within the contract period. This has long been the accepted rule in New York. (Lowinson v. Newman, 201 App.Div. 266, 194 N.Y.S. 253; Portfolio v. Rubin, 196 App.Div. 316, 187 N.Y.S. 302).

However, the U.C.C. in sub-paragraph (2) of Section 2-508 goes further and extends beyond the contract time the right of the seller to cure a defective performance. Under this provision, even where the contract period has expired and the buyer has rejected a non-conforming tender or has revoked an acceptance, the seller may ‘substitute a conforming tender’ if he had ‘reasonable grounds to believe’ that the nonconforming tender would be

accepted, and ‘if he seasonably notifies the buyer’ of his intention ‘to substitute a conforming tender.’ (51 NY Jur. Sales, p. 41).

This in effect extends the contract period beyond the date set forth in the contract itself unless the buyer requires strict performance by including such a clause in the contract. “The section (2-508(2) U.C.C.) rejects the time-honored and perhaps time-worn notion that the proper way to assure effective results in commercial transactions is to require strict performance. Under the Code a buyer who insists upon such strict performance must rely on a special term in his agreement or the fact that the seller knows as a commercial matter that strict performance is required.” (48 Cornell Law Quarterly 13; 29 Albany Law Review 260).

This section seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. (Official Comment, McKinney's Cons.Laws of N.Y., Book 62 1/2, Uniform Commercial Code, Section 2-508).

An additional burden, therefore, is placed upon the buyer by this section. ‘As a result a buyer may learn that even though he rejected or revoked his acceptance within the terms of Sections 2-601 and 2-711, he still may have to allow the seller additional time to meet the terms of the contract by substituting delivery of conforming goods.’ (Bender's U.C.C. Service-Sales and Bulk Transfers-Vol. 3, Section 14-02(1)(a)(ii)).

Has the plaintiff in this case complied with the conditions of Section 2-508?

The model delivered to the defendant was a newer and improved version of the model than was actually ordered. Of course, the defendant is entitled to receive the model that he ordered even though it may be an older type. But under the circumstances the plaintiff had reasonable grounds to believe that the newer model would be accepted by the defendant.

The plaintiff acted within a reasonable time to notify the defendant of his tender of a conforming model. (Section 1-204 U.C.C.). The defendant had not purchased another hearing aid elsewhere. His position had not been altered by reason of the original non-conforming tender.

The plaintiff made a proper subsequent conforming tender pursuant to Section 2-508(2) of the Uniform Commercial Code.

Judgment is granted to plaintiff.

PARKER v. BELL FORD, INC., 425 So.2d 1101 (Ala.,1983)

EMBRY, Justice.

This appeal is from a judgment entered on a directed verdict in behalf of the defendants Bell Ford, Inc. and Ford Motor Company, Inc. We affirm.

Plaintiff A.B. Parker purchased a 1979 Ford F-100 pickup truck from defendant Bell Ford, Inc. of Atmore, Alabama, on 6 August 1979. The purchase price was $6,155.40. The truck was manufactured by defendant Ford Motor Company, Inc., which provided the new truck warranty on the vehicle. Parker made several complaints to Bell Ford of excessive tire wear requiring replacement of the tires on the vehicle after approximately 4,000 miles of use. Bell Ford gave Parker a purchase order to have the vehicle aligned at Combs & Dailey, an alignment shop in Mobile, where repairs were allegedly made on the vehicle. Parker was not informed as to what had been done to the vehicle at the alignment shop. Whatever work was performed, however, did not cure Parker's complaint of excessive tire wear and his second set of tires had to be replaced shortly thereafter.

Parker never returned the vehicle to Bell Ford for repairs and never registered any further complaint with Bell Ford until Parker initiated suit against Bell Ford and the manufacturer, the Ford Motor Company. At an inspection of the vehicle after this suit was filed, it was determined by the service manager of Peach Ford, Inc. of Brewton, Alabama, that the vehicle had a defective wheel housing, causing the tires to wear excessively.

On 1 July 1980 Parker filed his complaint containing four counts: one against Bell Ford for misrepresentation; one against Bell Ford for breach of contract; one against Bell Ford and Ford Motor Company for breach of warranty; and one against Bell Ford and Ford Motor Company for breach of implied warranty of merchantability. The trial court granted Ford Motor Company's motion to dismiss count four involving implied warranty of merchantability whereupon Parker amended his complaint accordingly. Parker originally demanded damages of $20,000; a later amendment increased that demand for damages to $30,000. After trial before a jury, upon motion, the trial court directed a verdict in favor of Bell Ford and Ford Motor Company and entered judgment accordingly.

Parker urges as error the trial court's direction of a verdict denying his claims. Parker contends there was a scintilla of evidence in support of the allegations of his complaint; therefore, the trial court should have allowed the case to go to the jury.

We disagree.

Section 7-2-607(3)(a), Code 1975, describes the buyer's obligation upon learning of a defect in a product he has accepted:

"(3) Where a tender has been accepted:

"(a) The buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy...."

The transaction between Parker and Bell Ford and Ford Motor Company was one that required compliance with § 7-2-607.

This court, on several occasions, has characterized notice, such as required by § 7-2-607, as a condition precedent to recovery. See *Smith v. Pizitz of Bessemer, Inc.*, 271 Ala. 101, 122 So.2d 591 (1960)…..Official notice has been determined to be the degree of notice which at least comports with the notice an ordinary tortfeasor would have of his breach of duty. *Page, supra.* The evidence adduced at trial reveals that Parker was not satisfied with the repairs made on behalf of Bell Ford by the alignment shop. Parker admits that at no time did he contact Ford Motor Company about this problem, nor did he return the vehicle to Bell Ford after he took the vehicle from the alignment shop.

"... Notice of breach serves two distinct purposes. First, express notice opens the way for settlement through negotiation between the parties.... Second, proper notice minimizes the possibility of prejudice to the seller by giving him 'ample opportunity to cure the defect, inspect the goods, investigate the claim or do whatever may be necessary to properly defend himself or minimize his damages while the facts are fresh in the minds of the parties.' " *Standard Alliance Industries, Inc. v. Black Clawson Company,* 587 F.2d 813, 826 (6th Cir.1978), *cert. denied,* 441 U.S. 923, 99 S.Ct. 2032, 60 L.Ed.2d 396 (1979), quoting in part from Note, *Notice of Breach and the Uniform Commercial Code,* 25 U.Fla.L.Rev. 520, 522 (1973).

Bell Ford had no notice that the work performed by Combs & Dailey did not eliminate Parker's tire wear problem. In fact, Bell Ford never heard from Parker again until six months later when it received the summons initiating this lawsuit. This court held in *Pizitz of*

Bessemer, supra, that one reason for the notice requirement is to apprise the vendor that a claim will be made against him and give him an opportunity to prepare a defense or notify his supplier. We expand that rationale to also include the requirement of notice in order to enable the seller to make adjustments or replacements, or to suggest opportunities for cure, to the end of minimizing the buyer's loss and reducing the seller's own liability to the buyer. See White and Summers, *Uniform Commercial Code,* § 11-9 (1972).

....The judgment in this case is due to be, and is hereby, affirmed.

EMANUEL LAW OUTLINES, INC. V. MULTI-STATE LEGAL STUDIES, INC., 899 F.Supp. 1081 (S.D.N.Y.,1995)

BERNARD NEWMAN, Senior Judge, by designation:

Emanuel Law Outlines, Inc. (hereinafter "ELO"), a publisher of study aids for law students, brings this diversity action against Multi-State Legal Studies, Inc., (hereinafter "Multi-State"), a company that conducts state bar review preparation courses. ELO seeks $60,000 in damages for breach of contract; Multi-State counterclaims for $20,000 in damages, alleging breach of contract by ELO. This matter arises under the court's diversity jurisdiction in conformity with 28 U.S.C. § 1332(a), and the case was tried to the court in a one day bench trial. Pursuant to F.R.C.P. Rule 52(a), the following constitutes the court's findings of fact and conclusions of law.

THE RECORD

ELO offered the following two witnesses: Lazar Emanuel (hereinafter Lazar), General Counsel and Vice President of ELO and Steven Emanuel (hereinafter Steven), President of ELO. Multi-State offered one witness, Robert Feinberg, Multi-State's President. The parties submitted 16 documentary exhibits.

CONTENTIONS OF THE PARTIES

ELO contends that Multi-State's failure to pay the base fees for the second and third years of a three year installment contract breaches the agreement. According to the relevant terms of the contract, ELO was to provide Multi-State with a criminal procedure outline supplement (hereinafter "supplement") no later than May 1, 1993. Although the supplement was not delivered until June 3, 1993, ELO maintains that it performed its obligation under the contract. ELO argues that: (1) Multi-State orally agreed to change the May 1, 1993 contractual deadline to early June 1993; (2) any alleged breach was cured under the terms of the contract; (3) any alleged breach by ELO caused by failing to meet the May 1, 1993 deadline was not material; (4) the nonconforming delivery did not substantially impair the value of the entire contract; and (5) Multi-State reinstated the contract by accepting the supplement without seasonably notifying ELO of the breach.

Multi-State maintains that the failure of ELO to provide the supplements by May 1, 1993 constituted a breach of the agreement and excused Multi-State's obligations under the contract. Specifically, Multi-State disputes the existence of any modification or waiver of the May 1, 1993 deadline. It is further asserted by Multi-State that it sent ELO two letters, dated April 27, 1993 and May 7, 1993 respectively, informing ELO that the failure to meet the May 1st deadline would be considered a material breach of the contract. When ELO did not provide the supplement by May 1, 1993, Multi-State claims that ELO breached the agreement and excused any further performance by Multi-State. Multi-State also insists that the failure to timely provide the supplement by the agreed-upon date caused damage to Multi-State's business in the amount of $20,000.

FINDINGS OF FACT

Since 1978. ELO (a New York corporation) has been a leading publisher and distributor of study aids for law students. Steven is the main editor and writer of the Emanuel Law Outline series. The corporation is a continuation of the business started by Steven during his first year at Harvard Law School. The company enjoys an outstanding reputation among law students across the country. In addition to writing and editing, Steven negotiates transactions

for the corporation. Lazar, Steven's father, is ELO's general counsel and administrative officer. An experienced attorney and businessman, Lazar runs the office, finalizes contracts, oversees all printing and production of materials, and supervises the collections of accounts.

Multi-State Legal Studies, Inc. (a California corporation) conducts bar review courses for law school graduates. The company, which employs approximately 15 people, offers courses in 42 states and is run by its president and founder Robert Feinberg, who is admitted to the bar of several states, including New York and California. As president of the company, Feinberg develops course materials, directs promotion and marketing of the company, and is one of Multi-State's principle lecturers around the country.

In August 1992, Feinberg contacted ELO to propose an agreement whereby ELO would provide materials which could be distributed to students enrolled in Multi-State's course. As a result, the parties entered into a three-year contract beginning September 1, 1992 and ending August 31, 1995. Under the contract, ELO was required to supply at least 950 copies of each of two volumes of capsule summaries in nine subjects tested on the California bar exam in each of the three years. Multi-State agreed to pay ELO a fee of $30,000 per year and in addition pay printing and delivery costs. ELO did not receive the second installment of the first year payment of $15,000 from Multi-State by the due date of December 1, 1992. Accordingly, Lazar wrote Feinberg at Multi-State informing him that the payment was overdue and Multi-State should either send payment or a signed note. On December 16, 1992, Multi-State issued its check in the sum of $15,000 to ELO. There were no other disputes regarding payment of the first year fees.

For all subjects except Constitutional Law and Criminal Procedure, ELO was required to take verbatim text of the Capsule Summaries it had published in the Emanuel Law Outline for the particular subject and cosmetically change them as required by Multi-State. For Constitutional Law, ELO was to prepare, edit, and revise a text outline from the review portion of the Constitutional Law Audio Tapes sold commercially by ELO. The Criminal Procedure Supplement was to be created from scratch by ELO, but be similar in format and detail to the other outlines provided to Multi-State.

Under the first year of the contract, ELO agreed to produce two volumes containing materials for eight of the subjects as well as a Criminal Procedure Supplement. The two volumes were to be delivered to ELO's warehouse no later than October 10, 1992, whereas the

supplement, because it required more time for preparation, was to be delivered to the warehouse no later than May 1, 1993. There is no dispute that respecting the two volumes, ELO adequately performed under the contract.

In February 1993, Steven underwent quadruple bypass surgery. As a result of a six week convalescent period, he fell behind in his work on the supplement. Multi-State was informed of the upcoming surgery sometime in January 1993. ELO contends that in accordance with an early April telephone conversation between Steven and Feinberg, Multi-State orally agreed to move back the deadline for the production of the supplement. Specifically, Steven testified that he told Feinberg he had fallen behind in his work due to the operation and while he could still meet the May 1, 1993 deadline, he hoped that the deadline could be “relaxed”. Steven also stated that Feinberg told him a delay would be acceptable if the supplement was ready by “early June”, and that it “doesn't sound like a big deal”. The evidence presented by Multi-State directly conflicts with ELO's claim. Feinberg, in his testimony, flatly denies that he ever agreed to any change in the May 1, 1993 deadline. He emphatically stated that “[i]n 17 years of business, I can never remember one oral waiver that I would have agreed to”.

Resolving this factual dispute, the court finds that there was insufficient evidence to establish any change in the May 1st deadline. First, ELO failed to produce written confirmation of any waiver. Considering the experience of both Steven and Lazar, it is likely that if such a change in terms of the contract were made, a confirmatory letter would have been sent by ELO to Multi-State. Moreover, it was demonstrated that ELO relied on the letter of the contract as evidenced by its written demand for payment very soon after the December deadline for the second installment. Accordingly, ELO did not treat changes in the terms of the agreement casually. In sum, no writing from Multi-State was ever produced to corroborate ELO's claim that there was any change in the May 1, 1993 deadline. Therefore, considering the experience of Steven and Lazar, the lack of any writing either sent to Multi-State or even kept in ELO's files, the practice of ELO to closely adhere to the contract terms, and the failure to produce any writing from Multi-State, the court finds the weight of the evidence in favor of Multi-State and concludes that there was no oral modification regarding the May 1, 1993 deadline.

However, another factual dispute arises regarding Multi-State's claim that two letters were sent to ELO regarding the May 1 deadline. The first letter, dated April 27, 1993,

purportedly notified ELO that failure to meet the May 1 deadline would be considered a material breach of the agreement. The second letter, dated May 7, 1993, purportedly canceled Multi-State's obligations under the contract based on ELO's failure to meet the May 1 deadline. ELO, on the other hand, insists that it did not receive either letter.

The court concludes that ELO did not receive either letter. As a member of the bar of several states including New York, a lecturer on the law, an experienced businessman, and negotiator of the contract, Feinberg must have been aware that the contract specifically called for *receipt* of notice by the breaching party.[1] Additionally, Feinberg admitted knowledge that ELO would hold him to the specifics of the contract. ELO was, in Feinberg's words, “sticklers” regarding the agreement (R. 186). Further, Feinberg testified that these letters, supposedly notifying ELO of a material breach, were sent by ordinary mail, rather than a method which provides proof of receipt. This is significant because *receipt* of written notice of a claimed breach by the breaching party was a critical factor under the contract. Finally, if these letters were received, common sense dictates that there would be some response from ELO regarding the letters. Not only was Multi-State unable to produce evidence of any written response from ELO, but Feinberg never clearly demonstrated that there was any oral response. Based on the evidence presented, even if the court were to assume the letters were sent, the evidence is insufficient to find that either letter was received by ELO.

When the May 1 deadline passed, Multi-State contacted ELO by phone stating that the materials were needed, to which ELO replied that the supplement was being rushed and that it would be forthcoming. Regarding the materials, a third factual dispute arises. The parties agree that the ELO materials were to be utilized by Multi-State bar review course to help marketability, improve the quality of the materials, and give the Multi-State students additional materials for study purposes. Feinberg further argues that he needed the supplement to help prepare his criminal procedure “early-bird” lecture. ELO responds that the materials were not meant to be used either for lecture preparation or as reference points in any of the lectures.

[1] The contract states: "9.(a) Initial Term: Neither party may terminate this Agreement during the Initial Term, except on account of a material breach by the other, which breach shall have gone uncured for 30 days after the breaching party has *received* written notice of breach (which notice shall contain specific details of the breach) from the non-breaching party." (emphasis added).

The court credits the position of ELO and determines that the primary purpose of the outlines was to act as a supplement to Multi-State's materials and not as a research or reference tool for lecturers. Multi-State had its own outlines, and for seventeen years has been conducting reviews specifically for the multi-state portion of the bar examination of which Criminal Procedure is a part. It is difficult to imagine that a lecturer of Feinberg's experience would need to rely on an outline prepared by another company. Indeed, the fact that the lecture was scheduled only 17 days after the contractual due date for the materials to arrive at ELO's warehouse, renders it unlikely that any lecturer would have been able to substantially rely on those materials for preparation…

The supplement did arrive at ELO's warehouse on June 3, 1993. After having the materials shipped by UPS, Multi-State received the materials on June 10, 1993 and distributed them to the students. Multi-State maintains that the late delivery caused substantial damage to its reputation. Stressing that the "key in our business is word of mouth," Multi-State argues that student satisfaction with the course is critical (R. 148). Although Feinberg testified that there were numerous complaints about the late shipment, no documentary evidence was produced regarding any negative feedback received by Multi-State.

On August 19, 1993 under the terms of the contract, ELO wrote Multi-State requesting instructions for printing and delivery of the materials for the second year of the contract. On August 23, 1993 Multi-State sent a fax to ELO stating that ELO's failure to deliver the supplement by the May 1 deadline constituted a material breach of the contract and consequently Multi-State was excused from all future obligations under the contract. This fax constituted the last correspondence between the parties.

DISCUSSION

By the terms of the contract, this case is governed by New York law. Since this action involves a contract for the sale of goods, New York's version of the Uniform Commercial Code is the applicable legal authority. Because the court concludes that there is insufficient evidence of any modification of the May 1, 1993 deadline for the supplement, the failure to print the supplement by that date constitutes a breach of contract. While the failure to meet the

deadline constituted a breach, the court credits ELO's contentions that the breach was subsequently cured as provided by the agreement and in any case, the delay was not a material breach. Accordingly, Multi-State was still bound by the contract.

A.

Multi-State did not give ELO adequate notice of the breach as required by the agreement. The contract unequivocally requires that the agreement may not be terminated unless the breaching party *receives* written notice of the breach and such breach is not cured more than 30 days after the receipt of such notice. New York law states, "[a] person *receives* a notice or notification when (a) it comes to his attention; or (b) it is duly delivered to [his] place of business ..." N.Y.U.C.C. § 1-201(26) (emphasis in the original). In this case, there was inadequate evidence to prove that ELO received either the April 27th or May 7th letter. Accordingly, ELO did not have notice of the breach.

Multi-State's claim that N.Y.U.C.C. § 2-607 does not require notice of a contract breach be received, is inapplicable to this case. While Multi-State accurately states the provision of § 2-607, it ignores the fact that in this case there was a specific provision requiring *receipt* of written notice of a breach. It is recognized within the Code itself that parties may vary the terms of the statute and determine the standards by which performance of obligation is to be measured under the code, as long as the variations do not disclaim the obligations of good faith, diligence, reasonableness, care and the standards are not manifestly unreasonable. N.Y.U.C.C. § 1-102; *see also, Prompt Elec. Supply Co. v. Allen-Bradley Co.,* 492 F.Supp. 344, 347-48 (E.D.N.Y.1980); *Dulman v. Martin Fein & Co.,* 66 A.D.2d 809, 810, 411 N.Y.S.2d 358, 359 (2d Dept.1978) (the code is to be interpreted "to allow businessmen to make the terms of their own contracts and to allow them to arrange their own affairs among themselves within the bounds of reason and fair play"). It cannot be said that the written receipt of notice requirement is unreasonable. ...

Since no notice of a breach was received by ELO prior to its performance on June 3, this Court finds that ELO cured any breach within the guidelines of the agreement. Hence, Multi-State presents no valid basis to justify non-performance of the contract.

B.

Even if the Court were to agree that there was an uncured breach of contract by ELO, Multi-State's right to be relieved of its obligations requires a demonstration of substantial impairment of the whole contract. Inasmuch as this contract requires the delivery of goods in separate lots to be separately accepted, it is an installment contract as defined by N.Y.U.C.C. § 2-612(1). Under § 2-612(3), Multi-State's right to cancel the entire agreement required a showing of substantial impairment of the whole contract. Whether a breach constitutes "substantial impairment" is a question of fact. *Stinnes Interoil v. Apex Oil Co.,* 604 F.Supp. 978, 981 (1985). When there is no predicate for finding that the breach substantially impaired the value of the contract, there is no basis for the buyer to repudiate the contract. "[A] late shipment of one installment may be treated as a breach of the entire contract only if the default with respect to one or more installments substantially impairs the value of the whole contract." *Trans Works Metals Inc. v. Southwire Co.,* 769 F.2d 902, 907 (2d Cir.1985) (*citing* N.Y.U.C.C. § 2-612(3)). Here, there is no evidence to support Multi-States argument that failure to have the supplements ready by May 1, 1993 substantially impaired the entire contract.

Multi-State's only contention with regard to damages is that the company received oral complaints from students enrolled in the course. This claim is tenuous at best, considering that Multi-State offered no proof of any written complaints, nor did it provide any written records of the complaints, and it failed to show that it had to refund any tuition money to students. Moreover, Multi-State's students did in fact receive eight of the nine promised outline on time and subsequently received the supplement more than a month prior to the bar exam.

Finally, Multi-State's own actions demonstrate the minor nature of any breach. When ELO shipped the goods in June, Multi-State made no effort to expedite delivery. Because it was responsible for the cost of shipping, it could have utilized any delivery method it desired, including overnight mail. Instead, Multi-State opted for UPS delivery, which is far from the fastest method. Inasmuch as Multi-State's actions do not indicate significant urgency, it would be very difficult for the court to so find.

Nor can it be said that the June delivery of the supplements had any effect on future enrollment in Multi-State's course. After the 1993 course, Multi-State no longer offered the full service California bar review course. It is undisputed that Multi-State's decision was

unrelated to the instant action. Since Multi-State no longer offered the full service course, ELO's breach could not have had any damaging effect whatsoever for subsequent years.

The very purpose of the substantial impairment requirement of N.Y.U.C.C. § 2-612(3) is to preclude a party from canceling the contract for trivial defects. Multi-State has failed to demonstrate any substantial or lingering harm incurred from ELO's failure to have the supplement ready by May 1, 1993. Accordingly, Multi-State had no legal justification for not performing on the contract.

CONCLUSION

With regard to ELO's claim, the court determines that while ELO's delay in delivering the supplement breached the agreement it was cured under the terms of the contract. Moreover, the delay in delivery did not substantially impair the value of the instant contract with Multi-State. Accordingly, Multi-State was not entitled to cancel its performance thereof. Therefore, ELO shall recover the sum of $60,000 plus prejudgment interest at the New York statutory rate accruing from August 23, 1993, which represents the date when Multi-State repudiated the contract. Further, Multi-State's counterclaim is hereby dismissed. Each party shall bear its own expenses.

The Clerk of the Court is directed to enter judgment accordingly.

Hypothetical

On September 5, 1980, Petitioner, Nathan Gappelberg, purchased a large screen Advent television set from Respondent, Neely Landrum, doing business as The Video Station. Gappelberg gave as consideration for the new set $2,231.25 cash and was allowed a $1,500 credit on the trade-in of his old set. Gappelberg immediately experienced numerous and different problems with the new set. Landrum and Alpha Omega, the authorized repair agency, made several house calls in an effort to repair the set. On September 26, 1980, the set totally ceased operating. Gappelberg allowed the television set to be removed from his home, but refused offers to make further repairs on the set, saying he simply wanted his money and

old set returned to him. Landrum felt he was in no position to return the old set, as he had promised it as a prize for a promotional sweepstakes, and offered Gappelberg another Advent as replacement. Gappelberg refused to accept the substitute, and brought suit against Landrum.

Gappelberg v. Landrum, 666 S.W.2d 88, 88-89 (Tex. 1984)

QUASI-CONTRACT; DIVISIBILITY

MARTIN v. SCHOENBERGER, 8 Watts & Serg. 367, 369 (Pa. 1845)
[Plaintiff sued to recover on a contract he had made. Plaintiff had promised to ship goods using only Reliance Transit Company and no further west than Hollidaysburg, PA. Plaintiff shipped via numerous transit companies, including Reliance, and to towns both east and west of Hollisdaysburg. The Plaintiff, therefore, had not fully performed the contract and sued for the value of his partial performance. In rejecting his claim, the court stated the following:]

To permit a man to recover for part performance of an entire contract, or to permit him to recover on his agreement where he has failed to perform, would tend to demoralize the whole country. If the law were so, a man would just perform as much of his contract as would suit his convenience or cupidity; all faith and fair dealing would be at an end, and all confidence between man and man would be destroyed. The law is settled … that he who has performed a special agreement to do a particular thing may recover the stipulated price of it by an action of indebitatus assumpsit, and use the agreement as evidence of the amount of compensation due. But if there be but part performance by the plaintiff of his part of the contract, he cannot recover…..No plaintiff ought ever to be permitted to recover for part performance of his engagements, unless prevented by the defendant from performing….”

LANCELLOTTI v. THOMAS, 341 Pa.Super. 1, 491 A.2d 117 (Pa.Super.,1985)
SPAETH, President Judge.

This appeal raises the question of whether a defaulting purchaser of a business who has also entered into a related lease for the property can recover any part of his payments made prior to default. The common law rule precluded a breaching buyer from recovering these payments. Today, we reject this rule, which created a forfeiture of the breaching buyer's payments and unjustly enriched the nonbreaching seller, and adopt § 374 of the Restatement (Second) Contracts (1979), which permits limited restitution. This case is remanded for further proceedings so that the trial court may apply the Restatement rule.

- 1-

On July 25, 1973, the parties entered into an agreement in which appellant agreed to purchase appellees' luncheonette business and to rent from appellees the premises on which the business was located. Appellant agreed to buy the name of the business, the goodwill, and equipment; the inventory and real estate were not included in the agreement for the sale of the business. Appellees agreed to sell the business for the following consideration: $25,000 payable on signing of the agreement; appellant's promise that only he would own and operate the business; and appellant's promise to build an addition to the existing building, which would measure 16 feet by 16 feet, cost at least $15,000, and be 75 percent complete by May 1, [1974].

It was also agreed that appellees would lease appellant the property on which the business was operated for a period of five years, with appellant having the option of an additional five-year term. The rent was $8,000 per year for a term from September 1, 1973, to August 31, 1978. A separate lease providing for this rental was executed by the parties on the same date that the agreement was executed. This lease specified that the agreement to build the existing building was a condition of the lease. In exchange for appellant's promise to build the addition, there was to be no rental charge for the property until August 31, 1973. Further, if the addition was not constructed as agreed, the lease would terminate automatically. An addendum, executed by the parties on August 14, 1973, modified this agreement, providing that “if the addition to the building as described in the Agreement is not constructed in

accordance with the Agreement, the Buyer shall owe the Sellers $6,665 as rental for the property ...” for the period from July 25, 1973, to the end of that summer season. The addendum also provided that all the equipment would revert to appellees upon the appellant's default in regard to the addition.

Appellant paid appellees the $25,000 as agreed, and began to operate the business. However, at the end of the 1973 season, problems arose regarding the construction of the addition. Appellant claims that the building permit necessary to construct the addition was denied. Appellees claim that they obtained the building permit and presented it to appellant, who refused to begin construction. Additionally appellees claim that appellant agreed to reimburse them if they built the addition. At a cost of approximately $11,000, appellees did build a 20 feet by 40 feet addition. In the spring of 1974 appellees discovered that appellant was no longer interested in operating the business. There is no evidence in the record that appellant paid any rent from September 1, 1973, as the first rental payment was not due until May 15, 1974. Appellees resumed possession of the business and, upon opening the business for the 1974 summer season, found some of their equipment missing.

Appellant's complaint in assumpsit demanded that appellees return the $25,000 plus interest. …

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At one time the common law rule prohibiting a defaulting party on a contract from recovering was the majority rule. J. Calamari and J. Perillo, The Law of Contracts § 11-26, at 427 (2d ed. 1977). However, a line of cases, apparently beginning with *Britton v. Turner,* 6 N.H. 481 (1834), departed from the common law rule. The merit of the common law rule was its recognition that the party who breaches should not be allowed “to have advantage from his own wrong.” Corbin, The Right of a Defaulting Vendee to the Restitution of Instalments Paid, 40 Yale L.J. 1013, 1014 (1931). As Professor Perillo states, allowing recovery “invites contract-breaking and rewards morally unworthy conduct.” Restitution in the Second *Restatement of Contracts,* 81 Colum.L.Rev. 37, 50 (1981). Its weakness, however, was its failure to recognize that the nonbreaching party should not obtain a windfall from the breach. The party who breaches after almost completely performing should not be more severely

penalized than the party who breaches by not acting at all or after only beginning to act. Under the common law rule the injured party retains more benefit the more completely the breaching party has performed prior to the default. Thus it has been said that "to allow the injured party to retain the benefit of the part performance ..., without making restitution of any part of such value, is the enforcement of a penalty or forfeiture against the contract-breaker." Corbin, *supra*, at 1013.

Critics of the common law rule have been arguing for its demise for over fifty years. *See* Corbin, *supra. See also* Calamari and Perillo, *supra*, at § 11-26; 5A Corbin on Contracts §§ 1122-1135 (1964); 12 S. Williston, A Treatise on the Law of Contracts §§ 1473-78 (3d ed. 1970). In response to this criticism an alternative rule has been adopted in the Restatement of Contracts.

…

In 1979, this rule was liberalized. Restatement (Second) of Contracts § 374 (1979) provides:

"§ 374. Restitution in Favor of Party in Breach

(1) Subject to the rule stated in Subsection (2), if a party justifiably refuses to perform on the ground that his remaining duties of performance have been discharged by the other party's breach, the party in breach is entitled to restitution for any benefit that he has conferred by way of part performance or reliance in excess of the loss that he has caused by his own breach.

(2) To the extent that, under the manifested assent of the parties, a party's performance is to be retained in the case of breach, that party is not entitled to restitution if the value of the performance as liquidated damages is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss."

Thus the first Restatement's exclusion of the willful defaulting purchaser from recovery was deleted, apparently in part due to the influence of the Uniform Commercial Code's permitting recovery by a buyer who willfully defaults. *Id.*, Reporter's Note at 218. Professor

Perillo suggests that the injured party has adequate protection without the common law rule.[1] Choosing "the just path," he therefore rejects the common law rule, explaining this choice by saying that times have changed. "What appears to be just to one generation may be viewed differently by another." Perillo, *supra,* at 50. *See also* 12 S. Williston, *supra,* § 1473, at 222 ("The mores of the time and place will often determine which policy will be followed.").

Many jurisdictions have rejected the common law rule and permit recovery by the defaulting party.

This development has been called the modern trend. *See Quillen v. Kelley,* 216 Md. 396, 140 A.2d 517 (1958). *See also* 12 S. Williston, *supra,* § 1473, at 222 (cases permitting recovery are now the weight of the authority); 5A Corbin on Contracts, *supra,* § 1122, at 3 (common law rule is broad statement not supported by the actual decisions). *But see* 1 G. Palmer, *The Law of Restitution* 568 (1978) (no valid generalization may be made regarding when a defaulting vendee can recover). It may be that the growing number of jurisdictions permitting recovery have been influenced by the widespread adoption of the Uniform Commercial Code § 2-718. *See, e.g., Maxey v. Glindmeyer,* 379 So.2d 297 (Miss.1980) (allowing recovery of excess of seller's actual damages in land sale contract by following the logic of the state statute equivalent to § 2-718 of the Uniform Commercial Code). Indeed, the common law rule is no longer intact even with respect to land sales contracts. *See, e.g., Honey v. Henry's Franchise Leasing Corp.,* 64 Cal.2d 801, 415 P.2d 833, 52 Cal.Rptr. 18 (1966); *McLendon v. Safe Realty Corp.,* 401 N.E.2d 80 (Ind.App.1980); *Newcomb v. Ray, supra; De Leon v. Aldrete, supra; and see* 1 G. Palmer, *supra,* at 596 n. 15 (citing cases).

In Pennsylvania, the common law rule has been applied to contracts for the sale of real property. *Kaufman Hotel & Restaurant Co. v. Thomas,* 411 Pa. 87, 190 A.2d 434 (1963); *Luria v. Robbins,* 223 Pa.Super. 456, 302 A.2d 361 (1973). In such cases, however, the seller has several remedies against a breaching buyer, including, in appropriate cases, an action for specific performance or for the purchase price. *See Trachtenburg v. Sibarco Stations, Inc.,*

[1] He identifies four types of protection: First, the defaulting party's right to recovery is subject to the aggrieved party's right to offset his damages. Second, the measure of benefit is limited to the actual enrichment and cannot exceed a ratable portion of the contract price. Third, restitution is denied to the extent that the criteria for a valid liquidated damages clause are present. Fourth, restitution is denied if the aggrieved party seeks and is entitled to specific performance. Perillo, *supra,* at 50 (footnotes omitted)

477 Pa. 517, 384 A.2d 1209 (1978). *See also* 5A Corbin on Contracts, *supra*, § 1145. As long as the seller remains ready, able, and willing to perform a contract for the sale of real property, the breaching buyer has no right to restitution of payments made prior to default. *See* 5A Corbin on Contracts, *supra*, at § 1130.

The common law rule has also been applied in Pennsylvania to contracts for the sale of goods. *Atlantic City Tire and Rubber Corp. v. Southwark Foundry & Machine Co.*, 289 Pa. 569, 137 A. 807 (1927). However, Pennsylvania has since adopted the Uniform Commercial Code, which, as to contracts for the sale of goods, has modified the common law rule by 13 Pa.C.S. § 2718(b), which permits a breaching party to recover restitution.

The viability of the common law rule permitting forfeiture has also been undermined in other areas of Pennsylvania law. In *Estate of Cahen*, 483 Pa. 157, 168 n. 10, 394 A.2d 958, 964 n. 10 (1978), the Supreme Court held that assuming that a breaching fiduciary could recover in unjust enrichment, the basis would be Restatement of Contracts § 357 (1932), which allows recovery by a breaching party to the extent that the benefits exceed the losses sustained by the other party.

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In regard to the present case, § 374 of the Restatement (Second) of Contracts represents a more enlightened approach than the common law rule. "Rules of contract law are not rules of punishment; the contract breaker is not an outlaw." Perillo, *supra*, at 50. The party who committed a breach should be entitled to recover "any benefit ... in excess of the loss that he has caused by his own breach." Restatement (Second) of Contracts § 374(1).

This conclusion leads to the further conclusion that we should remand this case to the trial court. The trial court rested its decision on the common law rule. Slip op. of trial court at 7-8. Thus it never considered whether appellant is entitled to restitution, Restatement (Second) of Contracts § 374(1), nor, if appellant is not entitled to restitution, whether retention of the $25,000 was "reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss," *id.*, § 374(2).

Remanded for further proceedings consistent with this opinion. Jurisdiction relinquished.

TAMILIA, Judge, dissenting:

I strongly dissent. In the first instance, the majority does not and cannot cite *any* Pennsylvania authority adopting the rule cited in § 374 of the Second Restatement of Contracts. Although the ostensible basis for remand is the trial court's reliance on outmoded law, the majority relies on law so new as to be virtually unknown in this jurisdiction. The law in Pennsylvania has been and continues to be that where a binding contract exists, and there is no allegation that the contract itself is void or voidable, a breaching party is not entitled to recovery. *Luria v. Robinson,* 223 Pa.Super. 456, 302 A.2d 361 (1978). While our Supreme Court may yet abrogate the forfeiture principle in this Commonwealth, it has not yet seen fit to do so, and we may not usurp its prerogatives, particularly when the result would be unjust.

Secondly, the Uniform Commercial Code § 2-718, cited by the majority in (partial) support, is applicable only to the sale of goods, and, while it and some of the equally inapplicable cases referred to by the majority may be part of a trend, the mainstream of contract law in Pennsylvania has not yet been diverted by it. Indeed the identification of the jurisdictions cited as the vanguard of change is for the most part questionable, as of those states relied upon to confer legitimacy on the majority's somewhat arbitrary conclusion, only one may be termed authoritative.

GILL v. JOHNSTOWN LUMBER CO., 151 Pa. 534, 538-540 (Pa. 1892)
OPINION BY MR. JUSTICE HEYDRICK:

[This lawsuit involves a contract to transport different types of lumber to the defendant lumber company. According to the Court, " Part of the lumber specified in the contract had been driven by plaintiff according to the contract, part he had attempted to drive but, after doing some work, stopped for want of water; some of this latter lumber was carried by the flood of May 31, 1889, into and through defendant's boom (the destination mentioned in the contract) and much of it was lost…."]

The single question in this cause is whether the contract upon which the plaintiff sued is entire or severable. If it is entire it is conceded that the learned court below properly directed a

verdict for the defendant; if severable, it is not denied that the cause ought to have been submitted to the jury. The criterion by which it is to be determined to which class any particular contract shall be assigned is thus stated in 1 Parsons on Contracts, 29-31: “If the part to be performed by one party consists of several and distinct items, and the price to be paid by the other is apportioned to each item to be performed, or is left to be implied by law, such a contract will generally be held to be severable. . . . But if the consideration to be paid is single and entire the contract must be held to be entire, although the subject of the contract may consist of several distinct and wholly independent items."

…

Applying the test of an apportionable or apportioned consideration to the contract in question, it will be seen at once that it is severable. The work undertaken to be done by the plaintiff consisted of several items, viz., driving logs, first, of oak, and second of various other kinds of timber, from points upon Stony creek and its tributaries above Johnstown to the defendant's boom at Johnstown, and also driving cross-ties from some undesignated point or points, presumably understood by the parties, to Bethel in Somerset county, and to some other point or points below Bethel. For this work the consideration to be paid was not an entire sum, but was apportioned among the several items at the rate of one dollar per thousand feet for the oak logs; seventy-five cents per thousand feet for all other logs; three cents each for cross-ties driven to Bethel, and five cents each for cross-ties driven to points below Bethel. But while the contract is severable, and the plaintiff entitled to compensation at the stipulated rate for all logs and ties delivered at the specified points, there is neither reason nor authority for the claim for compensation in respect to logs that were swept by the flood to and through the defendant's boom, whether they had been driven part of the way by the plaintiff or remained untouched by him at the coming of the flood. In respect to each particular log the contract in this case is like a contract of common carriage, which is dependent upon the delivery of the goods at the designated place, and if by casus the delivery is prevented the carrier cannot recover pro tanto for freight for part of the route over which the goods were taken: Wharton, Law of Contracts, sec. 714. Indeed this is but an application of the rule already stated. The consideration to be paid for driving each log is an entire sum per thousand feet for the whole distance and is not apportioned or apportionable to parts of the drive.

The judgment is reversed and a venire facias de novo is awarded.

CANTRELL-WAIND & ASSOCIATES, INC. v. GUILLAUME MOTORSPORTS, INC., 968 S.W.2d 72 (Ark.App.,1998)

BIRD, Judge.

Cantrell-Waind & Associates, Inc., has appealed from a summary judgment entered for appellee Guillaume Motorsports, Inc., in its action to recover a real estate brokerage commission. Because we agree with appellant that the circuit judge erred in his interpretation of the applicable law and because genuine issues of material fact remain to be tried, we reverse and remand.

On August 1, 1994, appellee, represented by its president and sole stock-holder Todd Williams, agreed to lease real property in Bentonville to Kenneth Bower and Kay Bower. The lease gave the Bowers an option to purchase and provided for the payment of a commission to appellant, the real estate broker in this transaction, as follows:

> "In the event of the *exercise* of this option within the first twenty-four (24) month period, ten per cent (10%) of the monthly rental payments shall apply to the purchase price. Thereafter, this credit shall reduce two per cent (2%) per year until the expiration of the original lease term hereof, to the effect that the credit will be eight per cent (8%) during the third year, six per cent (6%) during the fourth year, and four per cent (4%) during the fifth year. The sales price shall be $295,000.00. GUILLAUME MOTORSPORTS, INC., agrees [to] pay CANTREL-WAIND & ASSOCIATES, INC., a real estate commission of $15,200.00 upon closing of sale of the property under this Option to Purchase, provided the *closing* occurs within two (2) years from the date of execution of the Lease with Option to Purchase."

The Bowers' attorney, Charles Edward Young, III, notified Williams in writing on April 23, 1996, that the Bowers chose to exercise the option to purchase, and that they anticipated closing at the earliest possible date. Young also sent a copy of this letter to Samuel Reeves, appellee's attorney. Soon after this, Williams approached Mr. Bower and offered to credit him with one-half of the appellant's $15,200 commission if he would agree to delay closing until after August 1, 1996. Mr. Bower declined this offer.

Ruth Ann Whitehead, a loan officer at the Bank of Bentonville, notified Mr. Bower on July 19, 1996, that the loan had been approved and that she awaited notification of a closing date. In his deposition, Young said that he attempted to set a July closing date on behalf of the Bowers but had been told by Ms. Whitehead, Reeves, and a representative of the title

company that Williams had told them he would be out of the country in late July and unavailable for closing until after August 1.

Young also said that he had asked Reeves if Williams would utilize a power of attorney for closing before August 1 but Williams refused. Williams did not leave the country and was in Bentonville July 22 through 25. Closing occurred on August 14, 1996, and the commission was not paid.

Appellant filed a complaint against Guillaume Motorsports, Inc., on August 12, 1996, for breach of contract. Appellee moved for summary judgment on the ground that it was under no obligation to close the transaction before August 1. In support of its motion, appellee filed the affidavits of Ms. Whitehead and Mr. Carroll, who stated that, to their knowledge, a closing date was not scheduled before August 14, 1996.

Appellee Williams also filed his affidavit stating that a closing date was not established before August 14, 1996, and that the Bowers had not demanded an earlier closing date. Further, he admitted: “While I did in fact approach Kenneth Bower with a proposal to reduce the purchase price if he would agree to establish a closing date after August 1, 1996, my offer was not accepted and no such agreement was made.” He said although it would not have bothered him to put the closing off until after August 1, he did not think it was a “conscious decision” not to be available until after August 1.

In a hearing on the motion for summary judgment, counsel for appellee argued that neither the corporation nor Williams was under any obligation to close prior to August 1. He contended there was no bad faith to be inferred by the deliberate avoidance of a real estate commission that is keyed to a “drop-dead” date. He said the real estate broker agreed to the terms of the contract and was bound by it. Counsel pointed out the two separate terms used in the contract when referring to the option to purchase and the closing. The contract stated that to get the maximum discount in the purchase price the Bowers had to *exercise* the option before August 1, 1996. However, the clause referring to the commission stated that the transaction had to *close* by August 1. Counsel stated, “I believe my client had every right to do anything within his power, short of breaching his contract with this buyer, to see that this closing didn't occur earlier than that date so he would not owe the commission.”

In response to appellee's motion for summary judgment, appellant argued that appellee (by Williams) had a duty to act in good faith and that, in taking steps to prevent the

transaction from closing before August 1, 1996, appellee had not acted in good faith. Appellant contended that all contingencies and requirements for the loan had been satisfied by July 19, 1996, and that Mr. and Ms. Bower had attempted to establish a closing date before August 1, but had been deliberately prevented from doing so by Williams's misrepresentations that he would be out of the country and unavailable to close until after August 1….

In his order granting summary judgment, the judge stated that appellee had no obligation to appellant to arrange for a closing date that would have entitled appellant to a commission and said that the real estate commission was "clearly avoidable" by appellee….

The term of the contract providing that a commission would be due appellant only if closing occurred before August 1, 1996, is a condition precedent. *See Stacy v. Williams,* 38 Ark.App. 192, 834 S.W.2d 156 (1992). When a contract term leaves a decision to the discretion of one party, that decision is virtually unreviewable; however, courts will become involved when the party making the decision is charged with bad faith. *Vigoro Indus., Inc. v. Crisp,* 82 F.3d 785 (8th Cir.1996).

In *Willbanks v. Bibler,* 216 Ark. 68, 224 S.W.2d 33 (1949), the Arkansas Supreme Court held that "he who prevents the doing of a thing shall not avail himself of the nonperformance he has occasioned." *Id.* at 72, 224 S.W.2d at 35. *See also* Samuel Williston, *The Law of Contracts* § 677 (3d ed.1961). This principle is expressed in 17A Am.Jur.2d *Contracts* § 703 (1991):

"One who prevents or makes impossible the performance or happening of a condition precedent upon which his liability by the terms of a contract is made to depend cannot avail himself of its nonperformance. Even more broadly, where a promisor prevents or hinders the occurrence, happening, or fulfillment of a condition in a contract, and the condition would have occurred except for such hindrance or prevention, the performance of the condition is excused and the liability of the promisor is fixed regardless of the failure to perform the condition. Moreover, while prevention by one party to a contract of the performance of a condition precedent excuses the nonperformance of the condition, it must be shown that the nonperformance was actually due to the conduct of such party; if the condition would not have happened whatever such conduct, it is not dispensed with."

A party has an implied obligation not to do anything that would prevent, hinder, or delay performance…. Comment b to section 225 of the Restatement (Second) of Contracts (1981) provides that the non-occurrence of a condition of a duty is said to be "excused" when the condition need no longer occur in order for performance of the duty to become due: "It may be excused by prevention or hindrance of its occurrence through a breach of the duty of good faith and fair dealing." The Restatement (Second) of Contracts § 205 (1981) states: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." This legal principle also applies to contracts providing for the payment of commissions to real estate agents. *McKay and Co. v. Garland,* 17 Ark.App. 1, 701 S.W.2d 392 (1986). Accordingly, we hold that the circuit court erred in failing to recognize that a duty of good faith and fair dealing was included in this contract and, therefore, appellee was obligated to not deliberately avoid closing the transaction before August 1, 1996…..

Reversed and remanded.

SWARTZ v. WAR MEMORIAL COMMISSION OF CITY OF ROCHESTER, 25 A.D.2d 90, 267 N.Y.S.2d 253 (N.Y.A.D. 1966)

PER CURIAM:

Plaintiff's complaint, dismissed by Special Term for lack of merit, alleges, inter alia, that by contract with defendant Commission he has the exclusive concession for the sale of food and refreshments in the Rochester War Memorial Building; that on November 15, 1965 defendant Commission removed its prohibition against the sale of beer and ale therein and decided that sale thereof be permitted; that plaintiff chose not to sell said beverages; that on November 30, 1965 defendant Commission notified him that unless he made application for a license to sell beer and ale within 30 days he would be removed and would not be permitted to continue as concessionaire in said building. He further alleges that defendants threaten to violate his rights under the contract and he seeks a judgment declaring the rights and legal relations of the parties and decreeing that defendants are precluded by the contract from doing any act which may interfere with his right to continue as sole concessionaire…..

The introductory clause of the agreement recites: ‘It is the mutual desire of the parties hereto to enter into a contract whereby * * * the Concessionaire shall furnish such services as are hereinafter provided * * *’. The contract provides for sale of food, beverages, novelties, souvenirs, tobacco, cigars, candy, and other items. The contract further provides in paragraph 6 as follows:

“The privileges and sales rights granted herein shall not include the right to sell any alcoholic beverages during any period or periods in which such sale or sales are prohibited. However, in the event that such prohibition is removed at any time during the term of this agreement, the exclusive sales rights granted herein shall extend to the sale of such alcoholic beverages and the amount to be paid by the Concessionaire to the Commission on such sales as rental shall be identical to that provided for sales of food and beverages.”

The agreement recognizes the need of a license to sell beer and ale and provides that the Commission will cooperate with the Concessionaire in obtaining one. Although paragraph 6 contains no express provision requiring the Concessionaire to apply for a license, the thirteenth paragraph provides:

“Prior to entering into any and all operations contemplated hereunder, the Concessionaire shall obtain and keep in force all necessary local, state and/or federal permits or licenses * * *.”

Considering all the provisions of the contract and the inferences naturally derivable therefrom as to the intent and object of the parties in making it and the result which they intended to accomplish by its performance, we conclude that it was plaintiff's duty to attempt to qualify himself to sell beer and ale by applying for a license to do so.

Here the agreement expressed the mutual intent of the parties that plaintiff should perform the services provided for in the contract, one of which was to sell alcoholic beverages whenever the prohibition against such sale had been removed. The intent and object of the parties and the result which they intended to accomplish by its performance are apparent. Both

parties would derive income from its performance. The public would be convenienced by being able to purchase the food, beverages, and merchandise specified in the contract. Acceptance by plaintiff of the exclusive sales right given him by the contract was an assumption of its duties. Unless he sold the items specified in the contract neither party would derive income from it. His promise to pay defendant Commission a percentage of the gross receipts resulting from the exclusive agency was a promise to use reasonable efforts to bring profits and revenues into existence (Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 91, 92, 118 N.E. 214, 215). It was indispensable to defendant Commission that plaintiff having the exclusive right to sell should use all diligence to the end that sales be made of the specified items including beer and ale. (Booth v. Cleveland Rolling Mill Co., 74 N.Y. 15, 25.) The reasonable efforts and diligence required of plaintiff to bring profits and revenues into existence imposed upon him the duty to apply for a license to sell beer and ale. His failure to do so amounted to a default on his part of an obligation of the contract. The default continued unremedied for thirty days after his receipt of written notice of it, and the contract was terminated in accordance with its terms.

The judgment and order should be modified in accordance with this opinion, and as so modified affirmed.

STOP & SHOP, INC. v. GANEM, 347 Mass. 697, 200 N.E.2d 248 (Mass. 1964)

WHITTEMORE, Justice.

The defendants in this bill for declaratory relief are lessors under a percentage lease. They have appealed from the final decree in the Superior Court that ruled that the lease does not expressly or impliedly require the plaintiff, as lessee, to use the demised premises for any particular purpose or to keep the premises open and there engage in the supermarket business. Except for brief testimony which is reported, the facts were stipulated.

The lease, dated August 24, 1953, demised a lot and building at 154 Merrimack Street, Haverhill, for thirteen years and six months from September 1, 1953, for ‘the minimum rental’ of $22,000 a year and the further rent of 1 1/4% ‘of all gross sales' above $1,269,230.60 ‘made by the Lessee on the leased premises during each twelve month period.’ But the

percentage rent was to be paid only if sales at the demised premises and at premises in Lawrence exceeded $3,000,000 a year. …

The lease does not state the purposes for which the premises are to be used. Nothing therein in terms requires that the premises be used for any purpose or bars the opening by the lessee of places of business competitive to the lessee's business in the demised premises. The lease does, however, require the lessee to us suitable cash registers to record all sales, to keep accurate books, to furnish statements of gross sales on demand, and at the end of each yearly period to furnish such a statement certified by a certified public accountant. The testimony showed that when the lease was made the plaintiff was engaged in the supermarket business and that the lessors knew it. The premises prior to August 24, 1953, had been used for the conduct of a market.

The plaintiff had occupied the premises as a supermarket through 1962. It had paid percentage rent in 1956 ($2,288.15) and in 1957 ($377.21) but in no other year, and had paid excess taxes in each year. The plaintiff intended to cease operating a supermarket in the premises shortly after January 1, 1963, but to continue to pay the minimum rent and any excess real estate taxes and otherwise to conform to the lease. The defendant lessors had threatened suit to compel the continued operation of a supermarket or, alternatively, for damages.

The defendant lessors filed a counterclaim which alleged that the plaintiff beginning in 1956 had opened two competing stores in Haverhill, one within one-half mile and the other within about one mile of the demised premises. The prayers of the counterclaim were (1) that the lease be reformed to provide that the plaintiff continuously operate the premises as a supermarket, (2) that the plaintiff be ordered to pay to the defendants as part of the rent of the demised premises 1 1/4% of gross sales from all the plaintiff's stores in Haverhill in excess of $1,269,230.60, and (3) for general relief. An interlocutory decree sustained the plaintiff's demurrer to the counterclaim ‘with leave to amend denied.’ The lessors took no appeal from that decree.

Other facts are referred to later in the opinion.

The issue presented by the bill for declaratory relief is whether there is in the lease an implied covenant to continue operations. The counterclaim presents the issue whether the

lessee may open competing stores and then discontinue operations. We consider first the issue under the bill.

The controlling principles are well established. An omission to specify an agreement in a written lease is evidence that there was no such understanding. Snider v. Deban, 249 Mass. 59, 65, 144 N.E. 69. Covenants will not be extended by implication unless the implication is clear and undoubted. Smiley v. McLauthlin, 138 Mass. 363, 364-365; Mutual Paper Co. v. Hoague-Sprague Corp., 297 Mass. 294, 301, 8 N.E.2d 802. Justice, common sense and the probable intention of the parties are guides to construction of a written instrument. Clark v. State St. Trust Co., 270 Mass. 140, 153, 169 N.E. 897. 'Since the governing principle * * * is the justifiable assumption by one party of a certain intention on the part of the other, the undertaking of each promisor in a contract must include any promises which a reasonable person in the position of the promisee would be justified in understanding were included.' Williston, Contracts (Rev. ed.) § 1293, p. 3682.

The plaintiff contends that notwithstanding the interest of the lessors in having the premises operated so as to give it the benefit of possible percentage rent, the absence of an express requirement to operate together with a more than nominal minimum rent exclude the implication of a covenant to continue operations.

This may state too broad a rule. For even if there is a more than nominal minimum rent, other circumstances such as that the fixed rent is significantly below the fair rental value of the property might justify the conclusion that the parties intended that the lessors have the benefit of the percentage rent throughout the term.

The record does not show the fair rental value of the demised premises. An apparently substantial minimum rent in an apparently complete written lease, in the absence of a showing of disparity between the fixed rent and the fair rental value, gives ground for the inference that fixed rent and the lessee's self-interest in producing sales were the only assurance of rent that the lessor required. Other circumstances may give rise to the same inference. In cases where the minimum rent was not substantial continued operation has been held contemplated.

In *Smiley v. McLauthlin*, 138 Mass. 363, this court held that where rent under a lease of a brick yard was to be computed on the basis of bricks made with no provision for minimum rent, there was no implied covenant that the lessee would operate the yard. The opinion stressed the extrinsic circumstances attending the making of the lease. 'The premises leased

were not a brick yard in operation, equipped for work, but barren, unoccupied land. The parties did not know the amount of clay on the land, nor whether brick could be made on the land at a profit * * *. The lease, applied to the subject matter, furnishes indications that the parties regarded the enterprise as experimental, and that any stipulation binding the lessee to work the yard was purposely omitted.' Id. 138 Mass. at 365. The questions may be asked whether the parties did not intend a contract, and if so whether an implied covenant at least to try to operate the brick yard was the only consideration given by the lessee. Compare *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214. As to output and requirement contracts see Neofotistos v. Harvard Brewing Co. 341 Mass. 684, 686-687, 171 N.E.2d 865.

The minimum rent in this lease appears to be substantial. The figure of $22,000 is obviously not nominal in a lease that fixes as a base real estate tax figure the 1946 tax of 3,744.90. The total of real estate taxes for 1954 was $5,127.71. This roughly indicates the valuation for tax purposes of the demised premises at about the time the lease was made.

The burden of showing a disparity between fixed rent and fair rental value such as to furnish ground for implying a covenant to operate would be on the lessors.

Had the lessors brought an action for damages for breach of an implied covenant to continue operations they would, of course, have had the burden of showing the covenant. That the lessee initiated the proceeding for declaratory relief does not shift that burden to the lessee. ….

There is in this record no basis for implying a covenant to continue to operate beyond that time when in the business judgment of the lessee operations at the demised location, should cease. The lessors have not shown that 'a reasonable person in the position of the * * * [lessors] would be justified in understanding' (Williston, Contracts [Rev. ed.] § 1293) that such a covenant was intended and hence implied.

The percentage rent provision of course gave the lessors an interest in the lessee's operations of the demised premises as a retail store. We assume, without deciding, that such interest could be protected against certain acts of the lessee, as for example, discontinuance of operations for spite or to inflict harm. Such issues are outside this record for there is no intimation that the plaintiff has acted or proposes to act in respect of the leased premises otherwise than as its sound business judgment dictates in fairly promoting its retail business in Haverhill.

…

The allegations underlying the prayer that the sales of other stores be included in the computation of percentage rent are, that the 'plaintiff has not in good faith operated the demised premises so as to obtain the greatest volume of sales at this location, but has opened wrongfully [two] other stores at nearby locations, selling the same merchandise at lower prices.' The effect of the two newly opened stores was, it is alleged, to diminish sales. …The allegation 'not in good faith' adds nothing to the fact stated. In context, it says no more than that the plaintiff has acted in violation of implied obligations of the lease. The lessors do not contend otherwise.

The lessee, being free to disregard the effect on the lessors of its business decisions in respect of stopping operations, was free also to open stores elsewhere. We assume, without deciding, that had the lessee opened a competing store in the same location as the demised premises, that is adjacent, or nearly so, there might have been a basis for requiring it to regard the lessors' interest under the percentage rent provision in its conduct of the two stores. In such a case the lessee's acts would affirm the business advantage of remaining at the very place at which it had committed itself as tenant of the lessors. …But, on the allegations, this is plainly not such a case. At most we may infer that there is some overlap of the potential customer area of the two new stores with the demised premises.

The interlocutory decree sustaining the demurrer and the final decree …are affirmed.

So ordered.

MARKET STREET ASSOC'S LTD. PARTNERSHIP v. FREY, 941 F.2d 588 (7th Cir. 1991)

POSNER, Circuit Judge.

Market Street Associates Limited Partnership and its general partner appeal from a judgment for the defendants, General Electric Pension Trust and its trustees, entered upon cross-motions for summary judgment in a diversity suit that pivots on the doctrine of "good faith" performance of a contract. Cf. Robert Summers, " 'Good Faith' in General Contract

Law and the Sales Provisions of the Uniform Commercial Code," 54 *Va.L.Rev.* 195, 232-43 (1968). Wisconsin law applies-common law rather than Uniform Commercial Code, because the contract is for land rather than for goods, UCC § 2-102 …

We come at last to the contract dispute out of which the case arises. In 1968, J.C. Penney Company, the retail chain, entered into a sale and leaseback arrangement with General Electric Pension Trust in order to finance Penney's growth. Under the arrangement Penney sold properties to the pension trust which the trust then leased back to Penney for a term of 25 years. Paragraph 34 of the lease entitles the lessee to "request Lessor [the pension trust] to finance the costs and expenses of construction of additional Improvements upon the Premises," provided the amount of the costs and expenses is at least $250,000. Upon receiving the request, the pension trust "agrees to give reasonable consideration to providing the financing of such additional Improvements and Lessor and Lessee shall negotiate in good faith concerning the construction of such Improvements and the financing by Lessor of such costs and expenses." Paragraph 34 goes on to provide that, should the negotiations fail, the lessee shall be entitled to repurchase the property at a price roughly equal to the price at which Penney sold it to the pension trust in the first place, plus 6 percent a year for each year since the original purchase. So if the average annual appreciation in the property exceeded 6 percent, a breakdown in negotiations over the financing of improvements would entitle Penney to buy back the property for less than its market value (assuming it had sold the property to the pension trust in the first place at its then market value).

One of these leases was for a shopping center in Milwaukee. In 1987 Penney assigned this lease to Market Street Associates, which the following year received an inquiry from a drugstore chain that wanted to open a store in the shopping center, provided (as is customary) that Market Street Associates built the store for it. Whether Market Street Associates was pessimistic about obtaining financing from the pension trust, still the lessor of the shopping center, or for other reasons, it initially sought financing for the project from other sources. But they were unwilling to lend the necessary funds without a mortgage on the shopping center, which Market Street Associates could not give because it was not the owner but only the lessee. It decided therefore to try to buy the property back from the pension trust. Market Street Associates' general partner, Orenstein, tried to call David Erb of the pension trust, who was responsible for the property in question. Erb did not return his calls, so Orenstein wrote

him, expressing an interest in buying the property and asking him to “review your file on this matter and call me so that we can discuss it further.” At first, Erb did not reply. Eventually Orenstein did reach Erb, who promised to review the file and get back to him. A few days later an associate of Erb called Orenstein and indicated an interest in selling the property for $3 million, which Orenstein considered much too high.

That was in June of 1988. On July 28, Market Street Associates wrote a letter to the pension trust formally requesting funding for $2 million in improvements to the shopping center. The letter made no reference to paragraph 34 of the lease; indeed, it did not mention the lease. The letter asked Erb to call Orenstein to discuss the matter. Erb, in what was becoming a habit of unresponsiveness, did not call. On August 16, Orenstein sent a second letter-certified mail, return receipt requested-again requesting financing and this time referring to the lease, though not expressly to paragraph 34. The heart of the letter is the following two sentences: “The purpose of this letter is to ask again that you advise us immediately if you are willing to provide the financing pursuant to the lease. If you are willing, we propose to enter into negotiation to amend the ground lease appropriately.” The very next day, Market Street Associates received from Erb a letter, dated August 10, turning down the original request for financing on the ground that it did not “meet our current investment criteria”: the pension trust was not interested in making loans for less than $7 million. On August 22, Orenstein replied to Erb by letter, noting that his letter of August 10 and Erb's letter of August 16 had evidently crossed in the mails, expressing disappointment at the turn-down, and stating that Market Street Associates would seek financing elsewhere. That was the last contact between the parties until September 27, when Orenstein sent Erb a letter stating that Market Street Associates was exercising the option granted it by paragraph 34 to purchase the property upon the terms specified in that paragraph in the event that negotiations over financing broke down.

The pension trust refused to sell, and this suit to compel specific performance followed. Apparently the price computed by the formula in paragraph 34 is only $1 million. The market value must be higher, or Market Street Associates wouldn't be trying to coerce conveyance at the paragraph 34 price; whether it is as high as $3 million, however, the record does not reveal.

The district judge granted summary judgment for the pension trust on two grounds that he believed to be separate although closely related. The first was that, by failing in its

correspondence with the pension trust to mention paragraph 34 of the lease, Market Street Associates had prevented the negotiations over financing that are a condition precedent to the lessee's exercise of the purchase option from taking place. Second, this same failure violated the duty of good faith, which the common law of Wisconsin, as of other states, reads into every contract…. *Restatement (Second) of Contracts* § 205 (1981); 2 E. Allan Farnsworth, *Farnsworth on Contracts* § 7.17a (1990). In support of both grounds the judge emphasized a statement by Orenstein in his deposition that it had occurred to him that Erb mightn't know about paragraph 34, though this was unlikely (Orenstein testified) because Erb or someone else at the pension trust would probably check the file and discover the paragraph and realize that if the trust refused to negotiate over the request for financing, Market Street Associates, as Penney's assignee, would be entitled to walk off with the property for (perhaps) a song. The judge inferred that Market Street Associates didn't want financing from the pension trust-that it just wanted an opportunity to buy the property at a bargain price and hoped that the pension trust wouldn't realize the implications of turning down the request for financing. Market Street Associates should, the judge opined, have advised the pension trust that it was requesting financing pursuant to paragraph 34, so that the trust would understand the penalty for refusing to negotiate.

…. A court has to have a reason to interpolate a clause into a contract. The only reason that has been suggested here is that it is necessary to prevent Market Street Associates from reaping a reward for what the pension trust believes to have been Market Street's bad faith. So we must consider the meaning of the contract duty of "good faith." The Wisconsin cases are cryptic as to its meaning though emphatic about its existence, so we must cast our net wider. We do so mindful of Learned Hand's warning, that "such words as 'fraud,' 'good faith,' 'whim,' 'caprice,' 'arbitrary action,' and 'legal fraud' ... obscure the issue." *Thompson-Starrett Co. v. La Belle Iron Works,* 17 F.2d 536, 541 (2d Cir.1927). Indeed they do. Summers, *supra,* at 207-20; 2 *Farnsworth on Contracts,* supra, § 7.17a, at pp. 328-32. The particular confusion to which the vaguely moralistic overtones of "good faith" give rise is the belief that every contract establishes a fiduciary relationship. A fiduciary is required to treat his principal as if the principal were he, and therefore he may not take advantage of the principal's incapacity, ignorance, inexperience, or even naïveté. *Meinhard v. Salmon,* 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1928) (Cardozo, C.J.). If Market Street Associates were

the fiduciary of General Electric Pension Trust, then (we may assume) it could not take advantage of Mr. Erb's apparent ignorance of paragraph 34, however exasperating Erb's failure to return Orenstein's phone calls was and however negligent Erb or his associates were in failing to read the lease before turning down Orenstein's request for financing.

But it is unlikely that Wisconsin wishes, in the name of good faith, to make every contract signatory his brother's keeper, especially when the brother is the immense and sophisticated General Electric Pension Trust, whose lofty indifference to small (= < $7 million) transactions is the signifier of its grandeur. In fact the law contemplates that people frequently will take advantage of the ignorance of those with whom they contract, without thereby incurring liability. *Restatement, supra,* § 161, comment d. The duty of honesty, of good faith even expansively conceived, is not a duty of candor. You can make a binding contract to purchase something you know your seller undervalues. *Laidlaw v. Organ,* 15 U.S. (2 Wheat.) 178, 181 n. 2, 4 L.Ed. 214 (1817); *Teamsters Local 282 Pension Trust Fund v. Angelos,* 762 F.2d 522, 528 (7th Cir.1985); *United States v. Dial, supra,* 757 F.2d at 168; 1 *Farnsworth on Contracts, supra,* § 4.11, at pp. 406-10; Anthony T. Kronman, "Mistake, Disclosure, Information, and the Law of Contracts," 7 *J. Legal Stud.* 1 (1978). That of course is a question about formation, not performance, and the particular duty of good faith under examination here relates to the latter rather than to the former. But even after you have signed a contract, you are not obliged to become an altruist toward the other party and relax the terms if he gets into trouble in performing his side of the bargain. *Kham & Nate's Shoes No. 2, Inc. v. First Bank,* 908 F.2d 1351, 1357 (7th Cir.1990). Otherwise mere difficulty of performance would excuse a contracting party-which it does not. *Northern Indiana Public Service Co. v. Carbon County Coal Co.,* 799 F.2d 265, 276-78 (7th Cir.1986); *Jennie-O Foods, Inc. v. United States,* 217 Ct.Cl. 314, 580 F.2d 400, 409 (1978) (per curiam); 2 *Farnsworth on Contracts, supra,* § 7.17a, at p. 330.

But it is one thing to say that you can exploit your superior knowledge of the market-for if you cannot, you will not be able to recoup the investment you made in obtaining that knowledge-or that you are not required to spend money bailing out a contract partner who has gotten into trouble. It is another thing to say that you can take deliberate advantage of an oversight by your contract partner concerning his rights under the contract. Such taking advantage is not the exploitation of superior knowledge or the avoidance of unbargained-for

expense; it is sharp dealing. Like theft, it has no social product, and also like theft it induces costly defensive expenditures, in the form of overelaborate disclaimers or investigations into the trustworthiness of a prospective contract partner, just as the prospect of theft induces expenditures on locks. See generally Steven J. Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith," 94 *Harv.L.Rev.* 369, 393 (1980).

The form of sharp dealing that we are discussing might or might not be actionable as fraud or deceit. That is a question of tort law and there the rule is that if the information is readily available to both parties the failure of one to disclose it to the other, even if done in the knowledge that the other party is acting on mistaken premises, is not actionable. [cited cases omitted] All of these cases, however, with the debatable exception of *Guyer v. Cities Service Oil Co.,* 440 F.Supp. 630 (E.D.Wis.1977), involve failure to disclose something in the negotiations leading up to the signing of the contract, rather than failure to disclose after the contract has been signed. (*Guyer* involved failure to disclose during the negotiations leading up to a renewal of the contract.) The distinction is important, as we explained in *Maksym v. Loesch,* 937 F.2d 1237, 1242 (7th Cir.1991). Before the contract is signed, the parties confront each other with a natural wariness. Neither expects the other to be particularly forthcoming, and therefore there is no deception when one is not. Afterwards the situation is different. The parties are now in a cooperative relationship the costs of which will be considerably reduced by a measure of trust. So each lowers his guard a bit, and now silence is more apt to be deceptive. Cf. *AMPAT/Midwest, Inc. v. Illinois Tool Works Inc.,* 896 F.2d 1035, 1040-41 (7th Cir.1990).

Moreover, this is a contract case rather than a tort case, and conduct that might not rise to the level of fraud may nonetheless violate the duty of good faith in dealing with one's contractual partners and thereby give rise to a remedy under contract law. Burton, *supra,* at 372 n. 17. This duty is, as it were, halfway between a fiduciary duty (the duty of *utmost* good faith) and the duty merely to refrain from active fraud. Despite its moralistic overtones it is no more the injection of moral principles into contract law than the fiduciary concept itself is. *Tymshare, Inc. v. Covell,* 727 F.2d 1145, 1152 (D.C.Cir.1984); Summers, *supra,* at 204-07, 265-66. It would be quixotic as well as presumptuous for judges to undertake through contract law to raise the ethical standards of the nation's business people. The concept of the duty of good faith like the concept of fiduciary duty is a stab at approximating the terms the parties

would have negotiated had they foreseen the circumstances that have given rise to their dispute. The parties want to minimize the costs of performance. To the extent that a doctrine of good faith designed to do this by reducing defensive expenditures is a reasonable measure to this end, interpolating it into the contract advances the parties' joint goal.

It is true that an essential function of contracts is to allocate risk, and would be defeated if courts treated the materializing of a bargained-over, allocated risk as a misfortune the burden of which is required to be shared between the parties (as it might be within a family, for example) rather than borne entirely by the party to whom the risk had been allocated by mutual agreement. But contracts do not just allocate risk. They also (or some of them) set in motion a cooperative enterprise, which may to some extent place one party at the other's mercy. "The parties to a contract are embarked on a cooperative venture, and a minimum of cooperativeness in the event unforeseen problems arise at the performance stage is required even if not an explicit duty of the contract." *AMPAT/Midwest, Inc. v. Illinois Tool Works, Inc., supra,* 896 F.2d at 1041. The office of the doctrine of good faith is to forbid the kinds of opportunistic behavior that a mutually dependent, cooperative relationship might enable in the absence of rule. " 'Good faith' is a compact reference to an implied undertaking not to take opportunistic advantage in a way that could not have been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties." *Kham & Nate's Shoes No. 2, Inc. v. First Bank, supra,* 908 F.2d at 1357. The contractual duty of good faith is thus not some newfangled bit of welfare-state paternalism or (*pace* Duncan Kennedy, "Form and Substance in Private Law Adjudication," 89 *Harv.L.Rev.* 1685, 1721 (1976)) the sediment of an altruistic strain in contract law, and we are therefore not surprised to find the essentials of the modern doctrine well established in nineteenth-century cases, a few examples being *Bush v. Marshall,* 47 U.S. (6 How.) 284, 291, 12 L.Ed. 440 (1848); *Chicago, Rock Island & Pac. R.R. v. Howard,* 74 U.S. (7 Wall.) 392, 413, 19 L.Ed. 117 (1868); *Marsh v. Masterson,* 101 N.Y. 401, 410-11, 5 N.E. 59, 63 (1886), and *Uhrig v. Williamsburg City Fire Ins. Co.,* 101 N.Y. 362, 4 N.E. 745 (1886).

The emphasis we are placing on postcontractual versus precontractual conduct helps explain the pattern that is observed when the duty of contractual good faith is considered in all its variety, encompassing not only good faith in the *performance* of a contract but also good faith in its *formation,* Summers, *supra,* at 220-32, and in its *enforcement. Harbor Ins. Co. v.*

Continental Bank Corp., 922 F.2d 357, 363 (7th Cir.1990). The formation or negotiation stage is precontractual, and here the duty is minimized. It is greater not only at the performance but also at the enforcement stage, which is also postcontractual. "A party who hokes up a phony defense to the performance of his contractual duties and then when that defense fails (at some expense to the other party) tries on another defense for size can properly be said to be acting in bad faith." *Id.;* see also *Larson v. Johnson*, 1 Ill.App.2d 36, 46, 116 N.E.2d 187, 191-92 (1953). At the formation of the contract the parties are dealing in present realities; performance still lies in the future. As performance unfolds, circumstances change, often unforeseeably; the explicit terms of the contract become progressively less apt to the governance of the parties' relationship; and the role of implied conditions-and with it the scope and bite of the good-faith doctrine-grows.

We could of course do without the term "good faith," and maybe even without the doctrine. We could, as just suggested, speak instead of implied conditions necessitated by the unpredictability of the future at the time the contract was made. Farnsworth, "Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code," 30 *U.Chi.L.Rev.* 666, 670 (1963). …

But whether we say that a contract shall be deemed to contain such implied conditions as are necessary to make sense of the contract, or that a contract obligates the parties to cooperate in its performance in "good faith" to the extent necessary to carry out the purposes of the contract, comes to much the same thing. They are different ways of formulating the overriding purpose of contract law, which is to give the parties what they would have stipulated for expressly if at the time of making the contract they had had complete knowledge of the future and the costs of negotiating and adding provisions to the contract had been zero.

The two formulations would have different meanings only if "good faith" were thought limited to "honesty in fact," an interpretation perhaps permitted but certainly not compelled by the Uniform Commercial Code, see Summers, *supra*, at 207-20-and anyway this is not a case governed by the UCC. We need not pursue this issue. The dispositive question in the present case is simply whether Market Street Associates tried to trick the pension trust and succeeded in doing so. If it did, this would be the type of opportunistic behavior in an ongoing contractual relationship that would violate the duty of good faith performance however the duty is formulated. There is much common sense in Judge Reynolds' conclusion that Market

Street Associates did just that. The situation as he saw it was as follows. Market Street Associates didn't want financing from the pension trust (initially it had looked elsewhere, remember), and when it learned it couldn't get the financing without owning the property, it decided to try to buy the property. But the pension trust set a stiff price, so Orenstein decided to trick the pension trust into selling at the bargain price fixed in paragraph 34 by requesting financing and hoping that the pension trust would turn the request down without noticing the paragraph. His preliminary dealings with the pension trust made this hope a realistic one by revealing a sluggish and hidebound bureaucracy unlikely to have retained in its brontosaurus's memory, or to be able at short notice to retrieve, the details of a small lease made twenty years earlier. So by requesting financing without mentioning the lease Market Street Associates might well precipitate a refusal before the pension trust woke up to paragraph 34. It is true that Orenstein's second letter requested financing "pursuant to the lease." But when the next day he received a reply to his first letter indicating that the pension trust was indeed oblivious to paragraph 34, his response was to send a lulling letter designed to convince the pension trust that the matter was closed and could be forgotten. The stage was set for his thunderbolt: the notification the next month that Market Street Associates was taking up the option in paragraph 34. Only then did the pension trust look up the lease and discover that it had been had.

The only problem with this recital is that it construes the facts as favorably to the pension trust as the record will permit, and that of course is not the right standard for summary judgment. The facts must be construed as favorably to the nonmoving party, to Market Street Associates, as the record permits…. The district judge jumped the gun in choosing between these alternative characterizations. The essential issue bearing on Market Street Associates' good faith was Orenstein's state of mind, a type of inquiry that ordinarily cannot be concluded on summary judgment, and could not be here. If Orenstein believed that Erb knew or would surely find out about paragraph 34, it was not dishonest or opportunistic to fail to flag that paragraph, or even to fail to mention the lease, in his correspondence and (rare) conversations with Erb, especially given the uninterest in dealing with Market Street Associates that Erb fairly radiated. To decide what Orenstein believed, a trial is necessary. As for the pension trust's intimation that a bench trial (for remember that this is an equity case, since the only relief sought by the plaintiff is specific performance) will add no illumination beyond what

the summary judgment proceeding has done, this overlooks the fact that at trial the judge will for the first time have a chance to see the witnesses whose depositions he has read, to hear their testimony elaborated, and to assess their believability.

The judgment is reversed and the case is remanded for further proceedings consistent with this opinion.

Hypothetical

A sea wall the defendant contracted to build was destroyed by a storm before completion. The contract called for construction of a masonry wall, placing large quantities of riprap on the seaward side of the wall, filling in behind it, the driving of piles, and the use of both plain and reinforced concrete. The consideration named in the contract was based on specified unit prices for the various kinds of work involved, such as for each cubic yard of excavation, each cubic yard of fill, each cubic yard of cement masonry, etc. Payment was due in installments based on value of the labor performed and materials used. Each component of the wall was separately priced according to the quantity of work performed.

Bridgeport v. Scott Co., Inc., 94 Conn. 461, 109 A. 162 (1920)

ESTOPPEL; FORFEITURE

SHIPSVIEW CORP. v. BEECHE SYSTEMS CORP., 1996 WL 590910 (N.D.N.Y.,1996)
HURD, United States Magistrate Judge.

I. *INTRODUCTION*

Plaintiff Shipsview Corporation ("Shipsview") brought this 28 U.S.C. § 1332 diversity of citizenship action against defendant Beeche Systems, Inc. ("Beeche") alleging breach of contract. The basis of Shipsview's claim is that time was of the essence in a contract of sale with the defendant. Beeche defends on the ground that time was not of the essence, and counterclaims for anticipatory repudiation.

…

III. *FINDINGS OF FACT*

A. *The Agreement*

Shipsview is a bridge cleaning and painting contractor with its principal place of business in Plymouth, Massachusetts. In late 1993, Shipsview was the low bidder on a Connecticut bridge painting project. In January 1994, Shipsview contracted with the State of Connecticut to paint six bridges in the Towns of Meriden, Plainville, New Britain, and Hartford. …

Shortly after receiving the Connecticut contract, Shipsview began preliminary talks with Beeche regarding a bridge containment system for the Interstate-84 ("I-84") site in Hartford, Connecticut. In response to growing environmental concerns, bridge containment systems have emerged in the bridge painting business in the last five or six years. Before actual painting can begin, the bridge must be stripped of its existing layers of lead-based paint, a process requiring an elaborate system of containment in order to enclose the lead hazard and protect the workers and surrounding community.

The Beeche containment system is composed of three parts: the platform, the attachment apparatus, and the tarp enclosures. Once a containment system is designed and delivered to the site, a considerable amount of time, perhaps as long as two weeks, is spent assembling the platform. Next, the completed platform is erected under the bridge. To this point, approval of DOT is not required. DOT approval of the containment system is required, however, prior to hanging of the tarp enclosures and commencement of paint-stripping operations. …Approximately 75% of the containment system is composed of interchangeable standard parts which may be reused in future jobs, and the remaining 25% is custom manufactured to suit the individual project.

On March 26, 1994, the parties agreed that Beeche would design and deliver a bridge containment system for the I-84 site at a total cost of $210,435.00. Under the agreement, shipment was to be in eight to ten weeks from receipt of the order and initial deposit. Normally, Beeche required a deposit of fifty percent (50%) to be paid with an order to cover expenditures associated with purchasing parts and fabricating custom components, as well as securing a client's commitment. At Shipsview's request, however, the deposit terms were modified to extend payment over four installments: 15% with the order; 10% on April 4, 1994; 10% on April 11, 1994; and 15% on April 18, 1994.

The initial 15% deposit ($31,565.25) was received on March 29, 1994, thus triggering the eight to ten week delivery window. The next payment, scheduled for April 4, was not made until April 11, at which time Shipsview paid the 10% owing from April 4, and the 10% due on April 11 ($42,087.00). Thereafter, Shipsview became increasingly delinquent in deposit payment.

At the time of agreement, Beeche had only general details of the I-84 site based solely upon a visual inspection of the bridge. Upon Beeche's examination of the structural “as-built” drawings of the bridge, it was determined that a new platform design would better facilitate access to the I-84 site. On April 19, 1994, the parties agreed to an Option-III type platform, a modification of the original contract. Beeche immediately began engineering work on the modified system.

Adoption of the Option-III platform resulted in an increase in the purchase price to $269,514.00 to which both parties agreed. This corresponded with a proportionate increase in the required deposit. By letter of April 19, Beeche informed Shipsview of the modified deposit payment schedule. The original terms providing for four installments based on the original purchase price remained the same; the only change was an additional payment on April 25, 1994, which would account for the balance of the 50% deposit on the amended agreement. All other terms of the original contract remained in force.

B. *Problems in Performance.*

April 18, and 25, the dates of the 15% and remaining balance deposits, respectively, passed without payment being made. Due to the missed payments, an accumulated balance of $61,110.25 remained on the 50% deposit. On May 4, 1994, Beeche forwarded the engineering structural report for the Option-III platform to Shipsview, which in turn submitted it to DOT for approval.

On May 10, 1994, Beeche warned Shipsview that absent payment of the overdue deposit, fabrication of this project would cease and the delivery schedule would be delayed accordingly. Shipsview then tendered $10,000.00 toward payment, well short of the outstanding balance of $61,110.25. On May 13, 1994, Beeche informed Shipsview by letter fax, that the failure to pay the balance left no choice but to pull the project out of production. Later that same day in a second letter sent via fax, Beeche softened its tone, stating that failure

to pay the remaining $51,110.25 by May 16, 1994, would result in the system being pulled out of production. Receipt of the funds was necessary in order to continue fabricating parts according to the delivery schedule.

May 16 passed without Shipsview paying the deposit balance. On May 17, 1994, Gregory Beeche spoke with Deligiannidis regarding the final deposit payment. The parties agreed that Shipsview would send a check for $51,110.25 via Federal Express, to cover the entire balance due on the deposit.

On May 18, 1994, the parties exchanged correspondence outlining each other's interpretation of the previous day's discussions. Beeche's letter confirmed that the containment system would be delivered within three to three-and-one-half weeks after receipt of the deposit balance. With receipt of the final deposit payment on May 19, pursuant to Beeche's letter, the target date for delivery became June 13, 1994.

Deligiannidis' letter which contained the final deposit check ($51,110.25), unequivocally stated that payment was being made with the understanding that delivery of the platform was to be made by June 7, 1994. This date is significant because it marked the end of ten weeks from the date of the original contract. According to the letter, failure to deliver by June 7, would result in cancellation of the order and a demand for the return of all deposit funds. Similar language appeared on the back of the check which was deposited in the normal course of business. Both Gregory and Kirk Beeche saw the language regarding the June 7, delivery date on either the letter or check, but neither took the notice seriously.

There was no further oral communication between the parties after May 17, 1994. Gregory Beeche attempted to contact Deligiannidis by telephone three or four times in the ensuing weeks, but his calls went unanswered. On June 3, 1994, Beeche faxed Shipsview inquiring how Deligiannidis wished to proceed absent DOT approval. Beeche did not want to complete fabrication of the nonstandard components without DOT approval unless Deligiannidis provided a formal written order. At this point, Deligiannidis could have ensured both fabrication and shipment of the system, even absent DOT approval, simply by so instructing Beeche. Shipsview did not respond to Beeche's inquiry.

Delivery of the containment system did not occur on June 7, 1994. While DOT approval had not been obtained as of June 7, this was not enough to forestall delivery since assembly and attachment of the platform could have proceeded absent DOT approval. The system, quite

simply, was not ready to ship on June 7, because it was only roughly 90% complete. Neither side, however, was preparing for a June 7 delivery. A common carrier was never contacted, much less provided with directions, times, or telephone numbers for delivery. On June 7, 1994, there was no crew, crane, or forklift at the I-84 site to unload the anticipated trailers. Permission was not obtained for storage on one of the nearby lots, and security arrangements had not been made with respect to the portable aluminum cords which are valued as high as $300 a piece.

Deligiannidis testified that he was at the I-84 site on June 7, and that he remained there six to eight hours awaiting delivery of the system. Admitting that he had access to a telephone that day, Deligiannidis nonetheless stated that he made no effort to contact Beeche concerning the delay because he was “in a daze and ... too upset.” (Tr. at 125.) The next day, June 8, 1994, Shipsview canceled the order and demanded a full refund of the deposit money.

On June 8 or 9, Deligiannidis contacted KTA Environmental (“KTA”) regarding the possibility of providing an alternate containment system. On June 14, KTA's proposal for $18,700.00 was accepted by Shipsview, as was the subsequent upward modification of $2,500.00. The I-84 bridge painting job went forward with KTA providing the containment system.

On June 28, 1994, Shipsview commenced the current action alleging that Beeche breached the contract when it failed to deliver by June 7, 1994. At the time of trial, Shipsview claimed the return of the $134,762.50 deposit, and the $21,200.00 cost of designing a new containment system, for a total of $155,962.50 plus interest.

Beeche was “shocked” with Shipsview's cancellation of the contract on June 8. It contended that time was not of the essence, and it was to be allowed a reasonable time in which to deliver the system. Initially, Beeche sought adequate assurances of performance from Shipsview, but realized that it was not forthcoming in light of Shipsview's filing of this action. Beeche then found itself in a precarious financial situation and was forced to sell the system on the open market. On August 4, 1994, Beeche sold the system to EDT Company, another bridge painting company and subsidiary of Abhe & Svoboda, for $135,000.00, the price Beeche would have received if Shipsview had carried through on the contract.

Beeche contends that it did not breach the contract, but that the contract was, in fact, breached by Shipsview when it failed to perform. At trial, defendant claimed damages for lost profits in the amount of $34,141.92 because of plaintiff's alleged breach.

IV. *CONCLUSIONS OF LAW*

A. *Statement of the Law.*

The parties have agreed that this action is governed by New York law and the New York Uniform Commercial Code. Where a contract for the sale of goods fails to provide a time for shipment or delivery, the law requires delivery within a reasonable time. N.Y. U.C.C. § 2-309(1)(McKinney 1993); *see also Rosenfeld v. Basquiat,* 78 F.3d 84, 93 (2d Cir. 1996)(written contract for sale of goods need not contain delivery date, even though a delivery date was agreed upon). What constitutes a reasonable time is dependent upon "the nature, purpose and circumstances" of performance. N.Y. U.C.C. § 1-204(2)….

Time is never of the essence in an agreement which explicitly or impliedly provides for performance within a reasonable time. *John F. Trainor Co. v. G. Amsinck & Co.,* 236 N.Y. 392, 395 (1923). Nor is time of the essence in an agreement where the parties have waived time as an essential element of the contract. *Taylor v. Goelet,* 208 N.Y. 253, 259 (1913). Either party, though, may make or restore time as of the essence whenever it desires, simply by giving notice to that effect. *Id.; Mawhinney v. Millbrook Woolen Mills, Inc.,* 234 N.Y. 244, 249 (1922); N.Y. U.C.C. § 2-309(3). The notice must be clear, distinct and unequivocal; fix a reasonable time within which to act; and inform the other party that failure to perform by that date will be considered a default…It does not matter that the date is unilaterally set or that a party does not specifically state that time is of the essence "as long as the notice specifies a time ... and warns that failure to [perform] on that date will result in default." *Zev,* 134 A.D.2d at 557.

In sum, "courts do not allow a [cancellation] of the contract for mere delay in performance unless the parties have made time of the essence of the contract. The rule would seem to apply as aptly to contracts which when made leave indefinite the time of performance

as to contracts from which time as an essential element has been removed by acquiescence [or waiver] of the parties.

Taylor, 208 N.Y. at 259 (citation omitted)."

To prevail on a time of the essence claim, a party must show either that the contract specified a definite time of performance, or that notice was given which provided a reasonable fixed period within which to perform. *Id.* In the event of delay in a contract where time is of the essence, the nondefaulting party may cancel the contract or extend the time for performance and sue for damages resulting from the delay. *Mawhinney,* 234 N.Y. at 249.

B. *The Original Contract: Time is of the Essence.*

The original contract between Shipsview and Beeche executed on March 26, 1994, provided that shipment of the containment system occur within eight to ten weeks of Beeche's receipt of the order and deposit. Since the agreement provided for a definite time of delivery, i.e., eight to ten weeks, time was of the essence in the original contract. *See Towers Charter & Marine Corp.,* 894 F.2d at 523. It is of no significance that the original agreement did not provide a specific date such as June 7, 1994. A three week window for delivery is as fixed in the mind of the courts as a single day and will be treated with equal stringency. *See Mawhinney,* 234 N.Y. at 244 (time was of the essence in a contract which provided for delivery during the months of May, June and July; therefore, seller defaulted when delivery did not occur by July 31); *see also Schenectady Steel Co. v. Bruno Trimpoli General Constr. Co.,* 43 A.D.2d 234, 237 (3d Dep't)(where contract provided that time was of the essence and work was to be completed in 1968, appellant defaulted when the work was not finished on December 31, 1968), *aff'd,* 34 N.Y.2d 939 (1974). Thus, Beeche contracted to deliver the containment system in the eighth, ninth or tenth week. If delivery did not occur by the end of ten weeks, Beeche would be in default. When the order and deposit were received on March 29, 1994, Beeche had until June 7, 1994, in which to make timely delivery.

The subsequent modification in platform design and corresponding increase in purchase price had no effect on the delivery schedule of the system. Hence, time remained of the essence.

C. *The Delay in Deposit Payment: Time is No Longer of the Essence.*

Following the modification, Shipsview fell behind in deposit payments notwithstanding the fact that it understood the terms in both the original and modified contracts called for a 50% deposit. In early May 1994, Beeche made clear that delay in receipt of the deposit would stall production of the system and have a similar effect on delivery.

After a series of frustrating communications and apparent misunderstandings, Beeche sent Shipsview two letters via fax on May 13, 1994, and warned that the $51,110.25 deposit must be received by May 16, 1994, in order to continue fabrication of the project. Unless the funds were received by that date, Beeche would have no choice but to pull the project out of production. These notices made time of the essence with respect to the final deposit payment, and were clear, distinct and unequivocal. Moreover, in light of the parties' ongoing discussions and the fact that the full deposit was scheduled to be paid in April, the notices fixed a reasonable time in which to perform. Finally, the notices informed Shipsview of the consequences of nonperformance - delay in fabrication of the system.

Beeche's notices to Shipsview made the time of deposit an essential element of this contract. When May 16 passed without payment of the balance on deposit, Shipsview defaulted on the contract. At this point, Beeche had the option of canceling the contract or waiving the stipulation as to time and continuing negotiations with Shipsview. Beeche chose the latter course and reached a subsequent agreement with Shipsview regarding payment of the $51,110.25 balance. In continuing negotiations, time was waived as an essential element of this contract. Time was no longer of the essence to either side. Shipsview now had a reasonable time in which to pay, and Beeche had a reasonable time in which to deliver. *See Mawhinney*, 234 N.Y. at 248.

D. *Shipsview's Unsuccessful Attempt to Reimpose Time as of the Essence.*

Shipsview soon sought to reimpose time as an essential element of this contract. On May 19, 1994, Beeche received notice from Shipsview, both in the letter and on the back of the accompanying check, that payment was being made with the understanding that delivery of the system would occur no later than June 7, 1994, the deadline provided in the original

contract. Shipsview warned Beeche that failure to deliver by June 7, would result in cancellation of the contract and a demand for the return of all funds paid.

At first glance, this notice appears to reinstate time as of the essence in this contract. Not only is it clear, distinct and unequivocal, but it properly informs Beeche that failure to perform by June 7, would be considered a default. The facts and circumstances of this case, however, suggest that a June 7, delivery date no longer constituted a reasonable time in which to perform. *See Zev*, 73 N.Y.2d at 783 (must determine reasonableness on a case by case basis); N.Y. U.C.C. § 1-204. Devoid of reasonable time, a determining element of sufficient notice, time could not be restored as of the essence in this contract.

Shipsview last made a timely deposit payment on April 11, 1994. The next payment, scheduled one week later, was not made for an entire month, until May 10, 1994, and even then amounted to only partial payment. Significantly, Shipsview was warned that fabrication and ultimate delivery of the system might be delayed if payment was not made. Following the month-long delay in deposit payment, Beeche lacked the interim funds required to fabricate the system according to the original contract schedule.

When the deadline imposed by reasonable notice, May 16, 1994, passed without payment of the deposit balance, Beeche, true to its word, could have taken the system out of production. This would, of course, have made delivery of the system according to the terms of the original contract untenable. Again, Shipsview was notified of the potential consequences. Nothing, not even receipt of the delinquent payment on May 19, could place production of the system back on the original eight to ten week delivery track.

In light of the foregoing, this court finds that June 7, did not constitute a reasonable time for Beeche to perform. The more than thirty day delay in deposit payment in a contract that provided for performance within ten weeks made the attempted reimposition of the same delivery date as set forth in the original contract (June 7, 1994), quite simply, unreasonable. *See Zev*, 73 N.Y.2d at 783 ("Included within a courts determination of reasonable [time] are the ... previous conduct of the parties ... as well as the specific number of days provided for performance."); N.Y. U.C.C. § 1-204. Because it was unreasonable with respect to time, Shipsview's notice to Beeche to perform by June 7, 1994, "was not such a warning ... as the law requires." *Taylor*, 208 N.Y. at 260. Thus, time was not made of the essence. Beeche still had a reasonable time in which to deliver.

E. *The Actions of the Parties.*

An analysis of the parties' actions up to and beyond June 7, 1994, further supports the conclusion that time, ultimately, was not of the essence. Beeche's letter to Shipsview on May 18, 1994, confirmed delivery within three-and-one-half weeks after receipt of the balance due on deposit. This would have imposed a June 13, 1994, delivery date, a more probable one in light of the delay in deposit receipt. Shipsview, however, made no attempt to contact Beeche regarding the obvious difference in understanding as to delivery terms.

Beeche, in contrast, tried three or four times to contact Shipsview, albeit unsuccessfully, in the period leading up to June 7. Shipsview failed to return Beeche's telephone calls. On June 3, 1994, Beeche again resorted to fax and inquired of Shipsview how it wished to proceed. Again, Shipsview failed to respond; this, at a time when it could have ensured both fabrication and delivery of the system regardless of DOT approval, simply by issuing a written order. Surely, if Shipsview was adamant about a June 7, 1994, delivery date, then the company would have done more than simply exchange the contradictory letters of May 18. Deligiannidis would have done what any ordinary and reasonable businessman would have done - contacted Beeche and clarified delivery date and details.

Besides the failure to communicate with Beeche prior to June 7, Shipsview also failed to make arrangements for delivery. A common carrier was not contacted. No directions, times, or telephone numbers were exchanged between the parties in relation to a containment system delivery at the I-84 bridge site. In the event of delivery, no work crew was available to unload the trailers. Nor was there equipment available to assist in unloading, for example, a crane or forklift. Moreover, no security arrangements were made to oversee this $269,000.00 system which, incidentally, would lie in an empty parking lot until assembled. Without a single one of these preparations being made, Shipsview's claim that it expected delivery on June 7, 1994, is inconceivable.

Equally incredible was Deligiannidis' testimony that he remained at the I-84 site for six to eight hours on June 7, 1994, awaiting delivery. There was no corroborating testimony adduced at trial which placed Deligiannidis at the site on June 7. In any event, it was purposeless for him to be at the site when there was absolutely no indication, absent delivery preparations, that delivery would occur that day. Finally, the court fails to see why, if having a

cellular phone on his person, Deligiannidis would not simply call Beeche regarding the delay as opposed to wasting an entire day at the site. The explanation of this experienced businessman, that he was in a daze and too upset, is beyond belief.

Thus, the court finds that the parties' actions leading up to June 7, do not indicate that time was of the essence in this contract. In this period, communications lapsed and delivery arrangements were ignored. On June 7, 1994, neither party was prepared to send or receive the containment system, and the mutual inaction of the parties precludes a finding of time being of the essence.

The more plausible theory in this case is that the parties became increasingly frustrated in their dealings, and that Shipsview imposed a June 7, delivery date, suspecting that it could not be met, in an effort to avoid the contract. Shipsview's immediate contacting and contracting with KTA Environmental for an alternate containment system, and the filing of this action three weeks later, only supports this theory.

V. *CONCLUSION*

The defect in Shipsview's case is that it did not take the preliminary steps necessary to exercise the right of cancellation. *See Taylor*, 208 N.Y. at 261. The missing step, of course, was notice of a reasonable time in which to perform. Because June 7, 1994, did not provide a reasonable time, and because the parties' actions were not synonymous with a finding of time being of the essence, delivery need only have been performed within a reasonable time. Shipsview's cancellation of the contract on June 8, 1994, prior to giving adequate notice was premature, and has the effect of defeating its present claim.

Accordingly, it is ORDERED that: 1. The complaint and the counterclaim are both DISMISSED; and 2. Costs are DENIED to both parties. The Clerk of the Court is directed to enter judgment accordingly.

BURGER KING CORP. v. FAMILY DINING, INC., 426 F.Supp. 485 (D.C.Pa. 1977)
HANNUM, District Judge.

Presently before the Court is defendant's motion for an involuntary dismissal in accordance with Rule 41(b), Federal Rules of Civil Procedure, advanced at the close of plaintiff's case. The trial is before the Court sitting without a jury.

FACTS ESTABLISHED IN PLAINTIFF'S CASE

Plaintiff Burger King Corporation (hereinafter "Burger King") is a Florida corporation engaged in franchising the well-known Burger King Restaurants. In 1954, James W. McLamore, founder of Burger King Restaurants, Inc. (the corporate predecessor of Burger King) built the first Burger King Restaurant in Miami, Florida. In 1961 the franchise system was still relatively modest size having only about 60 or 70 restaurants in operation outside of Florida. By 1963, however, Burger King began to experience significant growth and was building and operating, principally through franchisees, 24 restaurants per year. It was also at this time that Burger King's relationship with defendant Family Dining, Inc., (hereinafter "Family Dining") was created.

Family Dining is a Pennsylvania corporation which at the present time operates ten Burger King Restaurants (hereinafter "Restaurant") in Bucks and Montgomery Counties in Pennsylvania. Family Dining was founded and is currently operated by Carl Ferris who had been a close personal friend of McLamore's for a number of years prior to 1963. In fact they had attended Cornell University together in the late 1940's. It would seem that this friendship eventually led to the business relationship between Burger King and Family Dining which was conceived in the "Burger King Territorial Agreement" (hereinafter "Territorial Agreement") entered on May 10, 1963.

In accordance with the Territorial Agreement Burger King agreed that Family Dining would be its sole licensee, and thus have an "exclusive territory," in Bucks and Montgomery Counties provided Family Dining operated each Restaurant pursuant to Burger King license agreements and maintained a specified rate of development. Articles I and II of the Territorial Agreement are pertinent to this dispute. They provide as follows:

"I

"For a period of one year, beginning on the date hereof, Company will not operate or license others for the operation of any BURGER KING restaurant within the following described territory hereinafter referred to as "exclusive territory," to-wit:

"The counties of Bucks and Montgomery, all in the State of Pennsylvania as long as licensee operates each BURGER KING restaurant pursuant to BURGER KING restaurant licenses with Company and faithfully performs each of the covenants contained.

"This agreement shall remain in effect and Licensee shall retain the exclusive territory for a period of ninety (90) years from the date hereof, provided that at the end of one, two, three, four, five, six, seven, eight, nine and ten years from the date hereof, and continuously thereafter during the next eighty years, Licensee has the following requisite number of BURGER KING restaurants in operation or under active construction, pursuant to Licenses with Company:

One (1) restaurant at the end of one year;

Two (2) restaurants at the end of two years;

Three (3) restaurants at the end of three years;

Four (4) restaurants at the end of four years;

Five (5) restaurants at the end of five years;

Six (6) restaurants at the end of six years;

Seven (7) restaurants at the end of seven years;

Eight (8) restaurants at the end of eight years;

Nine (9) restaurants at the end of nine years;

Ten (10) restaurants at the end of ten years; and continually maintains not less than ten (10) restaurants during the next eighty (80) years."

"II.

"If at the end of either one, two, three, four, five, six, seven, eight, nine or ten years from the date hereof, or anytime thereafter during the next eighty (80) years, there are less than the respective requisite number of BURGER KING operations or under active construction in the "exclusive territory" pursuant to licenses by Company, this agreement shall terminate and be of no further force and effect. Thereafter, Company may operate or license others for the operation of BURGER KING Restaurants anywhere within the exclusive territory, so long as such restaurants are not within the "Protected Area", as set forth in any BURGER KING Restaurant License to which the Licensee herein is a party."

The prospect of exclusivity for ninety years was clearly intended to be an inducement to Family Dining to develop the territory as prescribed and it appears that it had exactly this effect as Family Dining was to become one of Burger King's most successful franchisees. While Burger King considered Carl Ferris to be somewhat of a problem at various times and one who was overly meticulous with detail, it was nevertheless through his efforts which included obtaining the necessary financing and assuming significant risks, largely without assistance from Burger King, that enabled both parties to benefit from the arrangement.

On August 16, 1963 [nine months ahead of schedule], Family Dining opened the First Restaurant in King of Prussia, Pennsylvania. The second Restaurant was opened on July 2, 1965 [two months late], and the third Restaurant was opened October 19, 1966 [four months late].

However, by April, 1968, Family Dining had not opened or begun active construction on a fourth Restaurant which, in accordance with the development rate, should have been accomplished by May 10, 1967, and it was apparent that a fifth Restaurant would not be opened by May 10, 1968, the date scheduled. On May 1, 1968, the parties entered into a Modification of the Territorial Agreement (hereinafter “Modification”) whereby Burger King agreed to waive Family Dining's failure to comply with the development rate. There is nothing contained in the record which indicates that Burger King received anything of value in exchange for entering this agreement. However, McLamore testified that if the fourth and fifth Restaurants would be built nearly in compliance with the development rate for the fifth year he would overlook the year or so default in the fourth Restaurant. This attitude seems to be consistent with his overall view toward the development rate with respect to which, he testified, was “designed to insure the company of an orderly process of growth which would also enable the company to produce a profit on the sale of its franchises and through the collection of royalties that the restaurants would themselves produce.”

The fourth Restaurant was opened on July 1, 1968 [fourteen months late], and the fifth Restaurant was opened on October 17, 1968 [five months late].

On April 18, 1969, Ferris forwarded a letter to McLamore pertaining to certain delays in site approval and relating McLamore's earlier statement that there would be no problem in waiving the development schedule for the sixth Restaurant. The letter expressed Ferris' concern regarding compliance with the development rate. By letter dated April 26, 1969, from

Howard Walker of Burger King, Ferris was granted a month extension in the development rate. … On October 1, 1969, the sixth Restaurant was opened. The seventh Restaurant was opened on February 2, 1970, ahead of schedule…

At this point in time Burger King was no longer a modest sized franchise system. It had become a wholly owned subsidiary of the Pillsbury Company and had, in fact, evolved into a complex corporate entity. McLamore was elevated to Chairman of the Board of Burger King and, while he remained the chief executive officer for a time, Arthur A. Rosewall was installed as Burger King's President. Ferris was no longer able to expect the close, one to one relationship with McLamore that had previously obtained in his dealings with the company. It seems clear that as a result Family Dining began to experience difficulties in its day to day operations with Burger King.

One of the problem areas which arose concerned site selection. … In August, 1970, a Frankford Avenue location selected by Ferris was rejected by the [Burger King's] National Development Committee. The reasons offered in support of the decision to reject are not entirely clear and it seems that for the most part it was an exercise of discretion. The only plausible reason, given Ferris' expertise, was that the site was 2.7 miles from another Burger King franchise … outside Family Dining's exclusive territory. Yet Burger King chose not to exercise its discretion in similar circumstances when it permitted another franchisee to build a Restaurant in Devon, Pennsylvania, approximately 3 miles away from an existing Family Dining Restaurant.

…This was during a time, as Burger King management was well aware, where it was one thing to select a location and quite another to actually develop it. That is, local governing bodies were taking a much stricter view toward allowing this type of development. It was also during this time, Burger King realized that the Bucks-Montgomery territory was capable of sustaining substantially more Restaurants than originally thought.

Amidst these circumstances, the eighth Restaurant was opened ahead of schedule on October 7, 1970, at 601 South Broad Street in Lansdale, Pennsylvania. And in December, 1971, Burger King approved Family Dining's proposed sites for two additional Restaurants in Ambler, Pennsylvania and Levittown, Pennsylvania.

In early 1972, Arthur Rosewell became the chief executive officer of Burger King. At this time it also became apparent that the ninth Restaurant would not be opened or under

construction by May 10, 1972. On April 27, 1972, in a telephone conversation with McLamore, Ferris once again expressed his concern to Burger King regarding compliance with the development rate. McLamor indicated to him that, due to the fact that he was in the process of developing four sites at this time, the company would consider he had met, substantially, the requirements of exclusivity." McLamore testified that at that time he had in mind a further delay of 3 to 6 months.

In April, 1973, Burger King approved Family Dining's proposed site for a Restaurant in Warminster, Pennsylvania. However, as of May 10, 1973, neither the ninth or the tenth Restaurant had been opened or under active construction.

A letter dated May 23, 1973, from Helen D. Donaldson, Franchise Documents Administrator for Burger King, was sent to Ferris. The letter provides as follows:

"Dear Mr. Ferris:

"During a periodic review of all territorial agreements we note that as of this date your development schedule requiring ten restaurants to be open or under construction by May 10, 1973, has not been met. Our records reflect eight stores open in Bucks and/or Montgomery County, and one site approved but not manned.

"Under the terms of your territorial agreement failure to have the required number of stores in operation or under active construction constitutes a default of your agreement.

"If there are extenuating circumstances about which this office is not aware, we would appreciate your earliest advice."

It is doubtful that the Donaldson letter was intended to communicate to Ferris that the Territorial Agreement was terminated. The testimony of both Rosewall and Leslie W. Paszat, an executive of Burger King, who worked closely with Rosewall on the Family Dining matter indicates that even Burger King had not settled its position at this time. …

It seems that throughout this period Burger King treated the matter as something of a "hot potato" subjecting Ferris to contact with several different Burger King officials. … Ultimately Paszat was given responsibility for Family Dining and it appears that he provided Ferris with the first clear indication that Burger King considered the Territorial Agreement terminated in his letter of November 6, 1973. Burger King's corporate structure had become so complex

that the question of who, when or where the decision was made could not be answered. The abrupt manner in which Burger King's position was communicated to Family Dining, under the circumstances, was not straightforward.

From November, 1973, until some point early in 1975, the parties attempted to negotiate their differences with no success. The reason for the lack of success is understandable given that Burger King from the outset considered exclusivity a non-negotiable item. It was during this period on September 7, 1974, that Family Dining began actual construction of the ninth Restaurant in Warminster, Pennsylvania.

Several months before the instant litigation was begun Family Dining informed Burger King that it intended to open a ninth Restaurant on or about May 15, 1975, on Street Road, Warminster, Pennsylvania. …

In May, 1975, Burger King filed a complaint, which was the inception of this lawsuit, seeking to enjoin the use of Burger King trademarks by Family Dining at the Warminster Restaurant. … On May 13, 1975, the parties reached an agreement on terms under which the Burger King trademarks could be used …. Subsequently and also pursuant to this agreement Family Dining opened its tenth Restaurant in Willow Grove, Pennsylvania, the construction of which began on March 28, 1975.

DISCUSSION

Family Dining raises several arguments in support of its motion pursuant to Rule 41(b). One of its principal arguments is that the termination provision should be found inoperative because otherwise it would result in a forfeiture to Family Dining. For reasons which have become evident during the presentation of Burger King's case the Court finds Family Dining's position compelling both on legal and equitable grounds and is thus persuaded that the Territorial Agreement should not be declared terminated….

In bringing this suit Burger King maintains that the Territorial Agreement is a divisible contract wherein Family Dining promised to open or have under active construction one new Restaurant in each of the first ten years of the contract in exchange for which Burger King promised to grant one additional year of exclusivity for each new Restaurant. This, to be followed by an additional eighty years of exclusivity provided the first ten Restaurants were built on time. In support Burger King relies on the opening language of Article I of the

Territorial Agreement which provides that "(f)or a period of one year, beginning on the date hereof, Company will not operate or license . . ." It is thus argued that since Family Dining clearly failed to perform its promises the Court must, in accordance with the express language of Article II, declare the contract terminated. Burger King further argues that because Family Dining did not earn exclusivity beyond the ninth year, upon termination, it could not be found that Family Dining would forfeit anything in which it had an interest.

Contrary to the analysis offered by Burger King, the Court considers the development rate a condition subsequent, not a promise, which operates to divest Family Dining of exclusivity. Where words in a contract raise no duty in and of themselves but rather modify or limit the promisees' right to enforce the promise such words are considered to be a condition. Whether words constitute a condition or a promise is a matter of the intention of the parties to be ascertained from a reasonable construction of the language used, considered in liht of the surrounding circumstances. Feinberg v. Automobile Banking Corporation, 353 F.Supp. 508, 512 (E.D.Pa.1973). It seems clear that the true purpose of the Territorial Agreement was to create a long-term promise of exclusivity to act as an inducement to Family Dining to develop Bucks and Montgomery Counties within a certain time frame. A careful reading of the agreement indicates that it raises no duties, as such, in Family Dining. Both Article I and Article II contain language which refers to ninety years of exclusivity subject to limitation. For instance, Article I provides in part that "(t)his Agreement shall remain in effect and licensee shall retain the exclusive territory for a period of ninety (90) years from the date hereof, provided that at the end of one, two . . ." Failure to comply with the development rate operates to defeat liability on Burger King's promise of exclusivity. Liability, or at least Family Dining's right to enforce the promise, arose upon entering the contract. The fact that Burger King seeks affirmative relief premised on the development rate and the fact that it calls for a specified performance by Family Dining tend to obscure its true nature. Nevertheless, in the Court's view it is a condition subsequent. 8 P.L.E. Contracts §264 (1971).

Furthermore, the fact that performance is to occur in installments does not necessarily mean that the contract is divisible. Once again, this is a question of the intention of the parties ascertained, if possible, from a reasonable interpretation of the language used. Continental Supermarket Food Service, Inc. v. Soboski, 210 Pa.Super. 304, 232 A.2d 216, 217 (1967). In view of the fact that there was a single promise of exclusivity to have a ninety year duration,

assuming the condition subsequent did not occur by a failure to comply with the development rate, the Court believes, consistent with the views previously expressed herein, that the contract was intended to be entire rather than severable.

The question arises whether Burger King has precluded itself from asserting Family Dining's untimeliness on the basis that Burger King did not demand literal adherence to the development rate throughout most of the first ten years of the contract. Nothing is commoner in contracts than for a promisor to protect himself by making his promise conditional. Ordinarily a party would be entitled to have such an agreement strictly enforced, however, before doing so the Court must consider not only the written contract but also the acts and conduct of the parties in carrying out the agreement. As Judge Kraft, in effect, provided in Dempsey v. Stauffer, 182 F.Supp. 806, 810 (E.D.Pa.1960), after one party by conduct indicates that literal performance will not be required, he cannot without notice and a reasonable time begin demanding literal performance.

In the early going Burger King did not demand that Family Dining perform in exact compliance with the development schedule. It failed to introduce any evidence indicating that a change in attitude had been communicated to Family Dining. At the time of the Donaldson letter Family Dining's non-compliance with the development rate was no worse than it was with respect to the fourth and fifth Restaurants. The letter itself was sent by a documents administrator rather than a Burger King official and it seems to imply that the Territorial Agreement would not be terminated. Assuming that at some point between May and November, or even at the time of the Donaldson letter, Ferris realized literal performance would be required, the circumstances of this type of development are such that Burger King was unreasonable in declaring a termination such a short time after, if not concurrent with, notice that literal performance would be required.Considerable time was consumed in negotiations between November, 1973, until shortly before suit although it appears that these efforts were an exercise in futility given Burger King's view on exclusivity. Moreover, it could be expected that Burger King would have sued to enjoin any further progress by Family Dining, during this lengthy period, just as it did when Family Dining attempted to get the ninth Restaurant under way. The upshot being that the hiatus in development from November, 1973, until active construction began on the ninth and tenth Restaurants is not fully chargeable to Family Dining.

Based on the foregoing the Court concludes that Burger King is not entitled to have the condition protecting its promise strictly enforced.

Moreover and more important, even though a suit for declaratory relief can be characterized as neither legal nor equitable, United States Fidelity & Guaranty Co. v. Koch, 102 F.2d 288, 290 (3d Cir. 1939), giving strict effect to the termination provision involves divesting Family Dining of exclusivity, which, in the Court's view, would amount to a forfeiture. As a result the Court will not ignore considerations of fairness and believes that equitable principles, as well, ought to govern the outcome of this suit.

The Restatement, Contracts, §302 provides:

"A condition may be excused without other reason if its requirement

(a) will involve extreme forfeiture or penalty, and

(b) its existence or occurrence forms no essential part of the exchange for the promisor's performance."

Taking the latter consideration first, it seems clear that throughout the early duration of the contract Burger King was more concerned with a general development of the territory than it was with exact compliance with the terms of the development rate. Burger King offered no evidence that it ever considered literal performance to be critical. In fact, the evidence indicates quite the contrary. Even though McLamore testified that he never contemplated a delay of the duration which occurred with the ninth and tenth Restaurants, he felt a total delay of approximately 19 months with respect to the fourth and fifth Restaurants was nearly in compliance. On the basis of his prior conduct and his testimony considered in its entirety his comments on this point command little weight.

Clearly Burger King's attitude with respect to the development rate changed. Interestingly enough it was sometime after Burger King realized Bucks and Montgomery Counties could support substantially more than ten Restaurants as had been originally thought. It was also at a time after Rosewall replaced McLamore as chief executive officer.

Burger King maintains that Ferris' conduct indicates that he knew strict compliance with the development rate was required. This is based on the several occasions where Ferris expressed concern over non-compliance. However, during the presentation of Burger King's evidence it was established that Ferris was an individual who was overly meticulous with

details which caused him to be, in many respects, ignored by Burger King officials. Given this aspect of his personality and Burger King's attitude toward him very little significance can be attached to Ferris' expressions of concern. In short, the evidence fails to establish that either Burger King or Family Dining considered the development rate critical. If it eventually did become critical it was not until very late in the first ten years and in such a way that, in conscience, it cannot be used to the detriment of Family Dining.

As previously indicated, the Court believes that if the right of exclusivity were to be extinguished by termination it would constitute a forfeiture. In arguing that by termination Family Dining will lose nothing that it earned, Burger King overlooks the risks assumed and the efforts expended by Family Dining, largely without assistance from Burger King, in making the venture successful in the exclusive territory. While it is true that Family Dining realized a return on its investment, certainly part of this return was the prospect of continued exclusivity. Moreover, this is not a situation where Burger King did not receive any benefit from the relationship.

In making the promise of exclusivity Burger King intended to induce Family Dining to develop its Restaurants in the exclusive territory. There is no evidence that the failure to fulfill the time feature of this inducement was the result of any intentional or negligent conduct on the part of Family Dining. And at the present time there are ten Restaurants in operation which was all the inducement was intended to elicit. Assuming all ten were built on time Burger King would have been able to expect some definable level of revenue, a percentage of which it lost due to the delay. Burger King did not, however, attempt to establish the amount of this loss at trial.

In any event if Family Dining were forced to forfeit the right of exclusivity it would lose something of incalculable value based on its investment of time and money developing the area, the significant risks assumed and the fact that there remains some 76 years of exclusivity under the Territorial Agreement. Such a loss would be without any commensurate breach on its part since the injury caused to Burger King by the delay is relatively modest and within definable limits. Thus, a termination of the Territorial Agreement would result in an extreme forfeiture to Family Dining.

In accordance with the foregoing the Court finds that under the law and based upon the facts adduced in Burger King's case, it is not entitled to a declaration that the Territorial

Agreement is terminated. Therefore, Family Dining's Rule 41(b) motion for an involuntary dismissal is granted.

Hypothetical

In 1925 the City of East Orange, authorized the execution of a lease of 151 acres of city-owned land to the East Orange Golf Association. The lease referred to the city's desire to encourage athletic activities on the part of its citizens, and it provided that the rent to be paid by the association would be in the nominal sum of $ 1.00 per annum.

The Association expressly agreed in the lease to build a golf course of not less than 9 holes within two years, to extend it to 18 holes as soon as reasonably possible, and to maintain the course "for the sole use of the residents of the City of East Orange and their guests." The lease provided that if the association defaulted in any of the conditions for a period of 30 days, then it and any renewal would become null and void at the option of the city which would have the right to re-enter. The parties agreed that any violations of the lease would not be cumulative and that a waiver of any violation at any time would not be construed as a waiver of any subsequent violation.

The original lease of 1925 would have expired, after exercise of the option therein by the association, in 1945; it was first extended to 1955 and then to 1960 then to March 26, 1965. The extensions expressly provided that they were subject to all of the conditions set forth in the lease of 1925.

The Association, which had been incorporated as an association not for pecuniary profit proceeded with the raising of the necessary funds through the sale of bonds, and the building of the golf course at substantial cost. In 1927 a small additional parcel was added to the leased premises and a second parcel was added in 1936.

Mr. Peer, the current secretary of the Association, testified that during the Depression [the 1930's] , the Association was in dire need of members and vigorously sought them outside of East Orange as well as within East Orange. As a result the constituency of the association's membership shifted radically. Whereas in 1927 there were 465 members who were residents of East Orange and 92 members who were nonresidents, in 1938 there were

only 135 resident members as compared to 251 nonresident members. In 1961 there were only 82 resident members compared to 425 nonresident members.

The Association does not engage in any efforts to solicit East Orange memberships or to acquaint East Orange residents with its facilities. In 1957 the City Council of East Orange called the association's attention to the fact that there had been public dissatisfaction with its membership policies. Mr. Peer testified that at that time the members of the board of trustees held the view that they were giving priority to East Orange residents in the consideration of annual applications and were therefore "doing everything that was possible in that regard."

On August 8, 1961 Mr. MacArt from the City requested a list of the association's members in order to help ascertain whether there was a breach of the lease. In response he received a letter dated August 11 from Mr. Gedney of the Association which stated that there were 505 members of the club of whom 82 were residents of East Orange. Mr. Gedney closed his letter with the following: "It is not denied that the paragraph in the lease obligating the Association to maintain the golf course for the sole use of the residents of the City of East Orange and their guests has been technically breached, practically since the beginning of the term of the original lease. Were this not so, there would have been no golf course, for the use of any of the residents of East Orange. This has been well known at all times to the City officials concerned with the matter. The Association feels that under these circumstances it would be unconscionable for the City now to attempt to cancel the Association's lease on account of this breach, after having permitted the Association in reliance on the lease to invest a very large amount of money over so many years in placing upon the leased land improvements which at the termination of the lease will become the property of the owner of the land."

On September 18, 1961, James W. Kelly, Jr., Mayor of East Orange, advised the City Council that, in view of all that had transpired, he was recommending that immediate action be taken to cancel the lease between the city and the association.

East Orange v. Board of Water Comm'rs, 41 N.J. 6, 9-17 (N.J. 1963)

SATISFACTION

WESTERN HILLS, OREGON, LTD. v. PFAU, 265 Or. 137, 508 P.2d 201 (Or. 1973)
McALLISTER, Justice.

This is a suit to compel specific performance of an agreement to purchase real property. The plaintiff, the owner of the property, is a limited partnership. Defendants are members of a joint venture, formed for the purpose of purchasing the property from plaintiff and developing it. The trial court found that plaintiff was entitled to specific performance of the agreement, and entered its decree accordingly. Defendants appeal, contending that they were excused from performing by a failure of a condition contained in the agreement, and that the agreement is too indefinite to permit specific enforcement.

Plaintiff Western Hills owned a tract of approximately 286 acres in Yamhill County which it had listed for sale with a Salem real estate firm. Defendant Pfau, who is also a real estate broker, heard about this listing early in 1970. He contacted the other defendants, and they jointly submitted a proposal to purchase the property. Their original proposal was not accepted, but negotiations with Western Hills took place which culminated, on or about March 6, 1970, in the execution of the written agreement which is the subject of this suit. The agreement consists of a filled-in form entitled 'Exchange Agreement' together with several attached documents. Generally, it provides that in exchange for the Yamhill County property, defendants agreed to pay Western Hills $15,000 in cash, to convey to Western Hills four parcels of real property 'subject to appraisal and acceptance' by Western Hills, and to pay a balance of $173,600 on terms specified in the agreement. In addition to other terms not material to this appeal, the agreement provides:

"Closing of transaction is subject to ability of purchasers to negotiate with City of McMinnville as to a planned development satisfactory to both first and second parties within 90 days from date. A reasonable extension not to exceed 6 months to be granted if necessary."

Defendants made preliminary proposals for a planned development to the McMinnville Planning Commission, but, although the Commission's reaction to these proposals was favorable, defendants abandoned their attempts to secure approval of a development plan. In

September, 1970, defendant Pfau, who represented the other defendants in the transaction, met with some of the partners in Western Hills and notified them that defendants did not wish to go through with the purchase. Western Hills refused to release defendants from the agreement. This suit followed.

Defendants contend that their obligation to purchase the property never became absolute because the condition quoted above was never fulfilled. It appears from the evidence that defendants did not proceed with their application for Planning Commission approval of a planned development because they believed the development would be too expensive, primarily because city sewers would not be available to serve the property for several years. Immediate development would have required the developers to provide a private system of sewage treatment and disposal.

It also appears that at the time they executed the agreement, defendants knew that city sewers would not be available for some time. Defendants' initial offer of purchase included a proposal that the closing of the transaction be subject to satisfactory sewer development. This term was deleted from the final agreement; because, according to plaintiff's witnesses, the parties knew that sewers would not be available. Pfau testified that he agreed to the deletion of that term because he was led to believe that the provision for approval of a planned development accomplished the same thing.

The question is whether defendants were excused from performing their agreement to purchase the property because they never secured the city's approval of a ‘satisfactory’ planning development, when the evidence shows that they abandoned their application for an approved planned development because the expense of providing an alternative sewer system made the development financially unattractive. In Anaheim Co. v. Holcombe, 246 Or. 541, 426 P.2d 743 (1967) we considered an earnest money agreement which contained a provision making the purchaser's offer ‘contingent on obtaining a loan of $25,000.’ We held that when an agreement contains such a term, it imposes upon the vendee an implied condition that he make a reasonable effort to procure the loan. 246 Or. at 547, 426 P.2d 743. In the present case defendants had a similar duty, arising by implication, to make a reasonable effort to secure the city's approval of a planned development. As related above, defendants abandoned their attempt to secure the approval of the city Planning Commission in spite of that body's

favorable reaction to their initial proposals. There was never any indication that defendants' plan was likely to be rejected.

The condition required, however, not only approval of a planned development, but of a development which was ‘satisfactory’ to the parties. When a contract makes a party's duty to perform conditional on his personal satisfaction the courts will give the condition its intended effect. See, generally, 3A Corbin on Contracts, 78-109, ss 644-648; 5 Williston on Contracts (3d ed. 1961) 189-218, ss 675A, 675B; Restatement of Contracts s 265. Discussing such contracts, this court said in Johnson v. School District No. 12, 210 Or. 585, 590-591, 312 P.2d 591, 593 (1957):

> “Such contracts are generally grouped into two categories:
>
> “(1) Those which involve taste, fancy or personal judgment, the classical example being a commission to paint a portrait. In such cases the promisor is the sole judge of the quality of the work, and his right to reject, if in good faith, is absolute and may not be reviewed by court or jury.
>
> “ ‘(2) Those which involve utility, fitness or value, which can be measured against a more or less objective standard. In these cases, although there is some conflict, we think the better view is that performance need only be ‘reasonably satisfactory,’ and if the promisor refuses the proffered performance, thecorrectness of his decision and the adequacy of his grounds are subject to review.”

The condition with which we are concerned in this case properly belongs in the first of these categories as it requires the exercise of the parties' personal judgment. There is no objective test by which a court or jury could determine whether a particular development plan ought to be ‘satisfactory’ to reasonable men in defendants' position. The condition is similar to that in Mattei v. Hopper, 51 Cal.2d 119, 330 P.2d 625 (1958) in which the purchaser's duty under a land sale contract was ‘subject to Coldwell Banker & Company obtaining leases satisfactory to the purchaser.’ In a suit by the purchaser to compel specific performance, the seller contended that because of this provision there was no mutuality of obligation. The court held that there was a valid contract. Discussing the two types of ‘satisfaction’ clauses, the court said:

"However, it would seem that the factors involved in determining whether a lease is satisfactory to the lessor are too numerous and varied to permit the application of a reasonable man standard as envisioned by this line of cases."

"This multiplicity of factors which must be considered in evaluating a lease shows that this case more appropriately falls within the second line of authorities dealing with 'satisfaction' clauses, being those involving fancy, taste, or judgment. Where the question is one of judgment, the promisor's determination that he is not satisfied, when made in good faith, has been held to be a defense to an action on the contract." 330 P.2d at 627.

The condition in the present case is similar to that in Mattei in another respect as well. In that case as in this one the question of satisfaction was not concerned with the quality of the other party's performance. The court in Mattei held that the general rule was nevertheless applicable:

"Even though the 'satisfaction' clauses discussed in the above-cited cases dealt with performances to be received as parts of the agreed exchanges, the fact that the leases here which determined plaintiff's satisfaction were not part of the performance to be rendered is not material. The standard of evaluating plaintiff's satisfaction-good faith-applies with equal vigor to this type of condition." Id.

As in *Mattei* we are concerned in this case with a 'satisfaction' clause of the type requiring the exercise of personal judgment as to a matter which was not part of the other party's agreed performance. The test, as indicated, is the promisor's real, not feigned, dissatisfaction. See Johnson v. School District, supra, 210 Or. at 591, 312 P.2d 591.

It is clear from the authorities, however, that this dissatisfaction must be not only bona fide and in good faith, but also must relate to the specific subject matter of the condition. General dissatisfaction with the bargain will not suffice.

"Where a promise is conditional, expressly or impliedly, on his own satisfaction, he must give fair consideration to the matter. A refusal to examine the * * * performance, or a rejection of it, not in reality based on its unsatisfactory nature but on fictitious grounds or

none at all, will amount to prevention of performance of the condition and excuse it." 5 Williston, op.cit. 203-204.

As Corbin points out, although the promisor in under no duty if, in good faith, he is dissatisfied with a performance to be rendered to his personal satisfaction, nevertheless

"(n)ot infrequently it is possible to prove that the defendant is satisfied in fact, that the work has been done exactly as he specified, and that his dissatisfaction is either with his own specifications or merely with having to pay money that he prefers to use otherwise." 3A Corbin, op. cit. 92.

It is inherent in the requirement that dissatisfaction be bona fide and in good faith that the promisor cannot be allowed to base a claim of dissatisfaction on circumstances which were known or anticipated by the parties at the time of contracting. In the present case the evidence is clear that the defendants entered the agreement with full knowledge that city sewer service would not be immediately available and that their development of the property would have to include a sewage disposal system of some kind. The Brydon case is in point and its reasoning is persuasive. Although defendants were entitled under the contract to be the judges of their own satisfaction with any development plan that might be approved by the city, they should not be permitted to rely on the 'satisfaction' clause in order to reject the contract because of an expense known and contemplated at the time of contracting. We hold, therefore, that defendants were not justified in abandoning their attempts to secure city approval of a development plan simply because of the expense of providing a sewer system which they knew when they entered the contract would have to be provided as a part of the development. Not having performed their duty to use reasonable diligence to obtain city approval of a development plan, defendants may not rely on the nonoccurrence of the condition. ….

The decree of the trial court is affirmed.

Hypothetical

Jonah D. Cornett and Ralph Moore, Sellers, were potato farmers in DeKalb County, Alabama. Neumiller Farms, Inc., Buyer, was a corporation engaged in brokering potatoes

from the growers to the makers of potato chips. The controversy concerns Buyer's rejection of nine loads of potatoes out of a contract calling for twelve loads. A jury returned a verdict of $17,500 for Sellers based on a breach of contract. Buyer appealed.

On March 3, 1976, the parties signed a written contract whereby Sellers agreed to deliver twelve loads of chipping potatoes to Buyer during July and August, 1976, and Buyer agreed to pay $4.25 per hundredweight. The contract required that the potatoes be United States Grade No. 1 and "chip to buyer satisfaction."

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

When Sellers tendered additional loads of potatoes, Buyer refused acceptance, saying the potatoes would not "chip" satisfactorily. Sellers responded by having samples of their crop tested by an expert from the Cooperative Extension Service of Jackson County, Alabama, who reported that the potatoes were suitable in all respects. After receiving a letter demanding performance of the contract, Buyer agreed to "try one more load." Sellers then tendered a load of potatoes which had been purchased from another grower, Roy Hartline. Although Buyer's agent had recently purchased potatoes from Hartline at $2.00 per hundredweight, he claimed dissatisfaction with potatoes from the same fields when tendered by Sellers at $4.25 per hundredweight

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

Neumiller Farms, Inc. v. Cornett, 368 So. 2d 272 (Ala. 1979)

ANTICIPATORY BREACH

HOCHSTER v. DE LA TOUR, 118 Eng.Rep. 922 (Queen's Bench 1853)

On the trial before Erle, J., at the London sittings in last Easter Term, it appeared that plaintiff was a courier, who in April, 1852, was engaged by defendant to accompany him on a tour, to commence on 1st June, 1852…. On the 11th May, 1852, defendant wrote to plaintiff that he had changed his mind, and declined his services. He refused to make him any compensation. The action was commenced on 22d May. ….The defendant's counsel objected that there could be no breach of the contract before the 1st of June. The learned judge was of a contrary opinion, but reserved leave to enter a nonsuit on this objection. The other questions were left to the jury, who found for the plaintiff.

[Note: Before Lord Campbell delivered the judgment of the Court, there is a transcript of the oral argument. The comments and questions of the judges are indicated by parentheses]

Hannen [a barrister] showed cause:

… If one party to an executory contract gave the other notice that he refused to go on with the bargain, in order that the other side might act upon that refusal in such a manner as to incapacitate himself from fulfilling it, and he did so act, the refusal could never be retracted : and, accordingly, in Cort v. Ambergate , this Court, after considering the cases, decided that in such a case the plaintiff might recover, though he was no longer in a position to fulfil his contract. That was a contract under seal to manufacture and supply iron chairs. The purchasers discharged the vendors from manufacturing the goods ; and it was held that an action might be maintained by the vendors. It is true, however, that in that case the writ was issued after the time when the chairs ought to have been received. In the present case, if the writ had been issued on the 2nd of June, Cort v. Ambergate would have been expressly in point. The question, therefore, comes to be: does it make any difference that the writ was issued before the 1st June ? If the dicta of PARKE, B., in Phillpotts v. Evans are to be taken as universally applicable, it does make a difference; but they cannot be so taken. In a couti-act to marry at a future day, a marriage by the man before that day is a breach: Short v. Stone . The reason of this is, that the marriage is a final refusal to go on with the contract. It is not on the ground

that the defendant has rendered it impossible to fulfil the contract; for, as was urged in vain in Short v. Stone, the first wife might be dead before the day came. So also, on a contract to assign a term of years on a day future, a previous assignment to a stranger is a breach. (LORD CAMPBELL, Ch. J.: It probably will not be disputed that an act on the part of the defendant incapacitating himself from going on with the contract would be a breach. But how does the defendant's refusal in May incapacitate him from travelling in June ? It was possible that he might do so.) It was; but the plaintiff, who, so long as the engagement subsisted, was bound to keep himself disengaged and make preparations so as to be ready and willing to travel with the defendant on the 1st June, was informed by the defendant that he would not go on with the contract, in order that the plaintiff might act upon that information ; and the plaintiff then was entitled to engage himself to another, as he did. In Planche v. Colburn, the plaintiff had contracted with defendants to write a work for " The Juvenile Library ;" and he was held to be entitled to recover on their discontinuing the publication; yet the time for the completion of the contract, that is for the work being published in " The Juvenile Library," had not arrived, for that would not be till a reasonable time after the author had completed the work. Now in that case the author never did complete the work. (LORD CAMPBELL, Ch. J. : It certainly would have been cruelly hard if the author had been obliged, as a condition precedent to redress, to compose a work which he knew could never be published.)

(CROMPTON, J.: When a party announces his intention not to fulfill the contract, the other side may take him at his word and rescind the contract. That word " rescind " implies that both parties have agreed that the contract shall be at an end as if it had never been. But I am inclined to think that the party may also say: " Since you have announced that you will not go on with the contract, I will consent that it shall be at an end from this time; but I will hold you liable for the damage I have sustained; and I will proceed

to make that damage as little as possible by making the best use I can of my liberty." This is the principle of those cases in which there has been a discussion as to the measure of damages to which a servant is entitled on a wrongful dismissal….)

(LORD CAMPBELL, Ch. J.: The counsel in support of the rule have to answer a very able argument.)

Hugh Hill and Dcighton, contra:

In Cart v. Ambergate, the writ was taken out after the time for completing the contract. That case is consistent with the defendant's position, which is, that an act incapacitating the defendant, in law, from Completing the contract is a breach, because it is implied that the parties to a contract shall keep themselves legally capable of performing it; but that an announcement of an intention to break the contract when the time comes is no more than an offer to rescind. It is evidence, till retracted, of a dispensation with the necessity of readiness and willingness on the other side; and, if not retracted, it is, when the time for performance comes, evidence of a continued refusal: but till then it may be retracted. Such is the doctrine in Phillpotts v. Evans and Eipley v. M'Clure . (CROMPTON, J.: May not the plaintiff, on notice that the defendant will not employ him, look out for other employment, so as to diminish the loss ?) If he adopts the defendant's notice, which is in legal effect an offer, to rescind, he must adopt it altogether. (LORD CAMPBELL, Ch. J.: So that you say the plaintiff, to preserve any remedy at all, was bound to remain idle.)

(ERLE, J.: Do you go one step further ? Suppose the defendant, after the plaintiff's engagement with Lord Ashburton, had retracted his refusal and required the plaintiff to travel with him on 1st June, and the plaintiff had refused to do so, and gone with Lord Ashburton instead ? Do you say that the now defendant could in that case have sued the now plaintiff for a breach of contract ?)

It would be, in such a case, a question of fact for a jury, whether there had not been an exoneration. In Phillpotts v. Erans it was held that the measure of damages was the market price at the time when the contract ought to be completed. If a refusal before that time is a breach, how could these damages be ascertained ? (COLERIDGE, J.: No doubt it was possible, in this case, that, before the 1st June, the plaintiff might die, in which case the plaintiff would have gained nothing had the contract gone on.)

(LORD CAMPBELL, Ch. J.: All contingencies should be taken into account by the jury in assessing the damages.)

(CROMFTON, J.: That objection would equally apply to the action by a servant for dismissing him before the end of his term, and so disabling him from earning his wages; yet that action may be brought immediately on the dismissal); It is quite possible that the plaintiff himself might have intended not to go on ; no one can tell what intention is. (LORD

CAMPBELL, Ch. J.: The intention of the defendant might be proved by showing that he entered in his diary a memorandum to that effect; and, certainly, no action would lie for entering such a memorandum. But the question is as to the effect of a communication to the other side, made that he might know that intention and act upon it.)

Lord Campbell, C.J., now delivered the judgment of the Court.

On this motion in arrest of judgment, the question arises, Whether, if there be an agreement between A and B, whereby B engages to employ A on and from a future day for a given period of time, to travel with him into a foreign country as a courier, and to start with him in that capacity on that day, A being to receive a monthly salary during the continuance of such service, B may, before the day, refuse to perform the agreement and break and renounce it, so as to entitle A before the day to commence an action against B to recover damages for breach of the agreement; A having been ready and willing to perform it, til it was broken and renounced by B. The defendant's counsel very powerfully contended that, if the plaintiff was not contented to dissolve the contract and to abandon all remedy upon it, he was bound to remain ready and willing to perform it till the day when the actual employment as courier in the service of the defendant was to begin; and that there could be no breach of the agreement before that day to give a right of action. But it cannot be laid down as a universal rule that, whereby agreement an act is to be done on a future day, no action can be brought for a breach of the agreement till the day for doing the act has arrived. If a man promises to marry a woman on a future day, and before that day marries another woman, he is instantly liable to an action for breach of promise of marriage.

If a man contracts to execute a lease on and from a future day for a certain term, and before that day executes a lease to another for the same term, he may be immediately sued for breaking the contract. So, if a man contracts to sell and deliver specific goods on a future day, and before the day he sells and delivers them to another, he is immediately liable to an action at the suit of the person with whom he first contracted to sell and deliver them. One reason alleged in support of such an action is, that the defendant has, before the day, rendered it impossible for him to perform the contract at the day, but this does not necessarily follow; for

prior to the day fixed for doing the act, the first wife may have died, a surrender of the lease executed might be obtained, and the defendant might have repurchased the goods so as to be in a situation to sell and deliver them to the plaintiff. Another reason may be that, where there is a contract to do an act on a future day, there is a relation constituted between the parties in the meantime by the contract, and that they impliedly promise that in the meantime neither will do anything to the prejudice of the other inconsistent with that relation. As for example, a man and woman engaged to marry are affianced to one another during the period between the time of engagement and the celebration of marriage.

In this very case of traveller and courier, from the day of hiring till the day when the employment was to begin, they were engaged to each other; and it seems to be a breach of an implied contract if either of them renounces the engagement. This reasoning seems in accordance with the unanimous decision of the Exchequer Chamber in Elderton v. Emmens, 6 Com.B. 160, which we have followed in subsequent cases in this court.

The declaration in the present case, in alleging a breach, states a great deal more than a passing intention on the part of the defendant which he may repent of, and could only be proved by evidence that he had utterly renounced the contract, or done some act which rendered it impossible for him to perform it.

If the plaintiff has no remedy for breach of the contract unless he treats the contract as in force, and acts upon it down to June 1st, 1852, it follows that, till then, he must enter into no employment which will interfere with his promise "to start with the defendant on such travels on the day and year," and that he must then be properly equipped in all respects as a courier for a three months' tour on the continent of Europe. But it is surely much more rational, and more for the benefit of both parties, that, after the renunciation of the agreement by the defendant, the plaintiff should be at liberty to consider himself absolved from any future performance of it, retaining his right to sue for any damage he has suffered from the breach of it. Thus, instead of remaining idle and laying out money in preparations which must be useless, he is at liberty to seek service under another employer, which would go in mitigation of the damages to which he would otherwise be entitled for a breach of the contract. It seems strange that the defendant, after renouncing the contract, and absolutely declaring that he will never act under it, should be permitted to object that faith is given to his assertion, and that an opportunity is not left to him of changing his mind.

If the plaintiff is barred of any remedy by entering into an engagement inconsistent with starting as a courier with the defendant on the 1st June, he is prejudiced by putting faith in the defendant's assertion; and it would be more consistent with principle, if the defendant were precluded from saying that he had not broken the contract when he declared that he entirely renounced it.

Suppose that the defendant, at the time of his renunciation, had embarked on a voyage for Australia, so as to render it physically impossible for him to employ the plaintiff as a courier on the continent of Europe in the months of June, July and August, 1852; according to decided cases, the action might have been brought before the 1st June; but the renunciation may have been founded on other facts, to be given in evidence, which would equally have rendered the defendant's performance of the contract impossible. The man who wrongfully renounces a contract into which he has deliberately entered cannot justly complain if he is immediately sued for a compensation in damages by the man whom he has injured; and it seems reasonable to allow an option to the injured party, either to sue immediately, or to wait till the time when the act was to be done, still holding it as prospectively binding for the exercise of this option, which may be advantageous to the innocent party, and cannot be prejudicial to the wrong-doer. An argument against the action before the 1st of June is urged from the difficulty of calculating the damages; but this argument is equally strong against an action before the 1st of September, when the three months would expire. In either case, the jury in assessing the damages would be justified in looking to all that happened, or was likely to happen, to increase or mitigate the loss of the plaintiff down to the day of trial. We do not find any decision contrary to the view we are taking of this case. . . .

Upon the whole, we think that the declaration in this case is sufficient. It gives us great satisfaction to reflect that, the question being on the record, our opinion may be reviewed in a court of error. In the meantime we must give judgment for the plaintiff.

Judgment for plaintiff.

DANIELS v. NEWTON, 114 Mass. 530 (Mass. 1874)

WELLS, J.

This action is for breach of an agreement in writing, under seal, for the purchase of certain land from the plaintiff by the defendants. The time for performance is indicated by two clauses; one that "said premises are to be conveyed within thirty days from this date;" the other that "in case the said parties of the second part should fail to sell their estate at the expiration of the thirty days, then we agree to extend this agreement for thirty days." The inference from the latter clause is that the defendants were to have the whole thirty days for performance on their part, and, in the contingency mentioned, thirty days more. Such was the effect given to the terms of the written instrument, by the ruling at the trial, and we think correctly.

The plaintiff relied upon a supposed breach of the agreement by the defendants within the thirty days; to wit, May 29, the writing being dated May 15, and thereupon had brought his action May 30. The ruling of the court upon this point was that if the defendants "refused absolutely to perform said agreement on their part, then or at any other time, that would be a breach of the agreement on their part for which the plaintiff can maintain this action."…

The proposition involved in this ruling, to wit, that there may be a breach of contract, giving a present right of action, before the performance is due by its terms, seems to have been adopted by recent English decisions. *Frost v. Knight*, L. R. 7 Ex. 111 (1872). *Hochster v. De la Tour*, 2 E. & B. 678 (1853).

It is said to be applicable, not only in cases where performance has been rendered impossible by the voluntary conduct of the party, as, in agreements for marriage or conveyance of land, by marriage or conveyance to another, and by way of exception to the general rule formerly maintained, but to the full extent of a general rule; so that an absolute and unqualified declaration of a purpose not to fulfill or be held by the contract, made by one party to the other, may be treated as of itself a present breach of the contract by repudiation, as well before as after the time stipulated for its fulfillment by such party. …

The doctrine has never been adopted in this Commonwealth…

A renunciation of the agreement, by declarations or inconsistent conduct, before the time of performance, may give cause for treating it as rescinded, and excuse the other party from making ready for performance on his part, or relieve him from the necessity of offering

performance in order to enforce his rights. It may destroy all capacity of the party, so disavowing its obligations, to assert rights under it afterwards, if the other party has acted upon such disavowal. But we are unable to see how it can, of itself, constitute a present violation of any legal rights of the other party, or confer upon him a present right of action. An executory contract ordinarily confers no title or interest in the subject matter of the agreement. Until the time arrives when, by the terms of the agreement, he is or might be entitled to its performance, he can suffer no injury or deprivation which can form a ground of damages. There is neither violation of right, nor loss upon which to found an action. The true rule seems to us to be that in order to charge one in damages for breach of an executory personal contract, the other party must show a refusal or neglect to perform, at a time when and under conditions such that he is or might be entitled to require performance.

…

We have examined with care the opinions of Lord Chief Justice Cockburn in *Frost v. Knight,* and of Lord Campbell in *Hochster v. De la Tour,* and we are not convinced that the conclusions at which they arrive are founded in sound principles of jurisprudence, or sustained by the authorities cited in their support.

…

Hochster v. De la Tour appears to us to be the only case which sustains this position as an adjudication, although that decision has been recognized in several subsequent cases. *Avery v. Bowden,* 5 E. & B. 714; 6 E. & B. 952. *Wilkinson v. Verity,* L. R. 6 C. P. 206. It was an action upon a contract of hiring to go as courier for the plaintiff from June 1, 1852, at monthly wages. There was notice of renunciation of the employment; and the action brought May 22, 1852, was sustained. ….

But the question, in what mode and at what time that remedy may be sought, must depend upon the provisions of his contract, and the nature of the rights to which it entitles him, and which are affected by the conduct of the other party. Throughout the whole discussion both in *Hochster v. De la Tour,* and *Frost v. Knight,* the question as to what conduct of the defendant will relieve the plaintiff from the necessity of showing readiness and an offer to perform at the day, in order to make out a breach by the other, appears to us to be confounded with that of the plaintiff's cause of action; or rather, the question, in what consists

the plaintiff's cause of action, is lost sight of; the court dealing only with the conduct of the defendant in repudiating the obligations of his contract.

Much argument is expended in both cases upon the ground of convenience and mutual advantage to the parties from the rule sought to be established. But before that argument can properly have weight, the point to be reached must first be shown to be consistent with logical deductions from the strictly legal aspects of the case. The legal remedy must be founded on some present legal right, and must conform to the nature of that right. Until the plaintiff has either suffered loss or wrong in respect of that which has already vested in him in right, or has been deprived of or prevented from acquiring that which he is entitled to have or demand, he has no ground on which to seek a remedy by way of reparation. The conduct of the defendant is no wrong to the plaintiff until it actually invades some right of his. Actual injury and not anticipated injury is the ground of legal recovery. The plaintiff's rights are invaded by repudiation of the contract only when it produces the effect of non-performance, or prevents him from entering upon or completing performance on his part, at a time when and in the manner in which he is entitled to perform it or to have it performed.

…

[The contract allows the defendants] thirty days at least within which to fulfill their agreement. The plaintiff could require nothing of them until the expiration of that time; and no conduct on their part or declaration, whether of promise or denial, could give him any cause of action in respect of that agreement of sale. This action therefore cannot be maintained.

Exceptions sustained.

DRAKE v. WICKWIRE, 795 P.2D 195 (ALASKA,1990)

MATTHEWS, CHIEF JUSTICE.

This is a malpractice action against an attorney for allegedly inducing his client to break an earnest money sales agreement. The underlying facts are set forth in *Drake v. Hosley,* 713 P.2d 1203 (Alaska 1986).

On March 5, 1984, Paul Drake signed an exclusive listing agreement with The Charles Hosley Company, Realtors (hereafter "Hosley"). The agreement authorized Hosley to act as Drake's agent until March 30, 1984, to sell some land Drake owned in North Pole, Alaska. The agreement provided for payment of a ten percent commission if, during the period of the listing agreement, 1) Hosley located a buyer "willing and able to purchase at the terms set by the seller," or 2) the seller entered into a "binding sale" during the term set by the seller.

Hosley found a group of three buyers, Robert Goldsmith, Dwayne Hofschulte and David Nystrom (hereafter "buyers"), who were interested in the property. On March 23, 1984, Drake signed a purchase and sale agreement, entitled "earnest money receipt," in which he agreed to sell the land to the buyers at a specified price and terms. The buyers also signed the agreement. It provided that closing would occur "within 10 days of clear title" and "ASAP, 1984." A typed addendum stated that Drake agreed to pay Hosley a commission of ten percent of the price paid for the property. Both Drake and Hosley signed the addendum.

On April 3, 1984, Hosley received a preliminary commitment for title insurance. The title report listed a judgment in favor of Drake's ex-wife as the sole encumbrance on the title. The next day Hosley called Drake's attorney, Tom Wickwire, to ask about the judgment. Wickwire stated that the judgment would be paid with the cash received at closing.

Two or three days later, attorney Wickwire called Hosley and stated that his client (Drake) wanted the sale closed by April 11. Wickwire explained that he had negotiated a discounted settlement with Drake's ex-wife that required payment by April 11. Wickwire claims that Hosley agreed to close by April 11. Hosley disagrees, and claims he merely stated that he would try to close as quickly as possible.

When Hosley became concerned that the buyers would not be able to close on April 11, he telephoned the attorney for Drake's ex-wife and learned that the April 11 deadline for payment of the judgment had been extended to the end of the month.

On April 11, Wickwire called Hosley to set up the closing. Hosley told Wickwire that the buyers could not close that day because they did not have the money and would not have it before May 1. Wickwire indicated that he would advise Drake to call off the sale because the buyers had refused to perform. Wickwire mailed a letter to Hosley, dated April 11, stating that Drake's offer to sell was withdrawn. Hosley received the letter on approximately April 18. On April 12, Drake sold his property through another broker to different buyers.

On April 12, Hosley went to Wickwire's office to close the sale and submitted checks from the buyers totalling $33,000 for the down payment. Wickwire refused the checks, stating that another buyer already had purchased the property.

In *Drake*, Hosley sued Drake for his real estate commission. The trial court granted summary judgment to Hosley. On appeal we affirmed, holding that Hosley was Drake's agent, not the agent of the buyers and thus would have had no authority to change the deadline for closing from April 12 or 13 to April 11 as Drake contended.

[We] are of the view that Wickwire was negligent as a matter of law. In Drake's brief, authored by Wickwire, in the case of *Drake v. Hosley*, the critical conversation between Hosley and Wickwire relating to the alleged anticipatory repudiation is set forth as follows:

"[O]n the morning of April 11 [Wickwire] called Hosley to select a specific time and place for closing. But Hosley's response was that his buyers could not close on that day as they did not have the money but would need until May 1 to get it. Wickwire asked Hosley if the problem was just getting the time to get the money out of the bank or did they not have the downpayment. Hosley replied that the buyers in fact had the money but were "resisting the pressure to close."

The law of anticipatory repudiation is set forth in sections 253, 250 and 251 of the *Restatement (Second) of Contracts (1981)* (hereafter *Restatement*). Section 253(1) of the *Restatement* provides:

"Where an obligor repudiates a duty before he has committed a breach by non-performance and before he has received all of the agreed exchange for it, his repudiation alone gives rise to a claim for damages for total breach."

The concept of repudiation is explained in § 250 as follows: “A repudiation is (a) a statement by the obligor to the obligee indicating that the obligor will commit a breach that would of itself give the obligee a claim for damages....”

The commentary to this section explains that a statement, in order to qualify as a repudiation, must be reasonably clear:

“In order to constitute a repudiation, a party's language must be sufficiently positive to be reasonably interpreted to mean that the party will not or cannot perform. Mere expression of doubt as to his willingness or ability to perform is not enough to constitute a repudiation, although such an expression may given an obligee reasonable grounds to believe that the obligor will commit a serious breach and may ultimately result in a repudiation under the rule stated in § 251. However, language that under a fair reading “amounts to a statement of intention not to perform except on conditions which go beyond the contract” constitutes a repudiation.” *Restatement* § 250, comment b

In our view, Wickwire did not act reasonably in treating Hosley's statement as a repudiation. As recited by Wickwire, it was ambiguous on its face. Hosley first indicated that the buyers would need until May 1 to get the money. Later, though, Hosley indicated that the buyers had the money but were “resisting the pressure to close.” The latter statement itself is ambiguous in that it is unclear whether the buyers were resisting the pressure to close on April 11 as Drake desired, or on April 12 or 13 as the contract required.

If the former meaning was intended, there would have been no anticipatory repudiation because the buyers had no contractual obligation to close on the 11th. If the latter meaning was intended, Wickwire would have had at most reasonable grounds to believe that the buyers would breach the contract. Neither meaning justifies treating the statement as a repudiation. Instead, Wickwire could have sought assurances of performance under the rule stated in § 251 of the Restatement. That rule states:

“(1) Where reasonable grounds arise to believe that the obligor will commit a breach by nonperformance that would of itself give the obligee a claim for damages for total breach ... the obligee may demand adequate assurance of due performance and may, if

reasonable, suspend any performance for which he has not already received the agreed exchange until he receives such assurance.

"(2) The obligee may treat as a repudiation the obligor's failure to provide within a reasonable time such assurance of due performance as is adequate in the circumstances of the particular case."

Wickwire's negligence in this case was in advising precipitate conduct in the face of an ambiguous statement which was insufficient to indicate that the buyers would breach the contract.

The judgment is REVERSED and this case is REMANDED for further proceedings consistent with this decision.

Hypothetical

On June 13, 1989, James Decker and Wholesale Sand & Gravel, Inc., entered into a contract whereby Wholesale agreed to perform earth work, including the installation of a gravel driveway, on Decker's property in Bowdoin. The contract contained no provision specifying a completion date for the work [Note: The Court found that a reasonable time for the completion of performance was 60 days] Although Carl Goodenow, Wholesale's president, believed the company had 90 days within which to complete the work, he told Decker that the driveway portion of the work would be completed within one week.

Wholesale began work on the driveway on the weekend after the contract was executed and immediately experienced difficulty because of the wetness of the ground. In fact, Wholesale's bulldozer became stuck in the mud and had to be removed with a backhoe. Wholesale returned to the site the following weekend, when it attempted to stabilize the driveway site by hauling out mud and hauling in gravel. Because the ground was too wet to allow Wholesale to perform the work without substantially exceeding the contract price. Goodenow decided to wait for the ground to dry out before proceeding further.

On July 12, 1989 [after the ground had dried]. Decker contacted Goodenow concerning the lack of activity at the site and his urgent need to have the driveway completed. Goodenow responded that he would "get right on it." On July 19, Decker telephoned

Goodenow to inquire again about the lack of activity and gave him one week in which to finish the driveway. Again, Goodenow said that he would "get right on it." On July 28, Decker called Goodenow for the purpose of terminating the contract. When

Goodenow stated that he would be at the site the next day, Decker decided to give him one more chance. Goodenow, however, did not appear at the site and Decker subsequently terminated the contract. At that point, Goodenow believed Wholesale still had 45 days to complete the job. Decker, however, hired another contractor to finish the driveway and complete the excavation work.

Wholesale Sand & Gravel v. Decker, 630 A.2d 710 (Me. 1993)

INTERVENING EXCUSES

PARADINE v. JANE, King's Bench. 1647. [Reported Aleyn, 26.]

In debt the plaintiff declares upon a lease for years rendering rent at the four usual feasts; and for rent behind for three years, ending at the Feast of the Annunciation, 21 Car., brings his action : The defendant pleads, that a certain German prince, by name Prince Rupert, an alien born, enemy to the king and kingdom, hath invaded the realm with an hostile army of men; and with the same force did enter upon the defendant's possession, and him expelled, and held out of possession from the 19 of July, , till the Feast of the Annunciation, whereby he could not take the profits; whereupon the plaintiff demurred, and the plea was resolved insufficient.

… It was resolved, That the matter of the plea was insufficient; for though the whole army had been alien enemies, yet he ought to pay his rent. And this difference was taken, that where the law creates a duty or charge, and the party is disabled to perform it without any default in him, and hath no remedy over, there the law will excuse him. As in the case of waste, if a house be destroyed by tempest, or by enemies, the lessee is excused. Dyer, 33 a; Inst. 53 d, 283 a; 12 H. 4, 6. So of an escape. Co. 4, 84 b; 33 H. 6, 1. So in 9 E. 3, 16, a supersedeas was awarded to the justices, that they should not proceed in a cessavit upon a cesser during the war, but when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable

necessity, because he might have provided against it by his contract. And therefore if the lessee covenant to repair a house, though it be burned by lightning, or thrown down by enemies, yet he ought to repair it. Dyer, 33 a; 40 E. 3, 6 h.

Now the rent is a duty created by the parties upon the reservation, and had there been a covenant to pay it, there had been no question but the lessee must have made it good, notwithstanding the interruption by enemies, for the law would not protect him

beyond his own agreement, no more than in the case of reparations. This reservation then being a covenant in law, and whereupon an action of covenant hath been maintained (as Roll said), it is all one as if there had been an actual covenant. Another reason was added, that as the lessee is to have the advantage of casual profits, so he must ran the hazard of casual losses, and not lay the whole burden of them upon his lessor; and Dyer 56, 6, was cited for this purpose, that though the land be surrounded or gained by the sea, or made barren by wild-fire, yet the lessor shall have his whole rent: And judgment was given for the plaintiff.

TAYLOR v. CALDWELL, Queen's Bench 122 ER 309 (1863)

Blackburn J.

In this case the plaintiffs and defendants had, on the 27th May, 1861, entered into a contract by which the defendants agreed to let the plaintiffs have the use of The Surrey Gardens and Music Hall on four days then to come, viz., the 17th June, 15th July, 5th August and 19th August, for the purpose of giving a series of four grand concerts, and day and night fetes at the Gardens and Hall on those days respectively; and the plaintiffs agreed to take the Gardens and Hall on those days, and pay 100l. for each day.

The parties inaccurately call this a "letting," and the money to be paid a "rent;" but the whole agreement is such as to shew that the defendants were to retain the possession of the Hall and Gardens so that there was to be no demise of them, and that the contract was merely to give the plaintiffs the use of them on those days. Nothing however, in our opinion, depends on this. The agreement then proceeds to set out various stipulations between the parties as to what each was to supply for these concerts and entertainments, and as to the manner in which they should be carried on. The effect of the whole is to shew that the existence of the Music Hall in the Surrey Gardens in a state fit for a concert was essential for the fulfilment of the contract,-such entertainments as the parties contemplated in their agreement could not be

given without it. After the making of the agreement, and before the first day on which a concert was to be given, the Hall was destroyed by fire. This destruction, we must take it on the evidence, was without the fault of either party, and was so complete that in consequence the concerts could not be given as intended. And the question we have to decide is whether, under these circumstances, the loss which the plaintiffs have sustained is to fall upon the defendants. The parties when framing their agreement evidently had not present to their minds the possibility of such a disaster, and have made no express stipulation with reference to it, so that the answer to the question must depend upon the general rules of law applicable to such a contract.

There seems no doubt that where there is a positive contract to do a thing, not in itself unlawful, the contractor must perform it or pay damages for not doing it, although in consequence of unforeseen accidents, the performance of his contract has become unexpectedly burthensome or even impossible. But this rule is only applicable when the contract is positive and absolute, and not subject to any condition either express or

implied: and there are authorities which, as we think, establish the principle that where, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless when the time for the fulfilment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done; there, in the absence of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor.

There seems little doubt that this implication tends to further the great object of making the legal construction such as to fulfil the intention of those who entered into the contract. For in the course of affairs men in making such contracts in general would, if it were brought to their minds, say that there should be such a condition.

Accordingly, in the Civil law, such an exception is implied in every obligation of the class which they call obligatio de certo corpore….. The examples are of contracts respecting a slave, which was the common illustration of a certain subject used by the Roman lawyers, just as we are apt to take a horse; and no doubt the propriety, one might almost say necessity, of the implied condition is more obvious when the contract relates to a living animal, whether man or brute, than when it relates to some inanimate thing (such as in the present case a theatre) the existence of which is not so obviously precarious as that of the live animal, but the principle is adopted in the Civil law as applicable to every obligation of which the subject is a certain thing. The general subject is treated of by Pothier, who in his Traite des Obligations, partie 3, chap. 6, art. 3, § 668 states the result to be that the debtor corporis certi is freed from his obligation when the thing has perished, neither by his act, nor his neglect, and before he is in default, unless by some stipulation he has taken on himself the risk of the particular misfortune which has occurred.

Although the Civil law is not of itself authority in an English Court, it affords great assistance in investigating the principles on which the law is grounded. And it seems to us that the common law authorities establish that in such a contract the same condition of the continued existence of the thing is implied by English law.

There is a class of contracts in which a person binds himself to do something which requires to be performed by him in person; and such promises, e.g. promises to marry, or promises to serve for a certain time, are never in practice qualified by an express exception of the death of the party; and therefore in such cases the contract is in terms broken if the promisor dies before fulfilment. Yet it was very early determined that, if the performance is personal, the executors are not liable; Hyde v. The Dean of Windsor (Cro. Eliz. 552, 553). See 2 Wms. Exors. 1560, 5th ed., where a very apt illustration is given. "Thus," says the learned author, "if an author undertakes to compose a work, and dies before completing it, his executors are discharged from this contract: for the undertaking is merely personal in its nature, and, by the intervention of the contractor's death, has become impossible to be performed."For this he cites a dictum of Lord Lyndhurst in Marshall v. Broadhurst (1 Tyr. 348, 349), and a case mentioned by Patteson J. in Wentworth v. Cock (10 A. & E. 42, 45-46). In Hall v. Wright (E. B. & E. 746, 749), Crompton J., in his judgment, puts another case. "Where a contract depends upon personal skill, and the act of God renders it impossible, as, for instance, in the case of a painter employed to paint a picture who is struck blind, it may be that the performance might be excused."

It seems that in those cases the only ground on which the parties or their executors, can be excused from the consequences of the breach of the contract is, that from the nature of the contract there is an implied condition of the continued existence of the life of the contractor, and, perhaps in the case of the painter of his eyesight. In the instances just given, the person, the continued existence of whose life is necessary to the fulfilment of the contract, is himself the contractor, but that does not seem in itself to be necessary to the application of the principle; as is illustrated by the following example. In the ordinary form of an apprentice deed the apprentice binds himself in unqualified terms to "serve until the full end and term of seven years to be fully complete and ended," during which term it is covenanted that the apprentice his master "faithfully shall serve," and the father of the apprentice in equally unqualified terms binds himself for the performance by the apprentice of all and every covenant on his part. (See the form, 2 Chitty on Pleading, 370, 7th ed. by Greening.) It is undeniable that if the apprentice dies within the seven years, the covenant of the father that he shall perform his covenant to serve for seven years is not fulfilled, yet surely it cannot be that

an action would lie against the father? Yet the only reason why it would not is that he is excused because of the apprentice's death.

These are instances where the implied condition is of the life of a human being, but there are others in which the same implication is made as to the continued existence of a thing. For example, where a contract of sale is made amounting to a bargain and sale, transferring presently the property in specific chattels, which are to be delivered by the vendor at a future day; there, if the chattels, without the fault of the vendor, perish in the interval, the purchaser must pay the price and the vendor is excused from performing his contract to deliver, which has thus become impossible.

….It may, we think, be safely asserted to be now English law, that in all contracts of loan of chattels or bailments if the performance of the promise of the borrower or bailee to return the things lent or bailed, becomes impossible because it has perished, this impossibility (if not arising from the fault of the borrower or bailee from some risk which he has taken upon himself) excuses the borrower or bailee from the performance of his promise to redeliver the chattel…..

In none of these cases is the promise in words other than positive, nor is there any express stipulation that the destruction of the person or thing shall excuse the performance; but that excuse is by law implied, because from the nature of the contract it is apparent that the parties contracted on the basis of the continued existence of the particular person or chattel. In the present case, looking at the whole contract, we find that the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance.

We think, therefore, that the Music Hall having ceased to exist, without fault of either party, both parties are excused, the plaintiffs from taking the gardens and paying the money, the defendants from performing their promise to give the use of the Hall and Gardens and other things. Consequently the rule must be absolute to enter the verdict for the defendants. Rule absolute.

AMERICAN TRADING & PRODUCTION CORP. v. SHELL INTERN. MARINE LTD.,
453 F.2d 939 (2nd Cir. 1972)

MULLIGAN, Circuit Judge:

This is an appeal by American Trading and Production Corporation (hereinafter "owner") from a judgment entered on July 29th, 1971, in the United States District Court for the Southern District of New York, dismissing its claim against Shell International Marine Ltd. (hereinafter "charterer") for additional compensation in the sum of $131,978.44 for the transportation of cargo from Texas to India via the Cape of Good Hope as a result of the closing of the Suez Canal in June, 1967. The charterer had asserted a counterclaim which was withdrawn and is not in issue. The action was tried on stipulated facts and without a jury before Hon. Harold R. Tyler, Jr. who dismissed the claim on the merits in an opinion dated July 22, 1971.

We affirm.

The owner is a Maryland corporation doing business in New York and the charterer is a United Kingdom corporation. On March 23, 1967 the parties entered into a contract of voyage charter in New York City which provided that the charterer would hire the owner's tank vessel, WASHINGTON TRADER, for a voyage with a full cargo of lube oil from Beaumont/Smiths Bluff, Texas to Bombay, India. The charter party provided that the freight rate would be in accordance with the then prevailing American Tanker Rate Schedule (ATRS), $14.25 per long ton of cargo, plus seventy-five percent (75%), and in addition there was a charge of $.85 per long ton for passage through the Suez Canal. On May 15, 1967 the WASHINGTON TRADER departed from Beaumont with a cargo of 16,183.32 long tons of lube oil. The charterer paid the freight at the invoiced sum of $417,327.36 on May 26, 1967. On May 29th, 1967 the owner advised the WASHINGTON TRADER by radio to take additional bunkers at Ceuta due to possible diversion because of the Suez Canal crisis. The vessel arrived at Ceuta, Spanish Morocco on May 30, bunkered and sailed on May 31st, 1967. On June 5th the owner cabled the ship's master advising him of various reports of trouble in the Canal and suggested delay in entering it pending clarification. On that very day, the Suez Canal was closed due to the state of war which had developed in the Middle East. The owner then communicated with the charterer on June 5th through the broker who had negotiated the charter party, requesting approval for the diversion of the WASHINGTON TRADER which then had proceeded to a point about 84 miles northwest of Port Said, the entrance to the Canal. On June 6th the charterer responded that under the

circumstances it was “for owner to decide whether to continue to wait or make the alternative passage via the Cape since Charter Party Obliges them to deliver cargo without qualification.” In response the owner replied on the same day that in view of the closing of the Suez, the WASHINGTON TRADER would proceed to Bombay via the Cape of Good Hope and “[w]e [are] reserving all rights for extra compensation.” The vessel proceeded westward, back through the Straits of Gibraltar and around the Cape and eventually arrived in Bombay on July 15th (some 30 days later than initially expected), traveling a total of 18,055 miles instead of the 9,709 miles which it would have sailed had the Canal been open. The owner billed $131,978.44 as extra compensation which the charterer has refused to pay.

On appeal and below the owner argues that transit of the Suez Canal was the agreed specific means of performance of the voyage charter and that the supervening destruction of this means rendered the contract legally impossible to perform and therefore discharged the owner's unperformed obligation (Restatement of Contracts § 460 (1932)). Consequently, when the WASHINGTON TRADER eventually delivered the oil after journeying around the Cape of Good Hope, a benefit was conferred upon the charterer for which it should respond in *quantum meruit.* The validity of this proposition depends upon a finding that the parties contemplated or agreed that the Suez passage was to be the exclusive method of performance, and indeed it was so argued on appeal. We cannot construe the agreement in such a fashion. The parties contracted for the shipment of the cargo from Texas to India at an agreed rate and the charter party makes absolutely no reference to any fixed route. It is urged that the Suez passage was a condition of performance because the ATRS rate was based on a Suez Canal passage, the invoice contained a specific Suez Canal toll charge and the vessel actually did proceed to a point 84 miles northwest of Port Said. In our view all that this establishes is that both parties contemplated that the Canal would be the probable route. It was the cheapest and shortest, and therefore it was in the interest of both that it be utilized. However, this is not at all equivalent to an agreement that it be the exclusive method of performance. The charter party does not so provide and it seems to have been well understood in the shipping industry that the Cape route is an acceptable alternative in voyages of this character.

The District of Columbia Circuit decided a closely analogous case, Transatlantic Financing Corp. v. United States, 124 U.S.App.D.C. 183, 363 F.2d 312 (1966). There the plaintiff had entered into a voyage charter with defendant in which it agreed to transport a full cargo of wheat on the CHRISTOS from a United States port to Iran. The parties clearly contemplated a Suez

passage, but on November 2, 1956 the vessel reduced speed when war blocked the Suez Canal. The vessel changed its course in the Atlantic and eventually delivered its cargo in Iran after proceeding by way of the Cape of Good Hope. In an exhaustive opinion Judge Skelly Wright reviewed the English cases which had considered the same problem and concluded that "the Cape route is generally regarded as an alternative means of performance. So the implied expectation that the route would be via Suez is hardly adequate proof of an allocation to the promisee of the risk of closure. In some cases, even an express expectation may not amount to a condition of performance." Transatlantic Financing Corp. v. United States, *supra,* 363 F.2d at 317

Appellant argues that *Transatlantic* is distinguishable since there was an agreed upon flat rate in that case unlike the instant case where the rate was based on Suez passage. This does not distinguish the case in our view. It is stipulated by the parties here that the only ATRS rate published at the time of the agreement from Beaumont to Bombay was the one utilized as a basis for the negotiated rate ultimately agreed upon. This rate was escalated by 75% to reflect whatever existing market conditions the parties contemplated. These conditions are not stipulated. Had a Cape route rate been requested, which was not the case, it is agreed that the point from which the parties would have bargained would be $17.35 per long ton of cargo as against $14.25 per long ton.

Actually, in *Transatlantic* it was argued that certain provisions in the P. & I. Bunker Deviation Clause referring to the direct and/or customary route required, by implication, a voyage through the Suez Canal. The court responded "[a]ctually they prove only what we are willing to accept-that the parties expected the usual and customary route would be used. The provisions in no way condition performance upon non-occurrence of this contingency." Transatlantic Financing Corp. v. United States, *supra,* 363 F.2d at 317 n. 8. We hold that all that the ATRS rate establishes is that the parties obviously expected a Suez passage but there is no indication at all in the instrument or *dehors* that it was a condition of performance.

This leaves us with the question as to whether the owner was excused from performance on the theory of commercial impracticability (Restatement of Contracts § 454 (1932)). Even though the owner is not excused because of strict impossibility, it is urged that American law recognizes that performance is rendered impossible if it can only be accomplished with extreme and unreasonable difficulty, expense, injury or loss. There is no extreme or unreasonable difficulty apparent here. The alternate route taken was well recognized, and there is no claim that the vessel

or the crew or the nature of the cargo made the route actually taken unreasonably difficult, dangerous or onerous. The owner's case here essentially rests upon the element of the additional expense involved-$131,978.44. This represents an increase of less than one third over the agreed upon $417,327.36. We find that this increase in expense is not sufficient to constitute commercial impracticability under either American or English authority.

Mere increase in cost alone is not a sufficient excuse for non-performance (Restatement of Contracts § 467 (1932)). It must be an "extreme and unreasonable" [1] expense (Restatement of Contracts § 454 (1932)).[2] While in the *Transatlantic* case *supra*, the increased cost amounted to an increase of about 14% over the contract price, the court did cite with approval the two leading English cases Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia), [1964] 2 Q.B. 226, 233 (C.A.1963) (which expressly overruled Societete Franco Tunisienne D'Armement v. Sidermar S.P.A. (The Messalia), [1961] 2 Q.B. 278 (1960), where the court had found frustration because the Cape route was highly circuitous and involved an increase in cost of approximately 50%), and Tsakiroglou & Co. Lt. v. Noblee Thorl G.m.b.H., [1960] 2 Q.B. 318, 348, aff'd, [1962] A.C., 93 (1961) where the House of Lords found no frustration though the freight costs were exactly doubled due to the Canal closure.

Appellant further seeks to distinguish *Transatlantic* because in that case the change in course was in the mid-Atlantic and added some 300 miles to the voyage while in this case the WASHINGTON TRADER had traversed most of the Mediterranean and thus had added some 9000 miles to the contemplated voyage. It should be noted that although both the time and the length of the altered passage here exceeded those in the *Transatlantic*, the additional compensation sought here is just under one third of the contract price. Aside from this however, it is a fact that the master of the WASHINGTON TRADER was alerted by radio on May 29th, 1967 of a "possible diversion because of Suez Canal crisis," but nevertheless two days later he had left Ceuta

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[1] The Restatement gives some examples of what is "extreme and unreasonable" -- Restatement of Contracts § 460, Illus. 2 (tenfold increase in costs) and Illus. 3 (costs multiplied fifty times) (1932); compare § 467, Illus. 3. See generally G. Grismore, Principles of the Law of Contracts § 179 (rev. ed. J. E. Murray 1965).

[2] Both parties take solace in the Uniform Commercial Code which in comment 4 to Section 2-615 states that the rise in cost must "alter the essential nature of the performance . . . ." This is clearly not the case here. The owner relies on a further sentence in the comment which refers to a severe shortage of raw materials or of supplies due to "war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost . . . ." Since this is not a case involving the sale of goods but transportation of a cargo where there was an alternative which was a commercially reasonable substitute (see Uniform Commercial Code § 2-614(1)) the owner's reliance is misplaced.

(opposite Gibraltar) and proceeded across the Mediterranean. While we may not speculate about the foreseeability of a Suez crisis at the time the contract was entered, there does not seem to be any question but that the master here had been actually put on notice before traversing the Mediterranean that diversion was possible. Had the WASHINGTON TRADER then changed course, the time and cost of the Mediterranean trip could reasonably have been avoided, thereby reducing the amount now claimed. (Restatement of Contracts § 336, Comment *d* to subsection (1) (1932)).

In a case closely in point, Palmco Shipping Inc. v. Continental Ore Corp. (*The "Captain George K"*), [1970] 2 Lloyd's L.Rep. 21 (Q.B.1969), *The Eugenia, supra,* was followed, and no frustration was found where the vessel had sailed to a point three miles northwest of Port Said only to find the Canal blocked. The vessel then sailed back through the Mediterranean and around the Cape of Good Hope to its point of destination, Kandla. The distances involved, 9700 miles via the initially contemplated Canal route and 18,400 miles actually covered by way of the Cape of Good Hope, coincide almost exactly with those in this case. Moreover, in *The "Captain George K"* there was no indication that the master had at anytime after entering the Mediterranean been advised of the possibility of the Canal's closure.…

Matters involving impossibility or impracticability of performance of contract are concededly vexing and difficult. One is even urged on the allocation of such risks to pray for the "wisdom of Solomon." 6 A. Corbin, Contracts § 1333, at 372 (1962). On the basis of all of the facts, the pertinent authority and a further belief in the efficacy of prayer, we affirm.

EASTERN AIR LINES, INC. v. MCDONNELL DOUGLAS CORP., 532 F.2d 957 (5th Cir. Fla. 1976)

AINSWORTH, Circuit Judge:

This important Florida diversity case involves an appeal from a judgment for damages for breach of contract in favor of Eastern Air Lines against McDonnell Douglas Aircraft, Inc. based on a jury verdict in Eastern's favor for the sum of $24,552,659.11 plus costs of $241,149.02 one of the largest jury verdicts ever reviewed by this Court. Involved is a series of contracts covering the

years 1965-1968 by which Douglas Aircraft, Inc. agreed to manufacture and sell to Eastern Air Lines nearly 100 jet planes for approximately a half billion dollars. Suit was filed by Eastern against Douglas on July 3, 1970, based on allegations that 90 of these planes were delivered a total of 7,426 days late.

…

Letters of intent providing for Eastern's lease or purchase of DC-9-14's and for its purchase of the "stretched" DC-9-31 and the DC-8 planes were signed in February of 1965. The following July, Douglas and Eastern entered into the first three of what was to be a series of eight contracts providing for the delivery of a total of 99 planes. …

Much of the trial below was devoted to McDonnell's defense that the delivery delays were the result of the escalation of the war in Vietnam and were therefore excusable under the contracts, the Defense Production Act, and the Uniform Commercial Code. To prove this contention, McDonnell introduced evidence of government pressure on its suppliers and subcontractors to accord military orders priority over civilian projects.

Because we find that the Government's "jawboning" policy in effect during the years 1966-1969 comes within the terms of the contracts' excusable delay clause and the exculpatory provision of the Defense Production Act, we hold that the District Judge committed reversible error on this issue. The jury should have been instructed that McDonnell was not liable for any delays proximately caused by this government policy. The trial judge also erred in instructing the jury both that these particular delays had to have been unforeseeable and that the Code's impracticability defense was not available to McDonnell…..

[I]n February 1965, when Eastern and Douglas signed the letter of intent concerning all the agreements ultimately executed between them, the Vietnam conflict was having no significant effect on the American economy. There was, moreover, little indication at that time of the proportions which the war was quickly to assume.

It was not until 1966 that the war first began to have a substantial impact on the American economy. …This…led to conflicts between already scheduled commercial production and sudden, unexpectedly-large military needs. Rather than abandoning entirely the "guns and butter" policy upon which the war had been predicated, the Government sought instead to have military suppliers accord first priority to war production.

The vehicle by which military orders gained precedence over civilian production was the Defense Production Act of 1950 ("D.P.A."). Section 101 of the D.P.A. grants the President broad authority to require that priority be given to "contracts or orders . . . which he deems necessary or appropriate to promote the national defense." Under section 704, the President is authorized further to "make such rules, regulations, and orders as he deems necessary or appropriate to carry out the provisions of this Act."

[Instead of issuing rules, the Defense Department made a deal with airplane manufactures, in which] the Defense Department insisted that particular military orders be given preference on an individual and informal basis. It appears that the aviation industry agreed to the proposed arrangement. Official recognition of the new policy is found in a July 22, 1966 letter from Farris Bryant, Director of the Office of Emergency Planning, to the Assistant Secretary of Defense, Paul R. Ignatius:

"It is my understanding that, by voluntary agreement between the Department of Defense and the aircraft manufacturers, actions have been taken which permit the manufacturers to produce military orders ahead of all civil air-carrier aircraft although both have equal priority rating."
… Individual firms, moreover, were told that any resistance to informal requests by representatives of the military would result in a formal directive being issued against them. ….

Taking the view that the jawboning policy described above was voluntarily acquiesced in by the aviation industry, the District Court ruled and subsequently instructed the jury during the liability phase of the trial that only delays resulting from the actual issuance of formal ratings or directives could be deemed excusable. Consistent with this approach, the trial judge either excluded or struck evidence concerning government jawboning of Douglas' suppliers……
…..

B. The "Excusable Delay" Clause

McDonnell Douglas contends that the trial judge's instructions to the jury undercut the defense available to it under the excusable delay clause found in all of the contracts at issue in this appeal. In relevant part, the provision reads as follows:

"Seller shall not be responsible nor deemed to be in default on account of delays in performance . . . due to causes beyond Seller's control and not occasioned by its fault or negligence, including but not being limited to . . . any act of government, governmental priorities, allocation regulations or orders affecting materials, equipment, facilities or completed aircraft, . . .

failure of vendors (due to causes similar to those within the scope of this clause) to perform their contracts . . . , provided such cause is beyond Seller's control."

1. Ejusdem Generis and the Applicability of U.C.C. s 2-615

McDonnell's first contention in this regard is that the District Court unduly narrowed the scope of this clause by instructing the jury that an excusable delay must be the result of "one or more of the listed events in the excusable delay clause of the contracts, or . . . a similar cause beyond the defendant's control. . . . " This instruction, in McDonnell's view, effectively construes the specifically listed excusable causes of delay as restricting the application of the more general phrase which exempts Douglas from liability for delays beyond its control and not due to its negligence. McDonnell feels, therefore, that its affirmative defense was unjustifiably limited to delays caused by events similar to those specifically listed when, in fact, the contracts excused all delays which were not its fault.

The trial judge's construction of the clause, moreover, affords McDonnell Douglas a narrower range of excuses than is available under the modern view of impossibility as it is codified in U.C.C. § 2-615. Simply stated, section 2-615 excuses delay or nondelivery when the agreed upon performance has been rendered "commercially impracticable" by an unforeseen supervening event not within the contemplation of the parties at the time the contract was entered into. Uniform Commercial Code § 2-615 (Cal.Comm.Code s 2615) Comments 1 & 8; see Restatement, Contracts §§ 454, 457 (1932); 6 A. Corbin, Contracts §§ 1321, 1339 (1962).

Under section 2-615, the impossibility defense is available to the seller only if he has not "assumed a greater obligation" than that imposed upon him by this provision. During the trial, the court below ruled that section 2-615 was not applicable for this reason. Although the trial judge failed to explain his holding, it must have been based upon his restrictive construction of the excusable delay clause. Presumably, then, the protections of section 2-615 were deemed to have been waived because the contracts were interpreted as limiting McDonnell's impossibility defense to delays caused by events similar to those specifically provided for in the excusable delay clause.

In support of this approach, Eastern argues that the District Court correctly applied ejusdem generis, a canon of judicial construction limiting the application of general terms which follow specific ones to matters similar in kind or classification to those specified. This maxim, however, "is only an instrumentality for ascertaining the correct meaning of words when there is

uncertainty." Gooch v. United States, 297 U.S. 124, 128 (1936) Obviously, the application of the doctrine in this case would make superfluous the unambiguous words "including but not being limited to" which precede the specifically listed excuses for delay. It is clear, then, that by excusing delays not within McDonnell's control nor due to its negligence, "including but not being limited to" governmental acts, priorities, or orders, the parties intended to excuse all delays coming within the general description regardless of their similarity to the listed excuses. Consequently, there is no basis for the trial judge's conclusion that McDonnell waived the protections of section 2-615 and that its contract excuses are narrower than those available under the doctrine of commercial impracticability.

2. The Foreseeability Issue

McDonnell also challenges the trial judge's jury instruction which limited excusable delivery delays to those resulting from events which were not "reasonably foreseeable" at the time a contract was executed. By writing a foreseeability requirement into the excusable delay clause, the District Court appeared to construe the contracts as constituting nothing more than an application of the Code's commercial impracticability rule to those particular events specified in the contracts. Although there has been some doubt expressed as to whether the Code permits parties to bargain for exemptions broader than those available under section 2-615, this concern is ill-founded. See Hawkland, The Energy Crisis and Section 2-615 of the Uniform Commercial Code, 79 Com.L.J. 75 (1974). Comment 8 to this provision plainly indicates that parties may "enlarge upon or supplant" section 2-615. See United States v. Wegematic Corp., 2 Cir., 1966, 360 F.2d 674, 677 (Friendly, J.).

There appear to be, however, certain strictures imposed upon judicial interpretation of such agreements. Comment 8 provides:

"Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go."

While this provision could have been drafted in less vague terms, we presume that Comment 8 establishes “mercantile sense and reason” as a general standard governing our construction of agreements enlarging upon the protections of section 2-615. As we understand Comment 8, where there is doubt concerning the parties' intention, exemption clauses should not be construed as broadening the excuses available under the Code's impracticability rule. Applying this standard to the excusable delay clause, we cannot, in the absence of evidence to the contrary, hold that McDonnell is exempt from liability for any delay, regardless of its foreseeability, that is due to causes beyond its control. Exculpatory provisions which are phrased merely in general terms have long been construed as excusing only unforeseen events which make performance impracticable. Courts have often held, therefore, that if a promisor desires to broaden the protections available under the excuse doctrine he should provide for the excusing contingencies with particularity and not in general language.

We realize, of course, that this rule of construction developed in the pre-U.C.C. era when the scope of the impossibility and frustration doctrines was unclear and varied from jurisdiction to jurisdiction. Because of the uncertainty surrounding the law of excuse, parties had good reason to resort to general contract provisions relieving the promisor of liability for breaches caused by events “beyond his control.” Although the Uniform Commercial Code has ostensibly eliminated the need for such clauses, lawyers, either through an abundance of caution or by force of habit, continue to write them into contract. See generally Squillante & Congalton, Force Majeure, 80 Com.L.J. 4, 8-9 (1975). Thus, even though our interpretation would render the general terms of the excusable delay clause merely duplicative of section 2-615, we will adhere to the established rule of construction because it continues to reflect prevailing commercial practices.

We reiterate, however, that we are applying only a canon of contract interpretation which generally reflects commercial standards of reasonableness. We disagree with the suggestion of one commentator that section 2-615 imposes a fixed standard governing the interpretation of exemption clauses. The Code establishes no absolute requirement that any agreement purporting to enlarge upon section 2-615 must do so in plain and specific language. Even in the absence of detailed wording, trade usage and the circumstances surrounding a particular agreement may indicate that the parties intended to accord the seller an exemption broader than is available under the U.C.C.

While we hold that the provision of the excusable delay clause exempting McDonnell from liability for delays beyond its control should be interpreted as incorporating the Code's commercial impracticability doctrine, we disagree with the trial judge's jury instruction on foreseeability insofar as it implies that the events specifically listed in the excusable delay clause in each contract must have been unforeseeable at the time the agreement was executed. The rationale for the doctrine of impracticability is that the circumstance causing the breach has made performance so vitally different from what was anticipated that the contract cannot reasonably be thought to govern. 6 S. Williston, Contracts s 1963 at 5511 (rev. ed. 1938). However, because the purpose of a contract is to place the reasonable risk of performance on the promisor, he is presumed, in the absence of evidence to the contrary, to have agreed to bear any loss occasioned by an event which was foreseeable at the time of contracting. Lloyd v. Murphy, 1944, 25 Cal.2d 48, 54, 153 P.2d 47, 50 (Traynor, J.) Underlying this presumption is the view that a promisor can protect himself against foreseeable events by means of an express provision in the agreement.

Therefore, when the promisor has anticipated a particular event by specifically providing for it in a contract, he should be relieved of liability for the occurrence of such event regardless of whether it was foreseeable. See Edward Maurer Co. v. Tubeless Tire Co., 6 Cir., 1922, 285 F. 713, 714-15. As Justice Traynor noted for the California Supreme Court under different but nonetheless analogous circumstances,

"the question whether a risk was foreseeable is quite distinct from the question whether it was contemplated by the parties. . . . When a risk has been contemplated and voluntarily assumed . . . foreseeability is not an issue and the parties will be held to the bargain they made." Glenn R. Sewell Sheet Metal, Inc. v. Loverde, 1969, 70 Cal.2d 666, 451 P.2d 721, 728 n. 13;

In this case, it is clear that Eastern specifically "contemplated and voluntarily assumed" the risk that deliveries would be delayed by governmental acts, priorities, regulations or orders. Moreover, unlike the only case cited to us by Eastern which construes a similar provision, United States v. Brooks-Callaway Co., 318 U.S. 120 (1943), there is no indication from the wording of the excusable delay clause that McDonnell's defenses are to be limited to breaches caused by unforeseeable events. Therefore, we must conclude that the trial judge erred in instructing the jury

that the events specifically listed in the excusable delay clause must have been unforeseeable at the time the contracts were entered into for McDonnell to claim exemption from liability.

3. Informal Demands for Priority as an "Act of Government"

Turning next to the question of whether the Government's informal priorities policy came within the ambit of the excusable delay clause, we have seen in Part IV-A of this opinion that McDonnell and its suppliers, in granting priority to the military, were cooperating with the established, publicly announced procurement policy of the Federal Government. Eastern contends, however, that this informal program did not come within the scope of the contract clause specifically excusing "any act of government, governmental priorities, allocations, or orders affecting materials." Asserting that the Defense Production Act authorizes the Government to obtain precedence for certain orders only by means of formal, published regulations, Eastern concludes that any other method is illegal, if not unconstitutional, and therefore cannot be deemed an act of Government. We disagree for the following reasons.

The Defense Production Act, in "a sweeping delegation of power," grants the President broad authority to require that defense-related contracts be given precedence over less essential orders. D.P.A. s 101(a), 50 App.U.S.C. s 2071(a). Congress created no detailed scheme by which this power was to be exercised, providing only that "(t)he President may make such rules, regulations, and orders as he deems necessary or appropriate." D.P.A. §704, 50 App.U.S.C. §2154. There is, moreover, nothing in either the legislative history of the D.P.A. or in the wording of the Act itself which gives any indication that the Government may not seek compliance with its priorities policies by informal means. It is reasonable to conclude, therefore, that Congress intended to accord the Executive Branch great flexibility in molding its priorities policies to the frequently unanticipated exigencies of national defense.

This conclusion is reinforced by the fact that the Defense Production Act of 1950 was enacted in the face of established legal authority which had consistently construed previous procurement statutes as authorizing informal and indirect methods of securing compliance with the Government's military priorities policy. It was recognized that, for reasons of practical necessity, urgently needed government orders had to be obtained "by non-mandatory directions based ultimately on the powers of compulsion rather than by the actual exercise of the statutory compulsive powers." Dodd, Impossibility of Performance of Contracts Due to War-Time

Regulations, 32 Harv.L.Rev. 789, 798 (1919). The military's need for speed and flexibility in directing the flow of necessary materials precluded a ponderous bureaucratic procurement process. Thus, even though the World War I National Defense Act, 39 Stat. 213 (June 3, 1916), specifically provided that either the President or a department head placed priorities orders, several decisions held that literal compliance with this requirement was not necessary…..

There can be little question, then, that the Defense Production Act granted the Government authority to seek compliance with its priorities programs by informal means of persuasion whether written or oral. For this reason, many of the decisions relied on by Eastern are inapposite here. E. g. Northern Pacific Ry. v. American Trading Co., 195 U.S. 439, 25 S.Ct. 84, 49 L.Ed. 269 (1904).

We note, moreover, that this case precisely fits an established pattern of decisions rejecting the contention that breaches of contract are excused only by formal or technical acts of Government. Whether predicated on a contractual provision or simply on the common law defense of impossibility these decisions indicate in the clearest terms that fundamentally coercive acts of Government, whatever their form, constitute an excuse for breach. Thus, a promisor is not liable merely because the government order causing a breach is technically deficient. Texas Co. v. Hogarth Shipping Corp., 256 U.S. 619, 41 S.Ct. 612, 65 L.Ed. 1123 (1921). Neither is he required to resist a government requisition in order to be excused from performance. The Claveresk, 2 Cir., 1920, 264 F. 276. As the Claveresk court observed, "it would be 'a strange law' which required . . . (a promisor) to resist, 'till the hand of power was laid upon him, an order which it was his duty to obey'." 264 F. at 280-81. The Supreme Court, moreover, has excused breaches caused by a promisor's anticipation of government action. The Kronprinzessin Cecilie, 244 U.S. 12, 37 S.Ct. 490, 61 L.Ed. 960 (1917). Writing for the Court, Mr. Justice Holmes found the impossibility doctrine applicable to a ship which returned to port in expectation of World War I but before its actual declaration:

"(I)t hardly could change . . . (the ship owner's) liability that he prophetically and rightly had anticipated the . . . (war) by twenty-four hours. We are wholly unable to accept the argument that although a shipowner may give up his voyage to avoid capture after war is declared, he never is at liberty to anticipate war." 244 U.S. at 24.

Thus, the “apprehension of restraint, something much less than actual government compulsion, may suffice to dissolve the obligation of a contract.” The Claveresk, supra, 264 F. at 282….

Consequently, we will not permit the form of the military priorities policy to disguise what was in substance a governmental act beyond the control of McDonnell Douglas. The excusable delay clause cannot be made to turn on a distinction which for so long has been held to be entirely artificial and unrealistic. As Mr. Justice Holmes stated in a very similar context, “(b) usiness contracts must be construed with business sense, as they naturally would be understood by intelligent men of affairs.” The Kronprinzessin Cecilie, supra, 244 U.S. at 24, 37 S.Ct. at 492, 61 L.Ed. at 966.

This approach, moreover, is consistent with that required under the Uniform Commercial Code. In Comment 10 to section 615, the draftsmen of Article 2 stated:

“Following its basic policy of using commercial practicability as a test for excuse, this section . . . disregards any technical distinctions between “law,” “regulation,” “order” and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this Article and the best evidence of his good faith is the general commercial acceptance of the regulation.”

Given McDonnell's unquestioned good faith in complying with the Government's demands for priority and the uncontroverted evidence of the entire aviation industry's acceptance of the policy, we must hold as a matter of law that McDonnell is not liable for any delivery delay proximately resulting from the informal procurement program…..

REVERSED AND REMANDED FOR A NEW TRIAL.

KRELL v. HENRY, [1903] 2 Kings Bench 740

. APPEAL from a decision of Darling J.

The plaintiff, Paul Krell, sued the defendant, C. S. Henry, for 50l., being the balance of a sum of 75l., for which the defendant had agreed to hire a flat at 56A, Pall Mall on the days of June 26 and 27, for the purpose of viewing the processions to be held in connection with the coronation of His Majesty. The defendant denied his liability, and counter-claimed for the return of the sum of 25l., which had been paid as a deposit, on the ground that, the processions not having taken place owing to the serious illness of the King, there had been a total failure of consideration for the contract entered into by him.

The facts, which were not disputed, were as follows. The plaintiff on leaving the country in March, 1902, left instructions with his solicitor to let his suite of chambers at 56A, Pall Mall on such terms and for such period (not exceeding six months) as he thought proper. On June 17, 1902, the defendant noticed an announcement in the windows of the plaintiff's flat to the effect that windows to view the coronation processions were to be let. The defendant interviewed the housekeeper on the subject, when it was pointed out to him what a good view of the processions could be obtained from the premises, and he eventually agreed with the housekeeper to take the suite for the two days in question for a sum of 75l.

On June 20 the defendant wrote the following letter to the plaintiff's solicitor:--

“I am in receipt of yours of the 18th instant, inclosing form of agreement for the suite of chambers on the third floor at 56A, Pall Mall, which I have agreed to take for the two days, the 26th and 27th instant, for the sum of 75l. For reasons given you I cannot enter into the agreement, but as arranged over the telephone I inclose herewith cheque for 25l. as deposit, and will thank you to confirm to me that I shall have the entire use of these rooms during the days (not the nights) of the 26th and 27th instant. You may rely that every care will be taken of the premises and their contents. On the 24th inst. I will pay the balance, viz., 50l., to complete the 75l. agreed upon.”

On the same day the defendant received the following reply from the plaintiff's solicitor:--

“I am in receipt of your letter of to-day's date inclosing cheque for 25l. deposit on your agreeing to take Mr. Krell's chambers on the third floor at 56A, Pall Mall for the two days, the 26th and 27th June, and I confirm the agreement that you are to have the entire use of these rooms during the days (but not the nights), the balance, 50l., to be paid to me on Tuesday next the 24th instant.”

The processions not having taken place on the days originally appointed, namely, June 26 and 27, the defendant declined to pay the balance of 50l. alleged to be due from him under the contract in writing of June 20 constituted by the above two letters. Hence the present action.

Darling J., on August 11, 1902, held, upon the authority of *Taylor v. Caldwell* and *The Moorcock*, that there was an implied condition in the contract that the procession should take place, and gave judgment for the defendant on the claim and counter-claim.

The plaintiff appealed.

…

VAUGHAN WILLIAMS L.J. read the following written judgment:--

The real question in this case is the extent of the application in English law of the principle of the Roman law which has been adopted and acted on in many English decisions, and notably in the case of *Taylor v. Caldwell*. That case at least makes it clear that "where, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless, when the time for the fulfilment of the contract arrived, some particular specified thing continued to exist, so that when entering into the contract they must have contemplated such continued existence as the foundation of what was to be done; there, in the absence of any express or implied warranty that the thing shall exist, the contract is not to be considered a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor." Thus far it is clear that the principle of the Roman law has been introduced into the English law. The doubt in the present case arises as to how far this principle extends…. I do not think that the principle of the civil law as introduced into the English law is limited to cases in which the event causing the impossibility of performance is the destruction or non-existence of some thing which is the subject-matter of the contract or of some condition or state of things expressly specified as a condition of it. I think that you first have to ascertain, not necessarily from the terms of the contract, but, if required, from necessary inferences, drawn from surrounding circumstances recognized by both contracting parties, what is the substance of the contract, and then to ask the question whether that substantial contract needs for its foundation the assumption of the existence of a particular state of things. If it does, this will limit the operation of the general

words, and in such case, if the contract becomes impossible of performance by reason of the non-existence of the state of things assumed by both contracting parties as the foundation of the contract, there will be no breach of the contract thus limited.

Now what are the facts of the present case? The contract is contained in two letters of June 20 which passed between the defendant and the plaintiff's agent, Mr. Cecil Bisgood. These letters do not mention the coronation, but speak merely of the taking of Mr. Krell's chambers, or, rather, of the use of them, in the daytime of June 26 and 27, for the sum of 75l., 25l. then paid, balance 50l. to be paid on the 24th. But the affidavits, which by agreement between the parties are to be taken as stating the facts of the case, show that the plaintiff exhibited on his premises, third floor, 56A, Pall Mall, an announcement to the effect that windows to view the Royal coronation procession were to be let, and that the defendant was induced by that announcement to apply to the housekeeper on the premises, who said that the owner was willing to let the suite of rooms for the purpose of seeing the Royal procession for both days, but not nights, of June 26 and 27. In my judgment the use of the rooms was let and taken for the purpose of seeing the Royal procession. It was not a demise of the rooms, or even an agreement to let and take the rooms. It is a license to use rooms for a particular purpose and none other. And in my judgment the taking place of those processions on the days proclaimed along the proclaimed route, which passed 56A, Pall Mall, was regarded by both contracting parties as the foundation of the contract; and I think that it cannot reasonably be supposed to have been in the contemplation of the contracting parties, when the contract was made, that the coronation would not be held on the proclaimed days, or the processions not take place on those days along the proclaimed route; and I think that the words imposing on the defendant the obligation to accept and pay for the use of the rooms for the named days, although general and unconditional, were not used with reference to the possibility of the particular contingency which afterwards occurred.

It was suggested in the course of the argument that if the occurrence, on the proclaimed days, of the coronation and the procession in this case were the foundation of the contract, and if the general words are thereby limited or qualified, so that in the event of the non-occurrence of the coronation and procession along the proclaimed route they would discharge both parties from further performance of the contract, it would follow that if a cabman was engaged to take some one to Epsom on Derby Day at a suitable enhanced price for such a journey, say 10l., both parties to the contract would be discharged in the contingency of the race at Epsom for some reason

becoming impossible; but I do not think this follows, for I do not think that in the cab case the happening of the race would be the foundation of the contract. No doubt the purpose of the engager would be to go to see the Derby, and the price would be proportionately high; but the cab had no special qualifications for the purpose which led to the selection of the cab for this particular occasion. Any other cab would have done as well. Moreover, I think that, under the cab contract, the hirer, even if the race went off, could have said, "Drive me to Epsom; I will pay you the agreed sum; you have nothing to do with the purpose for which I hired the cab," and that if the cabman refused he would have been guilty of a breach of contract, there being nothing to qualify his promise to drive the hirer to Epsom on a particular day. Whereas in the case of the coronation, there is not merely the purpose of the hirer to see the coronation procession, but it is the coronation procession and the relative position of the rooms which is the basis of the contract as much for the lessor as the hirer; and I think that if the King, before the coronation day and after the contract, had died, the hirer could not have insisted on having the rooms on the days named. It could not in the cab case be reasonably said that seeing the Derby race was the foundation of the contract, as it was of the license in this case. Whereas in the present case, where the rooms were offered and taken, by reason of their peculiar suitability from the position of the rooms for a view of the coronation procession, surely the view of the coronation procession was the foundation of the contract, which is a very different thing from the purpose of the man who engaged the cab - namely, to see the race - being held to be the foundation of the contract. Each case must be judged by its own circumstances. In each case one must ask oneself, first, what, having regard to all the circumstances, was the foundation of the contract? Secondly, was the performance of the contract prevented? Thirdly, was the event which prevented the performance of the contract of such a character that it cannot reasonably be said to have been in the contemplation of the parties at the date of the contract? If all these questions are answered in the affirmative (as I think they should be in this case), I think both parties are discharged from further performance of the contract. I think that the coronation procession was the foundation of this contract, and that the non-happening of it prevented the performance of the contract; and, secondly, I think that the non-happening of the procession, to use the words of Sir James Hannen in *Baily v. De Crespigny* was an event "of such a character that it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made, and that they are not to be held bound by general words which, though large enough to include, were not used with reference to the possibility of the

particular contingency which afterwards happened." The test seems to be whether the event which causes the impossibility was or might have been anticipated and guarded against. It seems difficult to say, in a case where both parties anticipate the happening of an event, which anticipation is the foundation of the contract, that either party must be taken to have anticipated, and ought to have guarded against, the event which prevented the performance of the contract. …

I myself am clearly of opinion that in this case, where we have to ask ourselves whether the object of the contract was frustrated by the non-happening of the coronation and its procession on the days proclaimed, parol evidence is admissible to shew that the subject of the contract was rooms to view the coronation procession, and was so to the knowledge of both parties. When once this is established, I see no difficulty whatever in the case. It is not essential to the application of the principle of *Taylor v. Caldwell* that the direct subject of the contract should perish or fail to be in existence at the date of performance of the contract. It is sufficient if a state of things or condition expressed in the contract and essential to its performance perishes or fails to be in existence at that time. In the present case the condition which fails and prevents the achievement of that which was, in the contemplation of both parties, the foundation of the contract, is not expressly mentioned either as a condition of the contract or the purpose of it; but I think for the reasons which I have given that the principle of *Taylor v. Caldwell* ought to be applied. This disposes of the plaintiff's claim for 50l. unpaid balance of the price agreed to be paid for the use of the rooms. The defendant at one time set up a cross-claim for the return of the 25l. He paid at the date of the contract. As that claim is now withdrawn it is unnecessary to say anything about it.

WESTERN PROPERTIES v. SOUTHERN UTAH AVIATION, INC., 776 P.2d 656 (Utah App.,1989)

DEAN E. CONDER, Judge:

The trial court granted partial summary judgment in this case, awarding plaintiff Western Properties rent accrued to June 27, 1986, from which the defendants appeal. Western Properties appeals from the final judgment dismissing its claims for additional rent and for breach of a lease covenant regarding construction of a building. We affirm both the partial summary judgment and the final judgment.

Western Properties leased from Cedar City certain vacant land at the Cedar City Airport. Western Properties in turn subleased part of the land to the defendants for a 15-year term beginning March 6, 1985, with a covenant that the defendants "shall construct on the premises a maintenance building," which, upon termination of the sublease, was to have become property of Western Properties. In July of 1985, Cedar City approved the sublease in an addendum to it.

The defendants thereafter applied to Cedar City for site plan approval for the maintenance building, but as of the time of trial had not obtained such approval from Cedar City. Cedar City had also not approved a master plan for the airport as a whole. The defendants defaulted in payment of rent and abandoned the subleased land on June 27, 1986, without ever constructing a maintenance building on the land.

Western Properties sued for unpaid rent and the value of the maintenance building that it was to have received following the 15-year term of the sublease. The trial court granted partial summary judgment and awarded rent accrued to the date of abandonment, but reserved issues of further damages. Later, following trial, the trial court dismissed Western Properties' claims for further rent and for the residual income value of the maintenance building, and from that dismissal Western Properties appeals. …

Impossibility and Frustration

The trial court based its post-trial judgment on grounds of impossibility. Under the contractual defense of impossibility, an obligation is deemed discharged if an unforeseen event occurs after formation of the contract and without fault of the obligated party, which event makes performance of the obligation impossible or highly impracticable. The rationale for this rule is founded on principles of assent and basic equity. Parties are ordinarily thought to have made certain assumptions in visualizing their agreement, and those assumptions comprise part of the basis and extent of their assent. The impossibility defense serves to prevent enforcement where those assumptions, and hence, the parties assent, prove to be faulty.

In this case, the parties appear to have tacitly assumed that the City would cooperate in the development of the leased land. The lease makes no provision for the prospect that the City would not approve the development. In the absence of any contractual allocation of the

risk of the City's non-cooperation, the failure of the City to approve development of the land is an eventuality sufficiently unforeseen[1] for application of the impossibility defense.

The other facts required for application of the impossibility defense appear to have been sufficiently established at trial. The district court found that the defendants "could not build the maintenance building without city approval and the city did not ever give its approval." There appears to be no factual basis for implicating the defendants in the failure of the City to approve, and the defendants seem to have made every effort that could reasonably be required in order to induce the City to give its approval. In the absence of facts which could indicate fault or a lack of diligence on the part of the defendants, we rely on the trial court's findings in concluding that performance of the defendants' obligations was indeed impossible through no fault of their own. We therefore treat the obligation to construct the maintenance building as discharged from the time when performance of their obligations became impossible.

Construction of the promised building was impossible, but occupancy of the land pursuant to the lease was not necessarily precluded by the inability to construct the building. The land was, however, wholly undeveloped and uncultivated. Without a way of productively using the land, the purpose of the leasehold was effectively frustrated. Frustration of purpose differs from the defense of impossibility only in that performance of the promise, rather than being impossible or impracticable, is instead pointless. There was no point in leasing this land once its development became impossible. The covenant to pay rent is therefore also discharged, effective as of June 27, 1986.

The judgment is affirmed.

Hypothetical

Plaintiff, Louisiana Power & Light Company (hereinafter referred to as "LP& L"), entered into a contract with defendants, Allegheny Ludlum Industries, Inc. (hereinafter

[1] We recognize that the City's failure to approve seems, from our present perspective, to be rather easy to foresee. However, the critical fact is not whether the event could have been foreseen, but rather, whether the parties actually did foresee it and provide accordingly in their contract. A dictum in one Utah case on impossibility employs the word "unforeseeable" in describing the event causing impossibility, Holmgren v. Utah-Idaho Sugar Co., 582 P.2d at 861 (Utah 1978); however, the better and more widely accepted rule looks not to whether the parties could or should have foreseen the event, but rather whether, as a fact of assent, they did foresee it. Restatement (Second) of Contracts § 261 & comment b (1981).

"Allegheny,") in which Allegheny agreed to supply condenser tubing to LP&L for use at LP&L's Waterford 3 nuclear power plant.

Allegheny argues that its performance under the contract with LP&L was rendered commercially impracticable because of a "severe shortage of critical raw materials and an increase in the cost of labor, an unexpected contingency which caused a dramatic increase in the price of those raw materials and the condenser tubing. "

Allegheny contacted LP&L in May of 1975 and informed LP&L that since March of 1974, its costs for electrolytic nickel had risen by 24%, for low carbon ferrochrome had risen by 185%, and that its labor costs had risen by 21%. C. R. Hastings, General Manager of Allegheny's Wallingford Tubular Division stated in his deposition that had Allegheny performed under the contract as written, it would have sustained a loss of $ 428,500 on the contract ….By Allegheny's own estimate its costs of performance under the contract increased only 38% over the original contract price of $ 1,127,387.82.

Louisiana Power & Light Co. v. Allegheny Ludlum Industries, Inc., 517 F. Supp. 1319 (E.D. La. 1981)

DURESS, UNDUE INFLUENCE

GALLON v. LLOYD-THOMAS CO., 264 F.2d 821 (8th Cir.1959)

MATTHES, Circuit Judge.

For the second time we are asked to review the action of the trial court in rendering judgment for defendant notwithstanding the verdict favorable to appellant (plaintiff) on Counts I and IX of plaintiff's amended complaint. …

As reference to our former opinion will reveal, in Count I plaintiff alleged that on October 13, 1954, as the result of defendant's duress, threats and coercion, he was compelled to sign an agreement with respect to his employment. In this count plaintiff prayed for rescission and cancellation of the contract, and for $25,000 actual damages. The jury awarded him $100 as damages. Count IX sought punitive damages and thereon plaintiff received a verdict for $20,000.

The court's Judgment n.o.v. on Counts I and IX, was predicated on the conclusion that if the contract of October 13, 1954, was entered into by plaintiff under duress, it was nevertheless ratified in all respects by him as a matter of law.

…

Plaintiff was employed by defendant in November, 1949. In March, 1950, he was appointed district manager in St. Louis, Missouri. For his services in selling appraisal service to business concerns, plaintiff received 15 per cent commission of the initial appraisal charge as well as the annual service charge. In 1952, for reasons not here material, plaintiff was transferred by defendant to New York with a drawing account of $225, with the oral understanding that defendant would not charge any overdrafts which plaintiff might incur in New York against his commissions earned in St. Louis. Plaintiff's operations in New York proved unsuccessful. His draw or advancement of $225 a week exceeded his earnings of 15 per cent of the defendant's fee on all contracts closed by plaintiff, and in September, 1954, defendant reduced plaintiff's drawing account to $175 a week. Pursuant to a telephone call from Ernest E. Goran, president of defendant company, plaintiff met Mr. Goran at the Sheraton Park Plaza Hotel in New York on or about October 12, 1954. Plaintiff testified that in the telephone conversation Goran said, ‘ * * * that I had stuck my neck out too far and that a few days or weeks earlier he had received a call from an officer of the Department of Justice in Chicago; that they were investigating my character; that the investigator asked Goran if he knew that I was a bigamist; that he, Goran, didn't want to be implicated so he turned the investigator over to Mr. Gatenbey (vice-president of defendant) to deal with.’ Getting down to the events in the hotel, it appears that plaintiff's wife was with him, but Goran would not permit her to accompany plaintiff and Goran to the latter's room in the hotel. Plaintiff stated that he was very upset; that he and Goran found Gatenbey in the room and the latter began reading from a paper ‘* * * and telling me that I was a bad man, a bigamist, promiscuous or maybe worse and went on for nearly an hour and a half or two until I was completely broken down.’ Continuing, plaintiff testified that Gatenbey ‘said that if he had had his way he would have fired me long ago; that I would have to get out of the country in twelve hours or else take the consequences.’ From other testimony we learn that plaintiff came to the United States from England in November, 1949; that he first married Ethel Charle, apparently in England; he then married one Margaret Duffin in Gretna Green,

Scotland; he again married in East St. Louis, Illinois, to a woman whom he had met in Toronto, Canada. This marriage was annulled in New York in September, 1953, and on August 10, 1954, plaintiff married his fourth and present wife. At the time of the Sheraton Plaza Hotel incident on October 12, 1954, plaintiff had not been naturalized, and it is apparent that the statements made by Gatenbey in the hotel room caused plaintiff great anxiety and fear that he would be deported from the United States. Following the encounter with Gatenbey, above related, and after Gatenbey had gone into the washroom, Goran informed plaintiff that he had told Gatenbey ‘not to be so hard on me’; that Gatenbey's friend (a prominent citizen of New York, then an official of that state) would be contacted in an effort to delay the investigation. According to plaintiff' testimony, when he left the hotel room he was so sick that Mr. Goran had to walk him around in the hall before he was in a condition to be taken downstairs.

Mrs. Gallon testified that when she and her husband met Goran in the hotel lobby he stated to plaintiff: ‘John, you've gone too far this time. We're going to have a terrible time to keep the investigators from bothering you and I am afraid you will be deported, but we will see (what) Mr. Gatenbey and I can figure out about it.’ Mrs. Gallon stated she waited in the hotel lobby from two until four o'clock p.m. while her husband was with Goran and Gatenbey. That when Mr. Gallon appeared ‘he was very, very sick. I do not know what he went through, but he really went through something with those people, believe me. My husband was very, very upset. He had been crying you could see.’ While in the cocktail lounge later in the day, Goran again stated that he and Gatenbey would try to figure out what could be done to prevent the investigation, and plaintiff would be advised. Out of the foregoing came the contract which materially changed plaintiff's remuneration. From further testimony, it seems that following the events above set forth, and within a day or two thereafter, Goran and Gatenbey presented the contract to plaintiff who expressed some reluctance on signing it. Thereupon, Gatenbey lost his temper and stated he was in favor of firing plaintiff right then. In this setting, and with plaintiff still laboring under the fear of deportation, he signed the October 13, 1954, contract. The inference is clear from his testimony that he was then assured by Goran and Gatenbey that the investigation relating to deportation of plaintiff would be stopped and everything would be all right.

The salient features and terms of the October 13, 1954, contract were: Plaintiff acknowledged his services had not been performed satisfactorily; defendant was to retain plaintiff in its employ as long as his services were satisfactory, and his compensation was to be in an amount agreed upon between the parties; plaintiff acknowledged that he was overdrawn in his account with defendant in an amount in excess of $15,000, and authorized defendant to apply any and all credits and moneys due plaintiff from defendant toward payment of the overdraft (this terminated plaintiff's right to continue drawing commission on St. Louis business); plaintiff authorized defendant to pay out of moneys due him the sum of $200 to Mrs. Georgina Bird Gallon, one of his former wives, being the amount of a note held by her.

It is clear to us that the genuine trial issue revolved around and was focused upon the circumstances under which plaintiff entered into the October 13, 1954, contract. Was it the result of duress? That was the question. Plaintiff's testimony was sufficient to warrant a jury in finding that the contract came into existence as the direct result of the threats of Goran and Gatenbey, and that such threats caused plaintiff to be bereft of the quality of mind essential to the making of a contract.[1]

…

Did plaintiff ratify the contract as a matter of law? Appellee insists that in view of plaintiff's actions and conduct, and his attitude toward the contract following its execution, the question must be answered in the affirmative. We agree. In resolving this crucial issue, we are mindful of the well-established principle of law that a contract entered into as the result of duress is not void, but merely voidable, and is capable of being ratified after the duress is removed. Ratification results if the party who executed the contract under duress accepts the benefits flowing from it or remains silent or acquiesces in the contract for any considerable length of time after opportunity is afforded to annul or void it. An essential element in the doctrine of ratification is intention: Indeed, it has authoritatively been said that it is '* * * at the foundation

[1] "Under the modern doctrine there is no legal standard of resistance with which the victim must comply at the peril of being remediless for duress imposed, and no general rule respecting the sufficiency of facts to produce duress; the question in each case is whether or not the victim was so acted on by threats of the person claiming the benefit of the contract, as to be bereft of the quality of mind essential to the making of a contract, and whether or not the contract was thereby so obtained." 17 C.J.S. Contracts § 175…

of the doctrine of waiver or ratification.' 17A Am.Jur., Duress and Undue Influence § 26 at page 594.

Measured by the foregoing standard, the conclusion is inevitable that plaintiff ratified the contract in question. It appears without dispute that at the time the contract was signed, plaintiff was represented by an attorney, and in November or December, 1954, plaintiff informed his attorney of the conference in the hotel room preceding the execution of the contract, and also asked his attorney whether he could in fact be deported. From the time plaintiff signed the contract until he left defendant's employ in July, 1955, he never on a single occasion voiced any objection to the circumstances leading up to the contract nor did he at any time, after the alleged duress was removed, protest to Goran, Gatenbey or any other official of defendant that he had been pressured into signing the contract. To the contrary, he recognized the contract in all of its terms and provisions. He made weekly reports to defendant, in which he requested payment of his draw allowance of $175, which had been agreed upon. The commissions on the St. Louis, Missouri, business, which accrued after the contract was executed, were retained by defendant; the $200 due plaintiff's former wife was sent to her by defendant in accordance with one of the contract provisions, and in plaintiff's own words: "I never asked them (Goran and Gatenbey) to set the contract aside at anytime until after I resigned from the company. I never made such a claim to Goran, and I never made such a claim to Gatenbey until after I left the company."

In June or the early part of July, 1955, defendant reduced plaintiff's drawing account from $175 to $125 a week. This brought two letters from plaintiff, both written July 21, 1955. In one plaintiff proposed that his headquarters be transferred to Syracuse with a territory in out-state New York, and that he be permitted to draw $175 a week against his earnings. The other letter constituted his resignation to take effect within thirty days in the event his proposal was rejected. In neither letter did plaintiff question the validity of the contract. When defendant remained firm in its prior decision to reduce the weekly draw to $125, the parties parted company- and it was not until September, 1955, that plaintiff decided to take legal action to rescind or cancel the contract on the ground of duress in its procurement.

Without further discussion of undisputed testimony, bearing on ratification, we are of the opinion and so hold that when all of the facts and circumstances, viewed collectively, are fairly considered, only one conclusion can be reached and that is that plaintiff ratified the contract as

a matter of law. Having done so, it necessarily follows that under no theory is plaintiff entitled to actual damages (awarded in Count I) or punitive damages (awarded in Count IX), and that the Court properly entered judgment for defendant on both of said counts.

Affirmed.

Resolution Trust Corp. v. Ruggiero, 977 F.2d 309 (7th Cir. 1992)

COFFEY, Circuit Judge.

Angelo Ruggiero took out a $200,000 loan from Peoples Bank for Savings (Peoples Bank) in Libertyville, Illinois. Soon thereafter Peoples Bank went under and the Federal Savings and Loan Insurance Corporation was appointed receiver. To facilitate the liquidation of Peoples Bank, the Federal Home Loan Bank Board chartered Peoples Savings and Loan Association (Peoples Savings). Peoples Savings then executed a purchase and assumption transaction, taking over the assets and liabilities of Peoples Bank, including the right to collect the Ruggiero loan. Before it could collect on the loan, Peoples Savings went into receivership, this time under the direction of the Resolution Trust Corporation (RTC). This case deals with RTC's efforts to collect on the loan, as well as Ruggiero's claim that he signed the note under economic duress, and should not be held liable for it. We affirm.

I. BACKGROUND1

In December of 1988, the Midwest Bank and Trust Company of Chicago owned, as Trustee, the land and building housing the Hillside Cafe & Bar in Hillside, Illinois. The beneficiary of the trust was Gina Ruggiero, wife of Angelo Ruggiero. Midwest Bank's ownership of this property was subject to a first mortgage held by National Republic Bank (National Republic) of Chicago, with Neptune Investments, Inc. (Neptune), also of Chicago, as the mortgagor.

Neptune was $200,000 in default on mortgage payments when Hiram Patel of National Republic advised Angelo Ruggiero that the mortgage had to be removed from National Republic's records by the end of 1988 (or, presumably, National Republic would foreclose and the Ruggieros would lose the benefit of the trust). On December 27, 1988 Patel advised Ruggiero that he had spoken with representatives of the People's Bank who had agreed to loan him the $200,000 to satisfy the mortgage. Ruggiero then met with Patel and Peoples Bank

president John Schnure to work out the details. According to Ruggiero, the parties at this meeting agreed: (1) that Peoples Bank would loan Ruggiero $200,000 and he would be the obligor on the promissory note, which would be due sixty days after the loan was made; (2) that even though he was to sign the note as obligor, Ruggiero would not be personally responsible for it because, before the expiration of the sixty-day period, Peoples Bank would refinance the $200,000 as part of a much larger loan ($1.1 to $1.2 million) to Midwest Bank; (3) that if Peoples Bank failed to complete the refinancing arrangements within sixty days, National Republic would step in and repay the $200,000 loan to Peoples Bank; and (4) that the $200,000 loan would be made on December 30, 1988, enabling Ruggiero to meet National Republic's year-end deadline on the Neptune mortgage.

After the meeting Peoples Bank sent Ruggiero a $200,000 promissory note, which he signed and returned on December 29. This note did not contain any of the above conditions, despite his allegation that the parties agreed to these terms. Nevertheless, after signing the note Ruggiero forwarded it to the Bank, along with a letter reiterating the conditions outlined above; that is, the terms of the deal as he desired them to be. On the date of closing, December 30, when Ruggiero met with Peoples Bank president Schnure to receive the loan, Schnure informed him that Peoples Bank would not disburse the proceeds unless Ruggiero deleted from his letter all of the language inconsistent with the provisions of the note. Specifically, he was referring to the conditions expressed in Ruggiero's letter stating that Ruggiero would not be personally liable on the note and that the $200,000 would be rolled into a refinanced loan. Obviously neither the Bank nor Schnure had ever agreed to these terms, as none of them were included in the note that Ruggiero, a practicing attorney, had already signed. Never having agreed to the terms in the letter, the Bank naturally wanted to prevent Ruggiero from unilaterally modifying the note at the last minute, and thus directed that he cross out the sections of the letter contradicting the note. Ruggiero claims that since this was the last business day of the year and he would be unable to get the money from another source before the year ended, the Bank knowingly forced him to acquiesce to its demand. He makes this claim despite the fact that the Bank's demand ought to have been expected, given that the modifications proposed in Ruggiero's letter were not included in the note. He and Schnure then initialled the changes, making it clear that the crossed-out terms in the letter could not be interpreted as anything but that both signatories to the note agreed to the specific language of

the note on the date of their affixing their signatures thereto. At that time Ruggiero, without ever mentioning that he was being forced to modify his letter under duress, received the $200,000 from Peoples Bank, which he in turn used to pay off the Neptune mortgage at National Republic.

Despite the alleged agreement, the $200,000 loan was not refinanced within sixty days, nor did National Republic step in to pay off the note when the planned refinancing fell through. Needless to say, Ruggiero did not pay off the note, and thus the RTC, the receiver for Peoples Savings, commenced this action to collect the debt. Ruggiero asserted affirmative defenses, charging that the note was invalid because it was signed as the result of economic duress, that National Republic had breached its agreement to pay off the debt, and that People's Bank had reneged on its promise to refinance the note as part of a larger loan. RTC moved and the court dismissed these defenses under Federal Rule of Civil Procedure 12(c). Initially, the court found as a matter of law that there was no merit to Ruggiero's claim of economic duress since Peoples Bank had not committed any wrongful act that put Ruggiero in a vulnerable economic position or gave him no choice but to sign the note on its terms. See *De Fontaine v. Passalino,* 222 Ill.App.3d 1018 (1991). Rather, the court found, Ruggiero's need to have the money by the end of the year was his problem, and his alone, as borrower, and was neither contributed to nor caused by Peoples Bank. The Bank had every right to refuse Ruggiero's attempt to revise the agreement, and he could not now, twenty months later, claim that the Bank's refusal to make the revisions, knowing of his need for the money, amounted to economic duress….

II. ISSUES

The issues before this court are: (1) whether economic duress may be used as a defense against RTC's claim on a promissory note, and if so, whether Ruggiero in fact has stated a claim for economic duress….

III. DISCUSSION

Ruggiero (a licensed, practicing attorney who originally served as the defendants' attorney in this suit) initially contends that he should not be held liable on the note because Schnure forced him, at the last minute, to delete that portion of his letter recounting the agreement which stated that the parties had mutually agreed that he would not be made to answer for the money. Schnure did so, Ruggiero claims, by threatening to deny the loan unless he did as instructed, knowing that he had to have the money that day or he would be unable to satisfy the

Neptune mortgage, and thus he and his wife would be forced to surrender their interest in the Hillside Cafe & Bar. Ruggiero maintains that but for his precarious financial position he would not have acceded to Schnure's demands, and that Schnure was well aware of this fact and took advantage of it. Thus, he argues, the note was executed under economic duress, and he should not be held to answer for it.

Economic duress is a recognized affirmative defense to an action on a contract or note. *FDIC v. Linn,* 671 F.Supp. 547, 556 (N.D.Ill.1987). In Illinois,

Economic duress is present where one is induced by a wrongful act of another to make a contract under circumstances which deprive him of the exercise of free will, and a contract executed under duress is voidable.... To establish duress, one must demonstrate that the threat has left the individual "bereft of the quality of mind essential to the making of a contract." *Alexander v. Standard Oil Co*., 97 Ill.App.3d 809 (1981) (citations omitted); see also *Herget Nat'l Bank v. Theede*, 181 Ill.App.3d 1053, (1989). Of course, "[d]uress is not shown by the fact that one was subjected to ... a difficult bargaining position or the pressure of financial circumstances*." Herget Nat'l Bank*, 130 Ill.Dec. at 783; *Selmer Co. v. Blakeslee–Midwest Co*., 704 F.2d 924, 928 (7th Cir.1983) ("The mere stress of business conditions will not constitute duress where the defendant was not responsible for the conditions."), quoting *Johnson, Drake & Piper, Inc. v. United States*, 209 Ct.Cl. 313, 531 F.2d 1037, 1042 (1976); *Linn,* 671 F.Supp. at 560 ("Defendants cannot blame [plaintiffs] for the pressures caused by defendants' own business decisions and by general economic conditions.") Further, the pressure applied must have been wrongful or unlawful; mere hard bargaining is not enough. Linn, 671 F.Supp. at 556, 559.

[I]t is clear that Ruggiero was not a victim of economic duress. First of all, there is no evidence to suggest that Peoples Bank is guilty of committing any type of wrongful act forcing him to sign the note or accept the Bank's terms. *Alexander*, 53 Ill.Dec. at 198, 423 N.E.2d at 582. Driving a hard bargain is not a wrongful act, especially in this case, where Peoples Bank had nothing to do with putting Ruggiero in a position where he needed the money by the end of the year. See *Selmer*, 704 F.2d at 928. Moreover, the mere fact that one is in a difficult bargaining position due to desperate financial circumstances does not support a defense of economic duress. *Herget Nat'l Bank,* 130 Ill.Dec. at 783. A borrower cannot charge a lender

with economic duress where the pressures on the borrower are the result of his own business decisions and economic conditions. *Linn*, 671 F.Supp. at 560.

Further, Ruggiero's claim that Peoples Bank used economic duress to force him to delete the terms in his letter stating that he would not be personally accountable for the money is without merit. First of all, there is no evidence beyond Ruggiero's bald allegations that the Bank had ever agreed to the terms outlined in his letter. Second, the very terms in the letter were inconsistent with the note, and Peoples Bank had no reason, much less any obligation, to alter the terms of the note and make the new terms in the letter part of the agreement. Indeed, it takes quite a bold litigant (especially one with legal training) to assert that a lender's refusal to make a loan unless the borrower agrees to be held responsible for its repayment equals economic duress! The mere fact that a party to a contract is unable to obtain the terms he desires through negotiation does not mean that he can later attempt to avoid his obligations under the contract by claiming that he agreed to the contract (here, the loan note) under economic duress. See *Linn*, 671 F.Supp. at 559. If Ruggiero truly felt he was under duress he should have made it known to the Bank before signing the note, rather than later making unsubstantiated allegations that the parties actually had reached some agreement not expressed in the note. Finally, there can be no argument that Peoples Bank's demands left Ruggiero "bereft of the quality of mind essential to a contract." *Alexander*, 53 Ill.Dec. at 198, 423 N.E.2d at 582. As the district court noted, Ruggiero never raised the economic duress defense until the filing of his second set of affirmative defenses, some twenty months after signing the note and fourteen months after Peoples Bank originally filed this suit in state court. He also failed to mention to anyone that he had felt coerced into modifying his letter until that time. To quote the district court, "To be quite blunt, the entire matter creates the strongly suspicious inference that Ruggiero ... is now asserting whatever seems necessary to escape from what Ruggiero himself did at the loan closing." 756 F.Supp. 1092, 1094 (N.D.Ill.1992).

FRANCOIS v. FRANCOIS, 599 F.2d 1286 (C.A.V.I. 1979)

ROSENN, Circuit Judge.

We are asked in this appeal to assess whether the district court properly relieved a husband from the disastrous financial consequences of a “Property Settlement and Separation Agreement” (agreement) entered into with his wife. The plaintiff, Victor H. Francois, instituted an action in the district court against his wife, A. Jane Francois, seeking rescission of the agreement and various real and personal property transfers made pursuant to that agreement. The district court declared the agreement and the conveyances to be null and void on the grounds, Inter alia, that Jane Francois had exerted undue influence over her husband. The district court restored title to one parcel of real property and various securities to Victor Francois in his name alone. From the final order of the district court, Jane Francois appeals alleging that the district court improperly invalidated the agreement and reconveyed properties to her husband. We affirm.

I.

The controversy before us arises out of the troubled and relatively brief marriage of the parties. Victor H. Francois (Victor) and A. Jane Francois (Jane) were married on May 13, 1971 after a brief courtship of several months. At the time of the wedding, Victor was fifty years old, a bachelor residing with his elderly mother. Jane was thirty years old, twice divorced and the mother of two minor children, one approximately sixteen years old, and the other, thirteen. Victor was relatively secure financially, possessing an acre lot, Lilliendal and Marienhoj, St. Thomas, V.I. (Lilliendal), with a two story, five bedroom building containing two apartments, a one-fourth interest in his family's hardware business, thirty shares of a family close corporation (Francois Realty), four shares of stock in a multi-family close corporation (21 Queen's Quarter), a portfolio of publicly held stock valued at between $18,000 and.$19,000, and two bank accounts. Victor also received income from his job as manager of the family hardware business. Jane was gainfully employed at the time of the marriage but ceased working shortly thereafter. She apparently brought no money or property to the marriage.

The couple began to experience difficulties not long after the marriage. A series of events over the next four years centering on financial disputes led to the deterioration and eventual collapse of the marital relation. Within months of the wedding, Jane began to

express anxiety over her financial security in the event that Victor died. To allay his wife's fears, Victor opened a joint savings account into which he deposited $5,000 for her use.

Jane also expressed a continuing desire for a marital homestead. In response, in March of 1972, Victor purchased a fairly large house with a swimming pool (Misgunst) for a sum of $107,000. Victor supplied a $37,000 downpayment from his assets and undertook the responsibility for the monthly mortgage payments in excess of $860 per month. Title was taken by the entireties. The same year, Victor filed a petition seeking adoption of Jane's two children. The court granted the petition after Victor acknowledged under oath that he voluntarily assumed responsibility for the children.

In the fall of 1973, the couple's finances became further consolidated. Victor conveyed all of his interest in his Lilliendal property to Jane and assigned to her a half interest in both his thirty shares of Francois Realty stock and four shares of 21 Queen's Quarter stock. He also gave Jane a power of attorney over his portfolio of publicly held stock. Jane also insisted on having a boat. Victor sold $18,000 of his stock in order to purchase a boat for Jane in her name at the cost of $17,000. Jane sold this boat approximately a year later for $16,000 and personally invested the proceeds for herself. The couple also executed reciprocal wills leaving the entirety of the marital estate to the surviving spouse or, if no spouse survived, to the children.

In September of 1974 a domestic quarrel precipitated the demise of the marriage. The dispute centered on an incident in which Victor allegedly embarrassed Jane by his behavior in front of one of Jane's friends. As a result of the incident, Jane determined to divorce Victor and on October 8, 1974, contacted an attorney, Harold Monoson, to draw up divorce papers. Victor was unaware of his wife's decision to terminate the marriage. Two days later, Jane, without any explanation, invited Victor to accompany her to Monoson's office where Victor, to his complete surprise, was presented for his signature a “Property Settlement and Separation Agreement.” Monoson advised Victor that he would need an attorney, but Victor's choice was vetoed by his wife's insistence that this attorney was unacceptable. Monoson then asked a lawyer with an office in the same building, Gregory Ball, to come into the office. Ball read the agreement, which interestingly already had his name on it as Victor's counsel. Ball strenuously advised Victor not to sign the agreement because it would commit him to “financial suicide.” When Victor persisted in his

determination to sign, Ball informed him that he could not represent him in the matter, and left the office.

Victor, relying on representations made to him by Monoson and Jane, was persuaded that only by signing the agreement could he preserve his marriage. Victor signed the agreement and several related documents apparently in hope of saving his marriage. He conveyed to Jane his one-half interest in the marital home, Misgunst, and assigned to her his stock portfolio and his remaining stock interest in both close corporations. In addition, the agreement required Victor to pay $300 per month in alimony to his wife.

After signing the agreement, however, the parties resumed cohabitation for approximately one year. But early in 1975, Jane informed Victor that she had sold the entire portfolio of publicly held stock for around $20,000. In October of 1975, Jane informed Victor that she had sold the Misgunst and Lilliendal properties in exchange for properties owned in California by AD'M Enterprises, a limited partnership. In mid-October Jane also summarily informed Victor that she was leaving him permanently and promptly left the Virgin Islands. AD'M took title to the properties by a single deed dated October 15, 1975 but before it could record the deed, Victor instituted these proceedings. Apparently when AD'M learned of this litigation, it never recorded the deed but instead sued Jane for rescission of the conveyance.

Victor's suit against Jane and AD'M sought rescission of the agreement and reconveyance of all properties transferred to Jane. AD'M was duly served but never appeared and a default judgment was entered against them from which no appeal has been taken. The case was tried to the court without a jury.

Chief Judge Christian, the trial judge, declared the Property Settlement and Separation Agreement to be null and void as the result of: 1) the cohabitation of the parties subsequent to the signing of the agreement; 2) the undue influence exerted by Jane over Victor in connection with the signing of the agreement; 3) fraud and misrepresentation on the part of Jane; and 4) the unconscionable terms of the agreement. Judge Christian also declared the deed of October 10, 1974 transferring sole title in the Misgunst property to Jane to be null and void and awarded title to the property solely in Victor's name. The court held the attempted transfer of Misgunst and Lilliendal properties by Jane to AD'M to be null and void. The court likewise voided the assignment made to Jane, pursuant to the agreement of

Victor's stock in the two close corporations, Francois Realty and 21 Queen's Quarters, and restored sole title to the stock to Victor. The court decreed that title to the Lilliendal property remain in Jane's name because “the circumstances of that transfer were not explicated before the court in the testimony.” The court, however, placed a lien against the Lilliendal property to secure Victor's reimbursement for the value of the stock and monies converted by Jane in early 1975. Finally, the district court awarded costs and attorneys fees to Victor.

II.

Jane's first contention on appeal is that the district court erred in setting aside the Property Settlement and Separation Agreement. She challenges each of the four theories underpinning the district court's order of nullification. Because we agree that the district court properly voided the agreement on the grounds of undue influence exerted by Jane over her husband, we need not examine Jane's contentions relating to the three other theories supporting the district court's judgment.

The key inquiry in the case before us is whether Jane and Victor Francois, as husband and wife, also enjoyed a confidential relationship. The marital relation does not automatically give rise to a confidential relation, but it “arises when one party places confidence in the other with a resulting superiority and influence on the other side.” Thus, each marriage must be examined on its own facts to determine if a confidential relation exists.

[Earlier in the opinion, the Court had stated the following: “A common context in which undue influence may be exerted so as to warrant the imposition of a constructive trust is when a party to a confidential relationship abuses that relation to secure personal advantages. See Scott, s 469 at 3441; Stauffer v. Stauffer, 465 Pa. 558, 351 A.2d 236, 241-42 (1976); Buchanan v. Brentwood Federal Savings and Loan Ass'n, 457 Pa. 135, 320 A.2d 117, 127 (1974). A confidential relationship may arise as a matter of law; but it is usually a question of fact in each case. Buchanan, supra 320 A.2d at 127.

A confidential relation exists between two persons when one has gained the confidence of the other and purports to act or advise with the other's interest in mind. A confidential relation may exist although there is no fiduciary relationship; it is particularly

likely to exist where there is a family relationship . . . . Restatement (Second) of Trusts §2, at 7 (1959).”]

The district court unequivocally found that a confidential relationship existed between Jane and Victor Francois and that Jane was clearly the dominant partner. The district court found the evidence to be “replete with instances” in which Jane was able to secure her wishes simply by badgering Victor into submission. The record reveals that Victor, very early in the marriage, began to turn over the management of his finances to Jane who subsequently used her position to gain control incrementally over most of Victor's assets. The evidence supports the district court's findings that the relationship between the parties was one in which Victor reposed total trust and confidence in Jane who used her superior position in the marriage to Victor's financial detriment.

The existence of a confidential relationship does not automatically give rise to the imposition of a constructive trust. Rather, “its effect is simply to impose a burden upon the party benefiting from the transaction of proving that he took no unfair advantage of his relationship with the other.” Williston states that if the person alleging undue influence can prove that “he was the servient member of a confidential relationship, . . . (c)ourts hold that this raises a rebuttable presumption of undue influence requiring the dominant party to come forward with proof of the fairness of the transaction.” Williston on Contracts, §1625 at 800 (3d ed. 1970) (footnotes omitted). …The trial court, after determining the existence of a confidential relation quite properly allocated the burden of proof to Jane.

We must now consider whether Jane met her burden of proof to rebut the charge of undue influence. If she failed, a constructive trust may be imposed on the couple's properties in order to prevent Jane's unjust enrichment.

Undue influence is not a concept susceptible of unitary definition. The essence of the idea is the subversion of another person's free will in order to obtain assent to an agreement.

“If a party in whom another reposes confidence misuses that confidence to gain his own advantage while the other has been made to feel that the party in question will not act against his welfare, the transaction is the result of undue influence. The influence must be such that the victim acts in a way contrary to his own best interest and thus in a fashion in

which he would not have operated but for the undue influence." Williston on Contracts, § 1625 at 776-77 (3d ed. 1970) (footnotes omitted).

The degree of persuasion that is necessary to constitute undue influence varies from case to case. The proper inquiry is not just whether persuasion induced the transaction but whether the result was produced by the domination of the will of the victim by the person exerting undue influence. Restatement of Contracts §497, Comment c. Hence, the particular transaction must be scrutinized to determine if the agreement was truly the product of a free and independent mind. In this respect, the fairness of the agreement must be shown by clear and convincing evidence.

The district court found that Jane alone caused the agreement to be made and that she alone benefited from it. The district court described the circumstances under which Victor was urged to obtain legal advice as a charade. There is no evidence that the independent advice received by Victor was from an attorney of his choosing. In fact, the meeting with Attorney Ball was arranged spontaneously and without an opportunity for a full and private consultation. Ball's name was already on the agreement as Victor's counsel. (For importance of independent counseling, See Williston, Supra s 1625 at 778.) Victor was apparently surprised by his wife's decision to terminate the marriage and there is evidence that Monoson and/or Jane misled him into believing that by signing the agreement, the marriage could be salvaged. The district court also found that Jane, at the time the agreement was signed, had no real intent to save the marriage.

The terms of the agreement were hardly fair. Attorney Ball's assessment that the agreement was financial suicide for Victor was accurate. On this record, we conclude that the district court was correct in its finding that Jane had failed to rebut the presumption of undue influence.

We thus have a classic situation in which a constructive trust should be imposed over all the assets acquired by Jane. The district court properly used its equitable power to declare the agreement to be null and void. Equity should fully protect one spouse from exploitation through the exercise of undue influence by the other in whom confidence and trust has been innocently reposed.…

Accordingly the judgment of the district court will be affirmed. Costs taxed against appellant.

Hypothetical

Headley sued Hackley & McGordon to recover compensation for cutting, hauling and delivering in the Muskegon river a quantity of logs. The performance of the labor was not disputed, but the parties were not agreed as to the construction of the contract in some important particulars, and the amount to which Headley was entitled depended largely upon the determination of these differences. The defendants also claimed to have had a full and complete settlement with Headley, and produced his receipt in evidence thereof. Headley admitted the receipt, but insisted that it was given by him under duress, and the verdict which he obtained in the circuit court was in accordance with this claim.

The [settlement] paper reads as follows:

"Muskegon, Mich., August 3, 1875.

Received from Hackley & McGordon their note for four thousand dollars, payable in thirty days, at First National Bank, Grand Rapids, which is in full for all claims of every kind and nature which I have against said Hackley & McGordon.

Witness: Thomas Hume. John Headley."

Headley's account of the circumstances under which this receipt was given is in substance as follows: On August 3, 1875, he went to Muskegon, the place of business of Hackley & McGordon, from his home in Kent county, for the purpose of collecting the balance which he claimed was due him under the contract. The amount he claimed was upwards of $ 6200, estimating the logs by the Scribner scale. He had an interview with Hackley in the morning, who insisted that the estimate should be according to the Doyle scale, and who also claimed that he had made payments to others amounting to some $ 1400 which Headley should allow. Headley did not admit these payments, and denied his liability for them if they had been made.

Hackley told Headley to come in again in the afternoon, and when he did so Hackley said to him: "My figures show there is 4260 and odd dollars in round numbers your due, and

I will just give you $ 4000. I will give you our note for $ 4000." To this Headley replied: "I cannot take that; it is not right, and you know it. There is over $ 2000 besides that belongs to me, and you know it." Hackley replied: "That is the best I will do with you." Headley said: "I cannot take that, Mr. Hackley," and Hackley replied, "You do the next best thing you are a mind to. You can sue me if you please." Headley then said: "I cannot afford to sue you, because I have got to have the money, and I cannot wait for it. If I fail to get the money to-day, I shall probably be ruined financially, because I have made no other arrangement to get the money only on this particular matter." Finally he took the note and gave the receipt, because at the time he could do nothing better, and in the belief that he would be financially ruined unless he had immediately the money that was offered him, or paper by means of which the money might be obtained.
Hackley v. Headley, 45 Mich. 569 (1881)

CAPACITY

PETTIT V. LISTON
97 Or. 464, 191 P. 660 (Supreme Court of Oregon, 1920)

Plaintiff, a minor, brings this action by his guardian to recover $ 125, paid by him upon the purchase price of a certain motorcycle purchased from the defendants.

The case involves the question of whether or not a minor, who has purchased an article of this kind, and taken and used the same, after paying part or all of the purchase price, can return the article and recover the money paid without making good to the vendors the wear and tear and depreciation of the same while in his hands.

The defendants in the case were engaged in the selling of motorcycles and attachments. The plaintiff purchased from them a motorcycle at the agreed price of $ 325. He paid $125 down, and was to pay $ 25 per month upon the purchase price until the payments were completed. He took and used the motorcycle for a little over a month and finally returned the same to the defendants and demanded the return of his money. The defendants answer and allege that plaintiff used the machine, and in so doing damaged it to the amount of $ 156.65.

There was a demurrer to the answer, which was overruled by the court, and the plaintiff refusing to reply or plead further and standing upon his demurrer, a judgment and order were entered dismissing the cause, from which the plaintiff appeals.

BENNETT, J. (after stating the facts as above).

The amount involved in this proceeding is not large, but the question of law presented is a very important one, and one which has been much disputed in the courts, and about which there is a great and irreconcilable conflict in the authorities, and we have therefore given the matter careful attention.

The courts, in an attempt to protect the minor upon the one hand, and to prevent wrong or injustice to persons who have dealt fairly and reasonably with such minor upon the other, have indulged in many fine distinctions and recognized various slight shades of difference.

In dealing with the right of the minor to rescind his contract and the conditions under which he may do so, the decisions of the courts in the different states have not only conflicted upon the main questions involved, but many of the decisions of the same court in the same state seem to be inconsistent with each other; and oftentimes one court has made its decision turn upon a distinction or difference not recognized by the courts of other states as a distinguishing feature.

The result has been that there are not only two general lines of decisions directly upon the question involved, but there are many others, which diverge more or less from the main line, and make particular cases turn upon real or fancied differences and distinctions, depending upon whether the contract was executory or partly or wholly executed, whether it was for necessaries, whether it was beneficial to the minor, whether it was fair and reasonable, whether the minor still had the property purchased in his possession, whether he had received any beneficial use of the same, etc.

Many courts have held broadly that a minor may so purchase property and keep it for an indefinite time, if he chooses, until it is worn out and destroyed, and then recover the payments made on the purchase price, without allowing the seller anything whatever for the use and depreciation of the property.

Many other authorities hold that where the transaction is fair and reasonable, and the minor was not overcharged or taken advantage of in any way, and he takes and keeps the property and uses or destroys it, he cannot recover the payments made on the purchase price, without allowing the seller for the wear and tear and depreciation of the article while in his hands.

The plaintiff contends for the former rule, and supports his contention with citations from the courts of last resort of Maine, Connecticut, Indiana, Massachusetts, Vermont, Nebraska, Virginia, Iowa, Mississippi, and West Virginia, most of which (although not all) support his contention. On the contrary, the courts of New York, Maryland, Montana, Illinois, Kentucky, New Hampshire, and Minnesota, with some others, support the latter rule, which seems to be also the English rule.

Some of the cyclopedias and some of the different series of selected cases state the rule contended for by plaintiff, as supported by the strong weight of authority; but we find the decisions rather equally balanced, both in number and respectability.

In Rice v. Butler, 160 N. Y. 578, it is said:

> "There are numerous authorities bearing upon the question, but they are not in entire harmony. We have examined them with some care, but have found none in this court which appears to settle the question now presented. We, consequently, are left free to adopt such a rule as in our judgment will best promote justice and equity. The contract in this case in its entirety must be held to be executory; for, under its terms, payments were to mature in the future and the title was only to

> pass to the minor upon making all of the payments stipulated; but in so far as the payments made were concerned the contract was in a sense executed, for nothing further remained to be done with reference to those payments. Kent, in his Commentaries (volume 2, p. 240), says: 'If an infant pays money on his contract and enjoys the benefit of it and then avoids it when he comes of age he cannot recover back the consideration paid. On the other hand, if he avoids an executed contract when he comes of age on the ground of infancy, he must restore the consideration which he had received. The privilege of infancy is to be used as a shield and not as a sword. He cannot have the benefit of the contract on one side without returning the equivalent on the other.' "

…

Our attention has not been called to any Oregon case bearing upon the question, and as far as our investigation has disclosed, there is none.

In this condition of the authorities, we feel that we are in a position to pass upon the question as one of first impression, and announce the rule, which seems to us to be the better one, upon considerations of principle and public policy.

We think, where the minor has not been overreached in any way, and there has been no undue influence, and the contract is a fair and reasonable one, and the minor has actually paid money on the purchase price, and taken and used the article, that he ought not to be permitted to recover the amount actually paid, without allowing the vendor of the goods the reasonable compensation for the use and depreciation of the article, while in his hands.

Of course, if there has been any fraud or imposition on the part of the seller, or if the contract is unfair, or any unfair advantage has been taken of the minor in inducing him to make the purchase, then a different rule would apply. And whether there had been such an overreaching on the part of the seller would always, in case of a jury trial, be a question for the jury.

We think this rule will fully and fairly protect the minor against injustice or imposition, and at the same time it will be fair to the businessman who has dealt with such minor in good faith. This rule is best adapted to modern conditions, and especially to the conditions in our Far Western states.

Here, minors are permitted to and do in fact transact a great deal of business for themselves, long before they have reached the age of legal majority. Most young men have their own time long before reaching that age. They work and earn money and collect it and

spend it oftentimes without any oversight or restriction.

No businessman questions their right to buy, if they have the money to pay for their purchases. They not only buy for themselves, but they often are intrusted with the making of purchases for their parents and guardians. It would be intolerably burdensome for every one concerned if merchants and other businessmen could not deal with them safely, in a fair and reasonable way, in cash transactions of this kind.

Again, it will not exert any good moral influence upon boys and young men, and will not tend to encourage honesty and integrity, or lead them to a good and useful business future, if they are taught that they can make purchases with their own money, for their own benefit, and after paying for them in this way, and using them until they are worn out and destroyed, go back and compel the business man to return to them what they have paid upon the purchase price. Such a doctrine, as it seems to us, can only lead to the corruption of young men's principles and encourage them in habits of trickery and dishonesty.

In view of all these considerations, we think that the rule we have indicated, and which is substantially the rule adopted in New York, is the better rule, and we adopt the same in this state.

We must not be understood as deciding at this time what would be the rule where the vendor is seeking to enforce an executory contract against the minor, which is a different question not necessarily involved in this case.

It follows that the judgment of the court below should be affirmed.

ORTELERE V. TEACHERS' RETIREMENT BD. OF CITY OF NEW YORK

25 N.Y.2d 196, 250 N.E.2d 460 (New York Court of Appeals, 1969)

Breitel, J.

This appeal involves the revocability of an election of benefits under a public

employees' retirement system and suggests the need for a renewed examination of the kinds of mental incompetency which may render voidable the exercise of contractual rights. The particular issue arises on the evidently unwise and foolhardy selection of benefits by a 60-year-old teacher, on leave for mental illness and suffering from cerebral arteriosclerosis, after service as a public schoolteacher and participation in a public retirement system for over 40 years. The teacher died a little less than two months after making her election of maximum benefits, payable to her during her life, thus causing the entire reserve to fall in. She left surviving her husband of 38 years of marriage and two grown children.

There is no doubt that any retirement system depends for its soundness on an actuarial experience based on the purely prospective selections of benefits and mortality rates among the covered group, and that retrospective or adverse selection after the fact would be destructive of a sound system. It is also true that members of retirement systems are free to make choices which to others may seem unwise or foolhardy. The issue here is narrower than any suggested by these basic principles. It is whether an otherwise irrevocable election may be avoided for incapacity because of known mental illness which resulted in the election when, except in the barest actuarial sense, the system would sustain no unfavorable consequences.

The husband and executor of Grace W. Ortelere, the deceased New York City schoolteacher, sues to set aside her application for retirement without option, in the event of her death. It is alleged that Mrs. Ortelere, on February 11, 1965, two months before her death from natural causes, was not mentally competent to execute a retirement application. By this application, effective the next day, she elected the maximum retirement allowance. She thus revoked her earlier election of benefits under which she named her husband a beneficiary of the unexhausted reserve upon her death. Selection of the maximum allowance extinguished all interests upon her death.

Following a nonjury trial in Supreme Court, it was held that Grace Ortelere had been mentally incompetent at the time of her February 11 application, thus rendering it "null and void and of no legal effect". The Appellate Division, by a divided court, reversed the judgment of the Supreme Court and held that, as a matter of law, there was insufficient proof of mental incompetency as to this transaction (31 A D 2d 139).

Mrs. Ortelere's mental illness, indeed, psychosis, is undisputed. It is not seriously

disputable, however, that she had complete cognitive judgment or awareness when she made her selection. A modern understanding of mental illness, however, suggests that incapacity to contract or exercise contractual rights may exist, because of volitional and affective impediments or disruptions in the personality, despite the intellectual or cognitive ability to understand. It will be recognized as the civil law parallel to the question of criminal responsibility which has been the recent concern of so many and has resulted in statutory and decisional changes in the criminal law (e.g., A. L. I. Model Penal Code, § 4.01; Penal Law, §30.05; Durham v. United States, 214 F. 2d 862).

Mrs. Ortelere, an elementary schoolteacher since 1924, suffered a "nervous breakdown" in March, 1964 and went on a leave of absence expiring February 5, 1965. She was then 60 years old and had been happily married for 38 years. On July 1, 1964 she came under the care of Dr. D'Angelo, a psychiatrist, who diagnosed her breakdown as involutional psychosis, melancholia type. Dr. D'Angelo prescribed, and for about six weeks decedent underwent, tranquilizer and shock therapy. Although moderately successful, the therapy was not continued since it was suspected that she also suffered from cerebral arteriosclerosis, an ailment later confirmed. However, the psychiatrist continued to see her at monthly intervals until March, 1965. On March 28, 1965 she was hospitalized after collapsing at home from an aneurysm. She died 10 days later; the cause of death was "Cerebral thrombosis due to H[ypertensive] H [eart] D[isease]."

As a teacher she had been a member of the Teachers' Retirement System of the City of New York (Administrative Code, § B20-30). This entitled her to certain annuity and pension rights, preretirement death benefits, and empowered her to exercise various options concerning the payment of her retirement allowance.

Some years before, on June 28, 1958, she had executed a "Selection of Benefits under Option One" naming her husband as beneficiary of the unexhausted reserve. Under this option upon retirement her allowance would be less by way of periodic retirement allowances, but if she died before receipt of her full reserve the balance of the reserve would be payable to her husband. On June 16, 1960, two years later, she had designated her husband as beneficiary of her service death benefits in the event of her death prior to

retirement.

Then on February 11, 1965, when her leave of absence had just expired and she was still under treatment, she executed a retirement application, the one here involved, selecting the maximum retirement allowance payable during her lifetime with nothing payable on or after death. She also, at this time, borrowed from the system the maximum cash withdrawal permitted, namely, $8,760. Three days earlier she had written the board, stating that she intended to retire on February 12 or 15 or as soon as she received "the information I need in order to decide whether to take an option or maximum allowance." She then listed eight specific questions, reflecting great understanding of the retirement system, concerning the various alternatives available. An extremely detailed reply was sent, by letter of February 15, 1965, although by that date it was technically impossible for her to change her selection. However, the board's chief clerk, before whom Mrs. Ortelere executed the application, testified that the questions were "answered verbally by me on February 11th." Her retirement reserve totalled $62,165 (after deducting the $8,760 withdrawal), and the difference between electing the maximum retirement allowance (no option) and the allowance under "option one" was $901 per year or $75 per month. That is, had the teacher selected "option one" she would have received an annual allowance of $4,494 or $375 per month, while if no option had been selected she would have received an annual allowance of $5,395 or $450 per month. Had she not withdrawn the cash the annual figures would be $5,247 and $6,148 respectively.

Following her taking a leave of absence for her condition, Mrs. Ortelere had become very depressed and was unable to care for herself. As a result, her husband gave up his electrician's job, in which he earned $222 per week, to stay home and take care of her on a full-time basis. She left their home only when he accompanied her. Although he took her to the Retirement Board on February 11, 1965, he did not know why she went, and did not question her for fear "she'd start crying hysterically that I was scolding her. That's the way she was. And I wouldn't upset her."

The Orteleres were in quite modest circumstances. They owned their own home, valued at $20,000, and had $8,000 in a savings account. They also owned some farm land worth about $5,000. Under these circumstances, as revealed in this record, retirement for both of the Orteleres or the survivor of them had to be provided, as a practical matter,

largely out of Mrs. Ortelere's retirement benefits.

According to Dr. D'Angelo, the psychiatrist who treated her, Mrs. Ortelere never improved enough to "warrant my sending her back [to teaching]." A physician for the Board of Education examined her on February 2, 1965 to determine her fitness to return to teaching. Although not a psychiatrist but rather a specialist in internal medicine, this physician "judged that she had apparently recovered from the depression" and that she appeared rational. However, before allowing her to return to teaching, a report was requested from Dr. D'Angelo concerning her condition. It is notable that the Medical Division of the Board of Education on February 24, 1965 requested that Mrs. Ortelere report to the board's "panel psychiatrist" on March 11, 1965.

Dr. D'Angelo stated "[a]t no time since she was under my care was she ever mentally competent"; that "[m]entally she couldn't make a decision of any kind, actually, of any kind, small or large." He also described how involutional melancholia affects the judgment process: "They can't think rationally, no matter what the situation is. They will even tell you, 'I used to be able to think of anything and make any decision. Now,' they say, 'even getting up, I don't know whether I should get up or whether I should stay in bed.' Or, 'I don't even know how to make a slice of toast any more.' Everything is impossible to decide, and everything is too great an effort to even think of doing. They just don't have the effort, actually, because their nervous breakdown drains them of all their physical energies."

While the psychiatrist used terms referring to "rationality", it is quite evident that Mrs. Ortelere's psychopathology did not lend itself to a classification under the legal test of irrationality. It is undoubtedly, for this reason, that the Appellate Division was unable to accept his testimony and the trial court's finding of irrationality in the light of the prevailing rules as they have been formulated.

The well-established rule is that contracts of a mentally incompetent person who has not been adjudicated insane are voidable. Even where the contract has been partly or fully performed it will still be avoided upon restoration of the status quo.
Traditionally, in this State and elsewhere, contractual mental capacity has been measured by what is largely a cognitive test. Under this standard the "inquiry" is whether the mind was "so affected as to render him wholly and absolutely incompetent to comprehend and understand the nature of the transaction.” (Aldrich v. Bailey, supra.;, at p. 89). A

requirement that the party also be able to make a rational judgment concerning the particular transaction qualified the cognitive test (Paine v. Aldrich, 133 N. Y. 544, 546; Note, "Civil Insanity ": The New York Treatment of the Issue of Mental Incompetency in Non-Criminal Cases, 44 Cornell L. Q. 76). Conversely, it is also well recognized that contractual ability would be affected by insane delusions intimately related to the particular transaction (Moritz v. Moritz, 153 App. Div. 147, affd. 211 N. Y. 580; see Green, Judicial Tests of Mental Incompetency, 6 Mo. L. Rev. 141, 151).

These traditional standards governing competency to contract were formulated when psychiatric knowledge was quite primitive. They fail to account for one who by reason of mental illness is unable to control his conduct even though his cognitive ability seems unimpaired. When these standards were evolving it was thought that all the mental faculties were simultaneously affected by mental illness. (Green, Mental Incompetency, 38 Mich. L. Rev. 1189, 1197- 1202.) This is no longer the prevailing view (Note, Mental Illness and the Law of Contracts, 57 Mich. L. Rev. 1020, 1033-1036).

Of course, the greatest movement in revamping legal notions of mental responsibility has occurred in the criminal law. The nineteenth century cognitive test embraced in the M'Naghten rules has long been criticized and changed by statute and decision in many jurisdictions (see M'Naghten's Case, 10 Clark & Fin. 200; 8 Eng. Rep. 718 [House of Lords, 1843]; Weihofen, Mental Disorder as a Criminal Defense [1954], pp. 65-68; British Royal Comm. on Capital Punishment [1953], ch. 4; A. L. I. Model Penal Code, § 4.01, supra.; cf. Penal Law, §30.05).

While the policy considerations for the criminal law and the civil law are different, both share in common the premise that policy considerations must be based on a sound understanding of the human mind and, therefore, its illnesses. Hence, because the cognitive rules are, for the most part, too restrictive and rest on a false factual basis they must be re-examined. Once it is understood that, accepting plaintiff's proof, Mrs. Ortelere was psychotic and because of that psychosis could have been incapable of making a voluntary selection of her retirement system benefits, there is an issue that a modern jurisprudence should not exclude, merely because her mind could pass a "cognition " test based on nineteenth century psychology.

There has also been some movement on the civil law side to achieve a modern

posture. For the most part, the movement has been glacial and has been disguised under traditional formulations. Various devices have been used to avoid unacceptable results under the old rules by finding unfairness or overreaching in order to avoid transactions (see, e.g., Green, Proof of Mental Incompetency and the Unexpressed Major Premise, 53 Yale L. J. 271, 298- 305).

In this State there has been at least one candid approach. In Faber v. Sweet Style Mfg. Corp. (40 Misc 2d 212) Mr. Justice Meyer wrote: " [i]ncompetence to contract also exists when a contract is entered into under the compulsion of a mental disease or disorder but for which the contract would not have been made" (at p. 216; noted in 39 N.Y.U. L. Rev. 356). This is the first known time a court has recognized that the traditional standards of incompetency for contractual capacity are inadequate in light of contemporary psychiatric learning and applied modern standards. Prior to this, courts applied the cognitive standard giving great weight to objective evidence of rationality.

> It is quite significant that Restatement, 2d, Contracts, states the modern rule on competency to contract. This is in evident recognition, and the Reporter's Notes support this inference, that, regardless of how the cases formulated their reasoning, the old cognitive test no longer explains the results. Thus, the new Restatement section reads: "(1) A person incurs only voidable contractual duties by entering into a transaction if by reason of mental illness or defect
> . . . . . (b) he is unable to act in a reasonable manner in relation to the transaction and the other party has reason to know of his condition." (Restatement, 2d, Contracts [15]
>
> (See, also, Allen, Ferster, Weihofen, Mental Impairment and Legal Incompetency, p. 253 [Recommendation b] and pp. 260-282; and Note, 57 Mich. L. Rev. 1020, supra.;, where it is recommended "that a complete test for contractual incapacity should provide protection to those persons whose contracts are merely uncontrolled reactions to their mental illness, as well as for those who could not understand the nature and consequences of their actions " [at p. 1036]).

The avoidance of duties under an agreement entered into by those who have done so by reason of mental illness, but who have understanding, depends on balancing competing policy considerations. There must be stability in contractual relations and protection of the

expectations of parties who bargain in good faith. On the other hand, it is also desirable to protect persons who may understand the nature of the transaction but who, due to mental illness, cannot control their conduct. Hence, there should be relief only if the other party knew or was put on notice as to the contractor's mental illness. Thus, the Restatement provision for avoidance contemplates that "the other party has reason to know" of the mental illness (id.).

When, however, the other party is without knowledge of the contractor's mental illness and the agreement is made on fair terms, the proposed Restatement rule is: "The power of avoidance under subsection (1) terminates to the extent that the contract has been so performed in whole or in part or the circumstances have so changed that avoidance would be inequitable. In such a case a court may grant relief on such equitable terms as the situation requires." (Restatement, 2d, Contracts, supra.;, [§ 15, subd. [2].]

The system was, or should have been, fully aware of Mrs. Ortelere's condition. They, or the Board of Education, knew of her leave of absence for medical reasons and the resort to staff psychiatrists by the Board of Education. Hence, the other of the conditions for avoidance is satisfied.

Lastly, there are no significant changes of position by the system other than those that flow from the barest actuarial consequences of benefit selection.

Nor should one ignore that in the relationship between retirement system and member, and especially in a public system, there is not involved a commercial, let alone an ordinary commercial, transaction. Instead the nature of the system and its announced goal is the protection of its members and those in whom its members have an interest. It is not a sound scheme which would permit 40 years of contribution and participation in the system to be nullified by a one-instant act committed by one known to be mentally ill. This is especially true if there would be no substantial harm to the system if the act were avoided. On the record none may gainsay that her selection of a "no option " retirement while under psychiatric care, ill with cerebral arteriosclerosis, aged 60, and with a family in which she had always manifested concern, was so unwise and foolhardy that a factfinder might conclude that it was explainable only as a product of psychosis.

On this analysis it is not difficult to see that plaintiff's evidence was sufficient to sustain a finding that, when she acted as she did on February 11, 1965, she did so solely as a

result of serious mental illness, namely, psychosis. Of course, nothing less serious than medically classified psychosis should suffice or else few contracts would be invulnerable to some kind of psychological attack. Mrs. Ortelere's psychiatrist testified quite flatly that as an involutional melancholiac in depression she was incapable of making a voluntary "rational" decision. Of course, as noted earlier, the trial court's finding and perhaps some of the testimony attempted to fit into the rubrics of the traditional rules. For that reason rather than reinstatement of the judgment at Trial Term there should be a new trial under the proper standards frankly considered and applied.

Accordingly, the order of the Appellate Division should be reversed, without costs, and the action remanded to Trial Term for a new trial.

Jasen, J. (Dissenting).

The evidence conclusively establishes that the decedent, at the time she made her application to retire, understood not only that she was retiring, but also that she had selected the maximum payment during her lifetime.

Indeed, the letter written by the deceased to the Teachers' Retirement System prior to her retirement demonstrates her full mental capacity to understand and to decide whether to take an option or the maximum allowance. The full text of the letter reads as follows:

February 8, 1965
Gentlemen:
I would like to retire on Feb. 12 or Feb. 15. In other words, just as soon as possible after I receive the information I need in order to decide whether to take an option or maximum allowance. Following are the questions I would like to have answered:

1. What is my 'average' five-year salary?
2. What is my maximum allowance?
3. I am 60 years old. If I select option four-a with a beneficiary (female) 27 years younger, what is my allowance?
4. If I select four-a on the pension part only, and take the maximum annuity, what is my allowance?
5. If I take a loan of 89% of my year's salary before retirement, what would my maximum allowance be?
6. If I take a loan of $5,000 before retiring, and select option four-a on both the pension and annuity, what would my allowance be?
7. What is my total service credit? I have been on a leave without pay since Oct. 26, 1964.
8. What is the 'factor' used for calculating option four-a with the above beneficiary?

Thank you for your promptness in making the necessary calculations.
I will come to your office on Thursday afternoon of this week.

It seems clear that this detailed, explicit and extremely pertinent list of queries reveals a mind fully in command of the salient features of the Teachers' Retirement System. Certainly, it cannot be said that the decedent could possess sufficient capacity to compose a letter indicating such a comprehensive understanding of the retirement system, and yet lack the capacity to understand the answers.

As I read the record, the evidence establishes that the decedent's election to receive maximum payments was predicated on the need for a higher income to support two retired persons -- her husband and herself. Since the only source of income available to decedent and her husband was decedent's retirement pay, the additional payment of $75 per month which she would receive by electing the maximal payment was a necessity. Indeed, the additional payments represented an increase of 20% over the benefits payable under option 1. Under these circumstances, an election of maximal income during decedent's lifetime was

not only a rational, but a necessary decision.

Further indication of decedent's knowledge of the financial needs of her family is evidenced by the fact that she took a loan for the maximum amount ($8,760) permitted by the retirement system, at the time she made application for retirement.

…

Decedent's election of the maximum retirement benefits, therefore, was not so contrary to her best interests so as to create an inference of her mental incompetence….

Nor can I agree with the majority's view that the traditional rules governing competency to contract "are, for the most part, too restrictive and rest on a false factual basis". The issue confronting the courts concerning mental capacity to contract is under what circumstances and conditions should a party be relieved of contractual obligations freely entered. This is peculiarly a legal decision, although, of course, available medical knowledge forms a datum which influences the legal choice.

… The generally accepted test of mental competency to contract which has thus evolved is whether the party attempting to avoid the contract was capable of understanding and appreciating the nature and consequences of the particular act or transaction which he challenges. This rule represents a balance struck between policies to protect the security of transactions between individuals and freedom of contract on the one hand, and protection of those mentally handicapped on the other hand. In my opinion, this rule has proven workable in practice and fair in result.

…

As in every situation where the law must draw a line between liability and nonliability, between responsibility and nonresponsibility, there will be borderline cases, and injustices may occur by deciding erroneously that an individual belongs on one side of the line or the other. To minimize the chances of such injustices occurring, the line should be drawn as clearly as possible.

…. I fear that the majority's refinement of the generally accepted rules will prove unworkable in practice, and make many contracts vulnerable to psychological attack. Any benefit to those who understand what they are doing, but are unable to exercise self-

discipline, will be outweighed by frivolous claims which will burden our courts and undermine the security of contracts. The reasonable expectations of those who innocently deal with persons who appear rational and who understand what they are doing should be protected.

Accordingly, I would affirm the order appealed from.

Hypothetical

On September 25, 1991, appellant [Y.W.], an eleven-year-old child, was observed by National Super Markets, Inc.'s security personnel shoplifting candy. While the minor was still detained by National's employee, her mother entered into a stipulated release whereby National agreed not to prosecute the minor in consideration for the minor's agreement not to bring civil charges against National. Subsequently, the minor, by and through her duly-appointed next friend, filed a civil suit against National alleging an assault and battery upon her. The trial court granted National's motion to dismiss on the ground that the minor's right to bring suit against National had been contracted away. Although both the parent's and the minor's names appear on the signature line of the release, it is unclear from the contract, and contested by the parties, whether the minor actually signed the agreement or the mother signed both names in a representative capacity.

Did the trial court correctly dismiss Y.W.'s law suit?

Y.W. by & through Smith v. National Super Mkts., 876 S.W.2d 785, 787 (Mo. Ct. App. 1994)

MISREPRESENTATION

COUSINEAU v. WALKER, 613 P.2d 608 (Alaska, 1980)

BOOCHEVER, Justice.

The question in this case is whether the appellants are entitled to rescission of a land sale contract because of false statements made by the sellers. The superior court concluded that the buyers did not rely on any misrepresentations made by the sellers, that the misrepresentations were not material to the transaction, and that reliance by the buyers was not justified. Restitution of money paid under the contract was denied. We reverse and remand the case to the superior court to determine the amount of damages owed the appellants.

In 1975, Devon Walker and his wife purchased 9.1 acres of land in Eagle River, Alaska, known as Lot 1, Cross Estates. They paid $140,000.00 for it. A little over a year later, in October, 1976, they signed a multiple listing agreement with Pat Davis, an Anchorage realtor. The listing stated that the property had 580 feet of highway frontage on the Old Glenn Highway and that "ENGINEER REPORT SAYS OVER 1 MILLION IN GRAVEL ON PROP." The asking price was $245,000.00.

When the multiple listing expired, Walker signed a new agreement to retain Davis as an exclusive agent. In the broker's contract, the property was again described as having 580 feet of highway frontage, but the gravel content was listed as "minimum 80,000 cubic yds of gravel." The agreement also stated that 2.6 acres on the front of the parcel had been proposed for B-3 zoning (a commercial use), and the asking price was raised to $470,000.00.

An appraisal was prepared to determine the property's value as of December 31, 1976. Walker specifically instructed the appraiser not to include the value of gravel in the appraisal. A rough draft of the appraisal and the appraiser's notes were introduced at trial. Under the heading, "Assumptions and Limiting Conditions," the report stated the appraisal "does not take into account any gravel . . . ." But later in the report the ground was described as "all good gravel base . . . covered with birch and spruce trees." The report did not mention the highway footage of the lot.

Wayne Cousineau, a contractor who was also in the gravel extraction business, became aware of the property when he saw the multiple listing. He consulted Camille Davis, another Anchorage realtor, to see if the property was available. In January, Cousineau and Camille Davis visited the property and discussed gravel extraction with Walker, although according to Walker's testimony commercial extraction was not considered. About this time Cousineau offered Walker $360,000.00 for the property. Cousineau tendered a proposed sales agreement which stated that all gravel rights would be granted to the purchaser at closing.

Sometime after his first offer, Cousineau attempted to determine the lot's road frontage. The property was covered with snow, and he found only one boundary marker. At trial the appraiser testified he could not find any markers. Cousineau testified that he went to the borough office to determine if any regulations prevented gravel extraction.

Despite Walker's reference to an “Engineer Report” allegedly showing “over 1 million in gravel,” Walker admitted at trial that he had never seen a copy of the report. According to Walker's agent, Pat Davis, Camille Davis was told that if either she or Cousineau wanted the report they would have to pay for it themselves. It was undisputed that Cousineau never obtained the report.

In February, 1977, the parties agreed on a purchase price of $385,000.00 and signed an earnest money agreement. The sale was contingent upon approval of the zoning change of the front portion of the lot to commercial use. The amount of highway frontage was not included in the agreement. Paragraph 4(e) of the agreement conditionally granted gravel rights to Cousineau. According to the agreement, Cousineau would be entitled to remove only so much gravel as was necessary to establish a construction grade on the commercial portion of the property. To remove additional gravel, Cousineau would be required to pay releases on those portions of ground where gravel was removed. This language was used to prevent Walker's security interest in the property from being impaired before he was fully paid.

Soon after the earnest money agreement was signed, the front portion of the property was rezoned and a month later the parties closed the sale.

There is no reference to the amount of highway frontage in the final purchase agreement. An addendum to a third deed of trust incorporates essentially the same language as the earnest money agreement with regard to the release of gravel rights.

After closing, Cousineau and his partners began developing the commercial portion of the property. They bought a gravel scale for $12,000.00 and used two of Cousineau's trucks and a loader. The partners contracted with South Construction to remove the gravel. According to Cousineau's testimony, he first learned of discrepancies in the real estate listing which described the lot when a neighbor threatened to sue Cousineau because he was removing gravel from the neighbor's adjacent lot. A recent survey shows that there is 415 feet of highway frontage on the property not 580 feet, as advertised.

At the same time Cousineau discovered the shortage in highway frontage, South Construction ran out of gravel. They had removed 6,000 cubic yards. To determine if there was any more gravel on the property, a South Construction employee bulldozed a trench about fifty feet long and twenty feet deep. There was no gravel. A soils report prepared in 1978 confirmed that there were no gravel deposits on the property.

After December, 1977, Cousineau and his partners stopped making monthly payments. At that time they had paid a total of $99,000.00 for the property, including a down payment and monthly installments. In March, 1978, they informed Walker of their intention to rescind the contract. A deed of trust foreclosure sale was held in the fall of 1978, and Walker reacquired the property. At a bench trial in December, Cousineau and his partners were denied rescission and restitution.

Among his written findings of fact, the trial judge found:

"At some point in time, between October 24, 1976, and January 11, 1977, there existed a multiple listing advertisement which included information relating to gravel as well as road frontage, said information subsequently determined to be incorrect."

He further found:

"The plaintiffs did not rely on any misinformation or misrepresentations of defendants. The claimed misinformation about gravel on the property and the road frontage was not a material element of the parties' negotiations, and these pieces of information did

not appear in the February 16, 1977 purchase agreement document prepared by attorney Harland Davis, attorney for the plaintiffs and signed by the parties."

In part, based on these findings, the court adopted the following conclusions of law:

"The plaintiffs are not entitled to rescission of the contract of sale or restitution as they were not entitled to rely on the alleged misrepresentation.

The information which allegedly formed the basis of the misrepresentation was not material in the instant transaction, the agreement reached by the parties was valid and does not suffer any taint or defect of misrepresentation."

I. RESCISSION OF THE CONTRACT

Numerous cases hold and the Restatement provides that an innocent misrepresentation may be the basis for rescinding a contract. There is no question, as the trial judge's findings of fact state, that the statements made by Walker and his real estate agent in the multiple listing were false. Three questions must be resolved, however, to determine whether Cousineau is entitled to rescission and restitution of the amount paid for the property on the basis of the misrepresentations. First, it must be determined whether Cousineau in fact relied on the statements. Second, it must be determined whether the statements were material to the transaction that is, objectively, whether a reasonable person would have considered the statements important in deciding whether to purchase the property. Finally, assuming that Cousineau relied on the statements and that they were material, it must be determined whether his reliance was justified.

A. Reliance on the False Statements

As quoted above, in his findings of fact, the trial judge stated, "The plaintiffs did not rely on any misinformation or misrepresentations of defendants." In our opinion, the trial judge's finding that Cousineau and his partners did not rely on the statements made by Walker is clearly erroneous.

Regardless of the credibility of some witnesses, the uncontroverted facts are that Wayne Cousineau was in the gravel extraction business. He first became aware of the property through a multiple listing that said "1 MILLION IN GRAVEL." The subsequent listing stated that there were 80,000 cubic yards of gravel. Even if Walker might have taken

the position that the sale was based on the appraisal, rather than the listings, the appraisal does not disclaim the earlier statements regarding the amount of highway frontage and the existence of gravel. In fact, the appraisal might well reaffirm a buyer's belief that gravel existed, since it stated there was a good gravel base. All the documents prepared regarding the sale from the first offer through the final deed of trust make provisions for the transfer of gravel rights. Cousineau's first act upon acquiring the property was to contract with South Construction for gravel removal, and to purchase gravel scales for $12,000.00. We conclude that the court erred in finding that Cousineau did not rely on Walker's statement that there was gravel on the property.

We are also convinced that the trial court's finding that Cousineau did not rely on Walker's statement regarding the amount of highway frontage was clearly erroneous. The Cousineaus were experienced and knowledgeable in real estate matters. In determining whether to purchase the property, they would certainly have considered the amount of highway frontage to be of importance. Despite Walker's insistence that Cousineau knew the location of the boundary markers, neither Cousineau nor the appraiser ever found them. It is improbable that Cousineau would have started removing gravel from a neighbor's property had he known the correct location of his boundary line.

B. Materiality of the Statements

Materiality is a mixed question of law and fact. A material fact is one “to which a reasonable man might be expected to attach importance in making his choice of action.” W. Prosser, Law of Torts §108, at 719 (4th ed. 1971). It is a fact which could reasonably be expected to influence someone's judgment or conduct concerning a transaction. Under § 306 of the tentative draft of the Restatement (Second) of Contracts, a misrepresentation may be grounds for voiding a contract if it is either fraudulent or material. Restatement (Second) of Contracts § 306 (Tent. Draft No. 11, 1976)(note: Now § 164). The reason behind the rule requiring proof of materiality is to encourage stability in contractual relations. The rule prevents parties who later become disappointed at the outcome of their bargain from capitalizing on any insignificant discrepancy to void the contract.

We conclude as a matter of law that the statements regarding highway frontage and gravel content were material. A reasonable person would be likely to consider the existence

of gravel deposits an important consideration in developing a piece of property. Even if not valuable for commercial extraction, a gravel base would save the cost of obtaining suitable fill from other sources. Walker's real estate agent testified that the statements regarding gravel were placed in the listings because gravel would be among the property's “best points” and a “selling point.” It seems obvious that the sellers themselves thought a buyer would consider gravel content important.

The buyers received less than three-fourths of the highway frontage described in the listings. Certainly the amount of highway frontage on a commercial tract would be considered important.

C. Justifiable Reliance

The trial judge concluded as a matter of law that the plaintiffs “were not entitled to rely on the alleged misrepresentation.”

The bulk of the appellee's brief is devoted to the argument that Cousineau's unquestioning reliance on Walker and his real estate agent was imprudent and unreasonable. Cousineau failed to obtain and review the engineer's report. He failed to obtain a survey or examine the plat available at the recorder's office. He failed to make calculations that would have revealed the true frontage of the lot. Although the property was covered with snow, the plaintiffs, according to Walker, had ample time to inspect it. The plaintiffs were experienced businessmen who frequently bought and sold real estate. Discrepancies existed in the various property descriptions which should have alerted Cousineau and his partners to potential problems. In short, the appellees urge that the doctrine of caveat emptor precludes recovery.

In fashioning an appropriate rule for land sale contracts, we note initially that, in the area of commercial and consumer goods, the doctrine of caveat emptor has been nearly abolished by the Uniform Commercial Code and imposition of strict products liability. In real property transactions, the doctrine is also rapidly receding. Alaska has passed the Uniform Land Sales Practices Act, AS 34.55.004-.046, which imposes numerous restrictions on vendors of subdivided property. Criminal penalties may be imposed for violations. The Uniform Residential Landlord and Tenant Act, AS 34.03.010-.380, has greatly altered the common law of landlord and tenant in favor of tenants. Many states now

imply warranties of merchantability in new home sales. Wyoming has recently extended this warranty beyond the initial purchaser to subsequent buyers. Moxley v. Laramie Builders, Inc., 600 P.2d 733, 735-36 (Wyo.1979).

There is a split of authority regarding a buyer's duty to investigate a vendor's fraudulent statements, but the prevailing trend is toward placing a minimal duty on a buyer. Recently, a Florida appellate court reversed long-standing precedent which held that a buyer must use due diligence to protect his interest, regardless of fraud, if the means for acquiring knowledge concerning the transaction were open and available. In the context of a building sale the court concluded:

"A person guilty of fraudulent misrepresentation should not be permitted to hide behind the doctrine of caveat emptor." Upledger v. Vilanor, Inc., 369 So.2d 427, 430 (Fla.App.), cert. denied, 378 So.2d 350 (Fla.1979).

The Supreme Court of Maine has also recently reversed a line of its prior cases, concluding that a defense based upon lack of due care should not be allowed in land sales contracts where a reckless or knowing misrepresentation has been made. Letellier v. Small, 400 A.2d 371, 375 (Me.1979). This is also the prevailing view in California, Idaho, Kansas, Massachusetts, and Oregon. On the other hand, some jurisdictions have reaffirmed the doctrine of caveat emptor, but as noted in Williston on Contracts,

"(t)he growing trend and tendency of the courts will continue to move toward the doctrine that negligence in trusting in a misrepresentation will not excuse positive willful fraud or deprive the defrauded person of his remedy." W. Jaeger, Williston on Contracts s 1515B at 487 (3d ed. 1970).

There is also authority for not applying the doctrine of caveat emptor even though the misrepresentation is innocent. The Restatements, case law, and a ready analogy to express warranties in the sale of goods support this view.

The recent draft of the Restatement of Contracts allows rescission for an innocent material misrepresentation unless a buyer's fault was so negligent as to amount to "a failure to act in good faith and in accordance with reasonable standards of fair dealing." Restatement (Second) of Contracts § 314, Comment b (Tent. Draft. no. 11, 1976). (note: now § 172)

In Van Meter v. Bent Construction Co., 46 Cal.2d 588, 297 P.2d 644 (1956), the city of San Diego failed to properly mark the area of a reservoir that needed to be cleared of brush. A lower court concluded that the city's failure to mark the area properly was an innocent mistake, and that a bidder's actions in failing to discover the true area to be cleared was negligent. Recovery was denied because the city's misrepresentation was not willful. The California Supreme Court reversed, first noting that a party's negligence does not bar rescission for mutual mistake, and then concluding:

"There is even more reason for not barring a plaintiff from equitable relief where his negligence is due in part to his reliance in good faith upon the false representations of a defendant, although the statements were not made with intent to deceive. A defendant who misrepresents the facts and induces the plaintiff to rely on his statements should not be heard in an equitable action to assert that the reliance was negligent unless plaintiff's conduct, in the light of his intelligence and information, is preposterous or irrational." Id. 297 P.2d at 648 (citations omitted). The Massachusetts Supreme Judicial Court has expressed a similar view in Yorke v. Taylor, 332 Mass. 368, 124 N.E.2d 912, 916 (1955).

We do not contend that real property transactions are the same as those involving sales of goods. Nevertheless, an analogy to the applicability of the doctrine of caveat emptor under the Uniform Commercial Code is helpful. Under the Code, factual statements regarding the sale of goods constitute an express warranty. AS 45.05.094. The official comment to section 2-316 of the Code (codified as AS 45.05.100), dealing with disclaimers of warranties, states:

"Application of the doctrine of 'caveat emptor' in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected by this Article. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an 'express' warranty."

Numerous cases have concluded that a buyer is entitled to rely on an express warranty, regardless of an inadequate examination of the goods.

Furthermore, the protections of the Code extend to highly sophisticated buyers in arms length transactions as well as to household consumers. Other than tradition, no reason exists for treating land sales differently from the sale of commercial goods insofar as

application of the doctrine of caveat emptor is involved. We conclude that a purchaser of land may rely on material representations made by the seller and is not obligated to ascertain whether such representations are truthful.

A buyer of land, relying on an innocent misrepresentation, is barred from recovery only if the buyer's acts in failing to discover defects were wholly irrational, preposterous, or in bad faith.

Although Cousineau's actions may well have exhibited poor judgment for an experienced businessman, they were not so unreasonable or preposterous in view of Walker's description of the property that recovery should be denied. Consequently, we reverse the judgment of the superior court.

II. RESTITUTION

Walker received a total of $99,000.00 from Cousineau and his partners, but the appellants are not entitled to restitution of this amount. Cousineau apparently caused extensive damage to one building on the property, and he removed 6,000 cubic yards of gravel. Walker should be allowed some recoupment for these items, plus an amount for the fair rental value of the property less reasonable costs of rental.

It is necessary to remand this case to the trial court to determine the correct amount of damages.

REVERSED and REMANDED.

VOKES v. ARTHUR MURRAY, INC., 212 So.2d 906 (Fla.App. 1968)

PIERCE, Judge.

This is an appeal by Audrey E. Vokes, plaintiff below, from a final order dismissing with prejudice, for failure to state a cause of action, her fourth amended complaint, hereinafter referred to as plaintiff's complaint.

Defendant Arthur Murray, Inc., a corporation, authorizes the operation throughout the nation of dancing schools under the name of ‘Arthur Murray School of Dancing’ through local franchised operators, one of whom was defendant J. P. Davenport whose dancing establishment was in Clearwater.

Plaintiff Mrs. Audrey E. Vokes, a widow of 51 years and without family, had a yen to be ‘an accomplished dancer’ with the hopes of finding ‘new interest in life’. So, on February 10, 1961, a dubious fate, with the assist of a motivated acquaintance, procured her to attend a ‘dance party’ at Davenport's ‘School of Dancing’ where she whiled away the pleasant hours, sometimes in a private room, absorbing his accomplished sales technique, during which her grace and poise were elaborated upon and her rosy future as ‘an excellent dancer’ was painted for her in vivid and glowing colors. As an incident to this interlude, he sold her eight 1/2-hour dance lessons to be utilized within one calendar month therefrom, for the sum of $14.50 cash in hand paid, obviously a baited ‘comeon’.

Thus she embarked upon an almost endless pursuit of the terpsichorean art during which, over a period of less than sixteen months, she was sold fourteen ‘dance courses' totalling in the aggregate 2302 hours of dancing lessons for a total cash outlay of $31,090.45, all at Davenport's dance emporium. All of these fourteen courses were evidenced by execution of a written ‘Enrollment Agreement-Arthur Murray's School of Dancing’ with the addendum in heavy black print, ‘No one will be informed that you are taking dancing lessons. Your relations with us are held in strict confidence’, setting forth the number of ‘dancing lessons' and the ‘lessons in rhythm sessions' currently sold to her from time to time, and always of course accompanied by payment of cash of the realm.

These dance lesson contracts and the monetary consideration therefor of over $31,000 were procured from her by means and methods of Davenport and his associates which went beyond the unsavory, yet legally permissible, perimeter of ‘sales puffing’ and intruded well into the forbidden area of undue influence, the suggestion of falsehood, the suppression of truth, and the free exercise of rational judgment, if what plaintiff alleged in her complaint was true. From the time of her first contact with the dancing school in February, 1961, she was influenced unwittingly by a constant and continuous barrage of flattery, false praise, excessive compliments, and panegyric encomiums, to such extent that it would be not only inequitable, but unconscionable, for a Court exercising inherent chancery power to allow such contracts to stand.

She was incessantly subjected to overreaching blandishment and cajolery. She was assured she had ‘grace and poise’; that she was ‘rapidly improving and developing in her dancing skill’; that the additional lessons would ‘make her a beautiful dancer, capable of

dancing with the most accomplished dancers'; that she was ‘rapidly progressing in the development of her dancing skill and gracefulness', etc., etc. She was given ‘dance aptitude tests' for the ostensible purpose of ‘determining’ the number of remaining hours instructions needed by her from time to time.

At one point she was sold 545 additional hours of dancing lessons to be entitled to award of the ‘Bronze Medal’ signifying that she had reached ‘the Bronze Standard’, a supposed designation of dance achievement by students of Arthur Murray, Inc.

Later she was sold an additional 926 hours in order to gain the ‘Silver Medal’, indicating she had reached ‘the Silver Standard’, at a cost of $12,501.35.

At one point, while she still had to her credit about 900 unused hours of instructions, she was induced to purchase an additional 24 hours of lessons to participate in a trip to Miami at her own expense, where she would be ‘given the opportunity to dance with members of the Miami Studio’.

She was induced at another point to purchase an additional 123 hours of lessons in order to be not only eligible for the Miami trip but also to become ‘a life member of the Arthur Murray Studio’, carrying with it certain dubious emoluments, at a further cost of $1,752.30.

At another point, while she still had over 1,000 unused hours of instruction she was induced to buy 151 additional hours at a cost of $2,049.00 to be eligible for a ‘Student Trip to Trinidad’, at her own expense as she later learned.

Also, when she still had 1100 unused hours to her credit, she was prevailed upon to purchase an additional 347 hours at a cost of $4,235.74, to qualify her to receive a ‘Gold Medal’ for achievement, indicating she had advanced to ‘the Gold Standard’.

On another occasion, while she still had over 1200 unused hours, she was induced to buy an additional 175 hours of instruction at a cost of $2,472.75 to be eligible ‘to take a trip to Mexico’.

Finally, sandwiched in between other lesser sales promotions, she was influenced to buy an additional 481 hours of instruction at a cost of $6,523.81 in order to ‘be classifies as a Gold Bar Member, the ultimate achievement of the dancing studio’.

All the foregoing sales promotions, illustrative of the entire fourteen separate contracts, were procured by defendant Davenport and Arthur Murray, Inc., by false

representations to her that she was improving in her dancing ability, that she had excellent potential, that she was responding to instructions in dancing grace, and that they were developing her into a beautiful dancer, whereas in truth and in fact she did not develop in her dancing ability, she had no ‘dance aptitude’, and in fact had difficulty in ‘hearing that musical beat’. The complaint alleged that such representations to her ‘were in fact false and known by the defendant to be false and contrary to the plaintiff's true ability, the truth of plaintiff's ability being fully known to the defendants, but withheld from the plaintiff for the sole and specific intent to deceive and defraud the plaintiff and to induce her in the purchasing of additional hours of dance lessons'. It was averred that the lessons were sold to her ‘in total disregard to the true physical, rhythm, and mental ability of the plaintiff’. In other words, while she first exulted that she was entering the ‘spring of her life’, she finally was awakened to the fact there was ‘spring’ neither in her life nor in her feet.

The complaint prayed that the Court decree the dance contracts to be null and void and to be cancelled, that an accounting be had, and judgment entered against, the defendants ‘for that portion of the $31,090.45 not charged against specific hours of instruction given to the plaintiff’. The Court held the complaint not to state a cause of action and dismissed it with prejudice. We disagree and reverse.

The material allegations of the complaint must, of course, be accepted as true for the purpose of testing its legal sufficiency. Defendants contend that contracts can only be rescinded for fraud or misrepresentation when the alleged misrepresentation is as to a material fact, rather than an opinion, prediction or expectation, and that the statements and representations set forth at length in the complaint were in the category of ‘trade puffing’, within its legal orbit.

It is true that ‘generally a misrepresentation, to be actionable, must be one of fact rather than of opinion’. Tonkovich v. South Florida Citrus Industries, Inc., Fla.App.1966, 185 So.2d 710. But this rule has significant qualifications, applicable here. It does not apply where there is a fiduciary relationship between the parties, or where there has been some artifice or trick employed by the representor, or where the parties do not in general deal at ‘arm's length’ as we understand the phrase, or where the representee does not have equal opportunity to become apprised of the truth or falsity of the fact represented. As stated by

Judge Allen of this Court in Ramel v. Chasebrook Construction Company, Fla.App.1961, 135 So.2d 876:

"* * * A statement of a party having * * * superior knowledge may be regarded as a statement of fact although it would be considered as opinion if the parties were dealing on equal terms."

It could be reasonably supposed here that defendants had 'superior knowledge' as to whether plaintiff had 'dance potential' and as to whether she was noticeably improving in the art of terpsichore. And it would be a reasonable inference from the undenied averments of the complaint that the flowery eulogiums heaped upon her by defendants as a prelude to her contracting for 1944 additional hours of instruction in order to attain the rank of the Bronze Standard, thence to the bracket of the Silver Standard, thence to the class of the Gold Bar Standard, and finally to the crowning plateau of a Life Member of the Studio, proceeded as much or more from the urge to 'ring the cash register' as from any honest or realistic appraisal of her dancing prowess or a factual representation of her progress.

Even in contractual situations where a party to a transaction owes no duty to disclose facts within his knowledge or to answer inquiries respecting such facts, the law is if he undertakes to do so he must disclose the whole truth. Ramel v. Chasebrook Construction Company, supra; Beagle v. Bagwell, Fla.App.1964, 169 So.2d 43. From the face of the complaint, it should have been reasonably apparent to defendants that her vast outlay of cash for the many hundreds of additional hours of instruction was not justified by her slow and awkward progress, which she would have been made well aware of if they had spoken the 'whole truth'.

In Hirschman v. Hodges, etc., 1910, 59 Fla. 517, 51 So. 550, it was said that-

"* * * what is plainly injurious to good faith ought to be considered as a fraud sufficient to impeach a contract and that an improvident agreement may be avoided- * * * because of surprise, or mistake, *want of freedom, undue influence, the suggestion of falsehood, or the suppression of truth*'. (Emphasis supplied.)

We repeat that where parties are dealing on a contractual basis at arm's length with no inequities or inherently unfair practices employed, the Courts will in general 'leave the

parties where they find themselves'. But in the case sub judice, from the allegations of the unanswered complaint, we cannot say that enough of the accompanying ingredients, as mentioned in the foregoing authorities, were not present which otherwise would have barred the equitable arm of the Court to her. In our view, from the showing made in her complaint, plaintiff is entitled to her day in Court.

It accordingly follows that the order dismissing plaintiff's last amended complaint with prejudice should be and is reversed.

Reversed.

Hypothetical

This is a civil action wherein the plaintiff vendor seeks damages for the breach by the defendant vendee of a contract for the sale of real estate. The defendant filed a counter-claim in which he sought the return of his deposit. A jury trial was held in the Superior Court. The jury found for the defendant and judgment followed. The case is before us on the plaintiff's appeal.

On February 21, 1967, the parties hereto entered into a real estate agreement whereby plaintiff agreed to convey a one-family house located in Providence on the southeasterly corner of Wayland and Upton Avenues to defendant for the sum of $54,000. The defendant paid a deposit of $ 2,000 to plaintiff. The agreement provided for the delivery of the deed and the payment of the balance of the purchase price by June 30, 1967.

On May 17, 1967, a termite inspection was made of the premises, and it was discovered that the house was inhabited by termites. The defendant then notified plaintiff that, because of the termite infestation, he was not going to purchase the property. The defendant did not appear for the title closing which plaintiff had scheduled for June 30, 1967…..

In early February, defendant and his wife inspected the Halpert home. They asked the agent about termites and he told them that there was no termite problem and that he had never experienced any termite problem with any of the houses he sold in the East Side section of Providence.

Later on in February, defendant, his wife, his sister-in-law and his brother-in-law

met plaintiff. The brother-in-law inquired about the presence of termites; plaintiff said that there were no termites in the house.

When defendant was about to sign the purchase and sales agreement, he asked plaintiff's real estate agent whether it might not be advisable if the home be inspected for termites before the agreement was signed. The agent told defendant that such a step was unnecessary because there were no termite problems in the house.

The defendant concedes that there was no evidence which shows that plaintiff or her agent knowingly made false statements as to the existence of the termites….

[There is also a merger clause in the contract which] provides that the contract "…contains the entire agreement between the parties, and that it is subject to no understandings, conditions or representations other than those expressly stated herein."

Halpert v. Rosenthal, 107 R.I. 406 (1970)

MISTAKE, REFORMATION

WOOD v. BOYNTON, 64 Wis. 265, 25 N.W. 42 (Wis. 1885).

TAYLOR, J.

This action was brought in the circuit court for Milwaukee county to recover the possession of an uncut diamond of the alleged value of $1,000. The case was tried in the circuit court, and after hearing all the evidence in the case, the learned circuit judge directed the jury to find a verdict for the defendants. The plaintiff excepted to such instruction, and, after a verdict was rendered for the defendants, moved for a new trial upon the minutes of the judge. The motion was denied, and the plaintiff duly excepted, and after judgment was entered in favor of the defendants, appealed to this court. The defendants are partners in the jewelry business. On the trial it appeared that on and before the twenty-eighth of December, 1883, the plaintiff was the owner of and in the possession of a small stone of the nature and value of which she was ignorant; that on that day she sold it to one of the defendants for the sum of one dollar. Afterwards it was ascertained that the stone was a rough diamond, and of the value of about $700. After hearing this fact the plaintiff tendered the defendants the one dollar, and ten cents as interest, and demanded a return of the stone to her. The defendants refused to deliver it, and therefore she commenced this action.

The plaintiff testified to the circumstances attending the sale of the stone to Mr. Samuel B. Boynton, as follows: "The first time Boynton saw that stone he was talking about buying the topaz, or whatever it is, in September or October. I went into the store to get a little pin mended, and I had it in a small box,--the pin,--a small ear-ring; * * * this stone, and a broken sleeve-button were in the box. Mr. Boynton turned to give me a check for my pin. I thought I would ask him what the stone was, and I took it out of the box and asked him to please tell me what that was. He took it in his hand and seemed some time looking at it. I told him I had been told it was a topaz, and he said it might be. He says, 'I would buy this; would you sell it?' I told him I did not know but what I would. What would it be worth? And he said he did not know; he would give me a dollar and keep it as a specimen, and I told him I would not sell it; and it was certainly pretty to look at. He asked me where I found it, and I told him in Eagle. He asked about how far out, and I said right in the village,

and I went out. Afterwards, and about the twenty-eighth of December, I needed money pretty badly, and thought every dollar would help, and I took it back to Mr. Boynton and told him I had brought back the topaz, and he says, 'Well, yes; what did I offer you for it?' and I says, 'One dollar;' and he stepped to the change drawer and gave me the dollar, and I went out." In another part of her testimony she says: "Before I sold the stone I had no knowledge whatever that it was a diamond. I told him that I had been advised that it was probably a topaz, and he said probably it was. The stone was about the size of a canary bird's egg, nearly the shape of an egg,--worn pointed at one end; it was nearly straw color,--a little darker." She also testified that before this action was commenced she tendered the defendants $1.10, and demanded the return of the stone, which they refused. This is substantially all the evidence of what took place at and before the sale to the defendants, as testified to by the plaintiff herself. She produced no other witness on that point.

The evidence on the part of the defendant is not very different from the version given by the plaintiff, and certainly is not more favorable to the plaintiff. Mr. Samuel B. Boynton, the defendant to whom the stone was sold, testified that at the time he bought this stone, he had never seen an uncut diamond; had seen cut diamonds, but they are quite different from the uncut ones; "he had no idea this was a diamond, and it never entered his brain at the time." Considerable evidence was given as to what took place after the sale and purchase, but that evidence has very little if any bearing, upon the main point in the case.

This evidence clearly shows that the plaintiff sold the stone in question to the defendants, and delivered it to them in December, 1883, for a consideration of one dollar. By such sale the title to the stone passed by the sale and delivery to the defendants. How has that title been divested and again vested in the plaintiff? The contention of the learned counsel for the appellant is that the title became vested in the plaintiff by the tender to the Boyntons of the purchase money with interest, and a demand of a return of the stone to her. Unless such tender and demand revested the title in the appellant, she cannot maintain her action.

The only question in the case is whether there was anything in the sale which entitled the vendor (the appellant) to rescind the sale and so revest the title in her. The only reasons we know of for rescinding a sale and revesting the title in the vendor so that he may maintain an action at law for the recovery of the possession against his vendee are (1) that

the vendee was guilty of some fraud in procuring a sale to be made to him; (2) that there was a mistake made by the vendor in delivering an article which was not the article sold,--a mistake in fact as to the identity of the thing sold with the thing delivered upon the sale. This last is not in reality a rescission of the sale made, as the thing delivered was not the thing sold, and no title ever passed to the vendee by such delivery.

In this case, upon the plaintiff's own evidence, there can be no just ground for alleging that she was induced to make the sale she did by any fraud or unfair dealings on the part of Mr. Boynton. Both were entirely ignorant at the time of the character of the stone and of its intrinsic value. Mr. Boynton was not an expert in uncut diamonds, and had made no examination of the stone, except to take it in his hand and look at it before he made the offer of one dollar, which was refused at the time, and afterwards accepted without any comment or further examination made by Mr. Boynton. The appellant had the stone in her possession for a long time, and it appears from her own statement that she had made some inquiry as to its nature and qualities. If she chose to sell it without further investigation as to its intrinsic value to a person who was guilty of no fraud or unfairness which induced her to sell it for a small sum, she cannot repudiate the sale because it is afterwards ascertained that she made a bad bargain. There is no pretense of any mistake as to the identity of the thing sold. It was produced by the plaintiff and exhibited to the vendee before the sale was made, and the thing sold was delivered to the vendee when the purchase price was paid.

Suppose the appellant had produced the stone, and said she had been told it was a diamond, and she believed it was, but had no knowledge herself as to its character or value, and Mr. Boynton had given her $500 for it, could he have rescinded the sale if it had turned out to be a topaz or any other stone of very small value? Could Mr. Boynton have rescinded the sale on the ground of mistake? Clearly not, nor could he rescind it on the ground that there had been a breach of warranty, because there was no warranty, nor could he rescind it on the ground of fraud, unless he could show that she falsely declared that she had been told it was a diamond, or, if she had been so told, still she knew it was not a diamond.

It is urged, with a good deal of earnestness, on the part of the counsel for the appellant that, because it has turned out that the stone was immensely more valuable than the parties at the time of the sale supposed it was, such fact alone is a ground for the rescission of the sale, and that fact was evidence of fraud on the part of the vendee. Whether

inadequacy of price is to be received as evidence of fraud, even in a suit in equity to avoid a sale, depends upon the facts known to the parties at the time the sale is made. When this sale was made the value of the thing sold was open to the investigation of both parties, neither knowing its intrinsic value, and, so far as the evidence in this case shows, both supposed that the price paid was adequate. How can fraud be predicated upon such a sale, even though afterinvestigation showed that the intrinsic value of the thing sold was hundreds of times greater than the price paid? It certainly shows no such fraud as would authorize the vendor to rescind the contract and bring an action at law to recover the possession of the thing sold. Whether that fact would have any influence in an action in equity to avoid the sale we need not consider.

We can find nothing in the evidence from which it could be justly inferred that Mr. Boynton, at the time he offered the plaintiff one dollar for the stone, had any knowledge of the real value of the stone, or that he entertained even a belief that the stone was a diamond. It cannot, therefore, be said that there was a suppression of knowledge on the part of the defendant as to the value of the stone which a court of equity might seize upon to avoid the sale. The following cases show that, in the absence of fraud or warranty, the value of the property sold, as compared with the price paid, is no ground for a rescission of a sale. However unfortunate the plaintiff may have been in selling this valuable stone for a mere nominal sum, she has failed entirely to make out a case either of fraud or mistake in the sale such as will entitle her to a rescission of such sale so as to recover the property sold in an action at law.

The judgment of the circuit court is affirmed.

THEODORE C. SHERWOOD v. HIRAM WALKER, 66 Mich. 568; 33 N.W. 919 (Mich.1887)

OPINION BY: Morse

Replevin for a cow. Suit commenced in justice's court. Judgment for plaintiff. Appealed to circuit court of Wayne county, and verdict and judgment for plaintiff in that court. The defendants bring error, and set out 25 assignments of the same.

The main controversy depends upon the construction of a contract for the sale of the cow. The plaintiff claims that the title passed, and bases his action upon such claim.
The defendants contend that the contract was executory, and by its terms no title to the animal was acquired by plaintiff.

The defendants reside at Detroit, but are in business at Walkerville, Ontario, and have a farm at Greenfield, in Wayne county, upon which were some blooded cattle supposed to be barren as breeders. The Walkers are importers and breeders of polled Angus cattle.

The plaintiff is a banker living at Plymouth, in Wayne county. He called upon the defendants at Walkerville for the purchase of some of their stock, but found none there that suited him. Meeting one of the defendants afterwards, he was informed that they had a few head upon this Greenfield farm. He was asked to go out and look at them, with the statement at the time that they were probably barren, and would not breed.

May 5, 1886, plaintiff went out to Greenfield and saw the cattle. A few days thereafter, he called upon one of the defendants with the view of purchasing a cow, known as "Rose 2d of Aberlone." After considerable talk, it was agreed that defendants would telephone Sherwood at his home in Plymouth in reference to the price. The second morning after this talk he was called up by telephone, and the terms of the sale were finally agreed upon. He was to pay five and one-half cents per pound, live weight, fifty pounds shrinkage. He was asked how he intended to take the cow home, and replied that he might ship her from King's cattle-yard. He requested defendants to confirm the sale in writing, which they did by sending him the following letter:

"Walkerville, May 15, 1886.

T. C. Sherwood,

President, etc.,--

Dear Sir: We confirm sale to you of the cow Rose 2d of Aberlone, lot 56 of our catalogue, at five and a half cents per pound, less fifty pounds shrink. We inclose herewith order on Mr. Graham for the cow. You might leave check with him, or mail to us here, as you prefer.
Yours truly,
Hiram Walker & Sons."

The order upon Graham inclosed in the letter read as follows:

"Walkerville, May 15, 1886.

George Graham: You will please deliver at King's cattle-yard to Mr. T. C. Sherwood, Plymouth, the cow Rose 2d of Aberlone, lot 56 of our catalogue. Send halter with cow, and have her weighed.

Yours truly, Hiram Walker & Sons."

On the twenty-first of the same month the plaintiff went to defendants' farm at Greenfield, and presented the order and letter to Graham, who informed him that the defendants had instructed him not to deliver the cow. Soon after, the plaintiff tendered to Hiram Walker, one of the defendants, $ 80, and demanded the cow. Walker refused to take the money or deliver the cow. The plaintiff then instituted this suit. …

…

The defendants then introduced evidence tending to show that at the time of the alleged sale it was believed by both the plaintiff and themselves that the cow was barren and would not breed; that she cost $ 850, and if not barren would be worth from $ 750 to $ 1,000; that after the date of the letter, and the order to Graham, the defendants were informed by said Graham that in his judgment the cow was with calf, and therefore they instructed him not to deliver her to plaintiff, and on the twentieth of May, 1886, telegraphed to the plaintiff what Graham thought about the cow being with calf, and that consequently they could not sell her. The cow had a calf in the month of October following.…

It appears from the record that both parties supposed this cow was barren and would not breed, and she was sold by the pound for an insignificant sum as compared with her real value if a breeder. She was evidently sold and purchased on the relation of her value for beef, unless the plaintiff had learned of her true condition, and concealed such knowledge from the defendants. Before the plaintiff secured possession of the animal, the defendants learned that she was with calf, and therefore of great value, and undertook to rescind the sale by refusing to deliver her. The question arises whether they had a right to do so.

The circuit judge ruled that this fact did not avoid the sale, and it made no difference whether she was barren or not. I am of the opinion that the court erred in this holding. I know that this is a close question, and the dividing line between the adjudicated cases is not

easily discerned. But it must be considered as well settled that a party who has given an apparent consent to a contract of sale may refuse to execute it, or he may avoid it after it has been completed, if the assent was founded, or the contract made, upon the mistake of a material fact,--such as the subject-matter of the sale, the price, or some collateral fact materially inducing the agreement; and this can be done when the mistake is mutual.

If there is a difference or misapprehension as to the substance of the thing bargained for, if the thing actually delivered or received is different in substance from the thing bargained for and intended to be sold, then there is no contract; but if it be only a difference in some quality or accident, even though the mistake may have been the actuating motive to the purchaser or seller, or both of them, yet the contract remains binding.

It has been held, in accordance with the principles above stated, that where a horse is bought under the belief that he is sound, and both vendor and vendee honestly believe him to be sound, the purchaser must stand by his bargain, and pay the full price, unless there was a warranty.

It seems to me, however, in the case made by this record, that the mistake or misapprehension of the parties went to the whole substance of the agreement. If the cow was a breeder, she was worth at least $ 750; if barren, she was worth not over $ 80. The parties would not have made the contract of sale except upon the understanding and belief that she was incapable of breeding, and of no use as a cow. It is true she is now the identical animal that they thought her to be when the contract was made; there is no mistake as to the identity of the creature. Yet the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them for all purposes of use as there is between an ox and a cow that is capable of breeding and giving milk. If the mutual mistake had simply related to the fact whether she was with calf or not for one season, then it might have been a good sale; but the mistake affected the character of the animal for all time, and for her present and ultimate use. She was not in fact the animal, or the kind of animal, the defendants intended to sell or the plaintiff to buy. She was not a barren cow, and, if this fact had been known, there would have been no contract. The mistake affected the substance of the whole consideration, and it must be considered that there was no contract to sell or sale

of the cow as she actually was. The thing sold and bought had in fact no existence. She was sold as a beef creature would be sold; she is in fact a breeding cow, and a valuable one.

The court should have instructed the jury that if they found that the cow was sold, or contracted to be sold, upon the understanding of both parties that she was barren, and useless for the purpose of breeding, and that in fact she was not barren, but capable of breeding, then the defendants had a right to rescind, and to refuse to deliver, and the verdict should be in their favor.

The judgment of the court below must be reversed, and a new trial granted, with costs of this Court to defendants.

LENAWEE COUNTY BD. OF HEALTH v. MESSERLY, 417 Mich. 17, 331 N.W.2d 203 (Mich.,1982) RYAN, Justice.

In March of 1977, Carl and Nancy Pickles, appellees, purchased from appellants, William and Martha Messerly, a 600-square-foot tract of land upon which is located a three-unit apartment building. Shortly after the transaction was closed, the Lenawee County Board of Health condemned the property and obtained a permanent injunction which prohibits human habitation on the premises until the defective sewage system is brought into conformance with the Lenawee County sanitation code.

We are required to determine whether appellees should prevail in their attempt to avoid this land contract on the basis of mutual mistake and failure of consideration. We conclude that the parties did entertain a mutual misapprehension of fact, but that the circumstances of this case do not warrant rescission.

I

The facts of the case are not seriously in dispute. In 1971, the Messerlys acquired approximately one acre plus 600 square feet of land. A three-unit apartment building was situated upon the 600-square-foot portion. The trial court found that, prior to this transfer, the Messerlys' predecessor in title, Mr. Bloom, had installed a septic tank on the property without a permit and in violation of the applicable health code. The Messerlys used the

building as an income investment property until 1973 when they sold it, upon land contract, to James Barnes who likewise used it primarily as an income-producing investment.

Mr. and Mrs. Barnes, with the permission of the Messerlys, sold approximately one acre of the property in 1976, and the remaining 600 square feet and building were offered for sale soon thereafter when Mr. and Mrs. Barnes defaulted on their land contract. Mr. and Mrs. Pickles evidenced an interest in the property, but were dissatisfied with the terms of the Barnes-Messerly land contract. Consequently, to accommodate the Pickleses' preference to enter into a land contract directly with the Messerlys, Mr. and Mrs. Barnes executed a quit-claim deed which conveyed their interest in the property back to the Messerlys. After inspecting the property, Mr. and Mrs. Pickles executed a new land contract with the Messerlys on March 21, 1977. It provided for a purchase price of $25,500. A clause was added to the end of the land contract form which provides:

"17. Purchaser has examined this property and agrees to accept same in its present condition. There are no other or additional written or oral understandings."

Five or six days later, when the Pickleses went to introduce themselves to the tenants, they discovered raw sewage seeping out of the ground. Tests conducted by a sanitation expert indicated the inadequacy of the sewage system. The Lenawee County Board of Health subsequently condemned the property and initiated this lawsuit in the Lenawee Circuit Court against the Messerlys as land contract vendors, and the Pickleses, as vendees, to obtain a permanent injunction proscribing human habitation of the premises until the property was brought into conformance with the Lenawee County sanitation code. The injunction was granted, and the Lenawee County Board of Health was permitted to withdraw from the lawsuit by stipulation of the parties.

When no payments were made on the land contract, the Messerlys filed a cross-complaint against the Pickleses seeking foreclosure, sale of the property, and a deficiency judgment. Mr. and Mrs. Pickles then counterclaimed for rescission against the Messerlys, and filed a third-party complaint against the Barneses, which incorporated, by reference, the allegations of the counterclaim against the Messerlys. In count one, Mr. and Mrs. Pickles alleged failure of consideration. Count two charged Mr. and Mrs. Barnes with willful

concealment and misrepresentation as a result of their failure to disclose the condition of the sanitation system. Additionally, Mr. and Mrs. Pickles sought to hold the Messerlys liable in equity for the Barneses' alleged misrepresentation. The Pickleses prayed that the land contract be rescinded.

After a bench trial, the court concluded that the Pickleses had no cause of action against either the Messerlys or the Barneses as there was no fraud or misrepresentation. This ruling was predicated on the trial judge's conclusion that none of the parties knew of Mr. Bloom's earlier transgression or of the resultant problem with the septic system until it was discovered by the Pickleses, and that the sanitation problem was not caused by any of the parties. The trial court held that the property was purchased "as is", after inspection and, accordingly, its "negative * * * value cannot be blamed upon an innocent seller". Foreclosure was ordered against the Pickleses, together with a judgment against them in the amount of $25,943.09.

Mr. and Mrs. Pickles appealed from the adverse judgment. The Court of Appeals unanimously affirmed the trial court's ruling with respect to Mr. and Mrs. Barnes but, in a two-to-one decision, reversed the finding of no cause of action on the Pickleses' claims against the Messerlys. *Lenawee County Board of Health v. Messerly*, 98 Mich.App. 478, 295 N.W.2d 903 (1980). It concluded that the mutual mistake between the Messerlys and the Pickleses went to a basic, as opposed to a collateral, element of the contract, and that the parties intended to transfer income-producing rental property but, in actuality, the vendees paid $25,500 for an asset without value.

We granted the Messerlys' application for leave to appeal.

II

We must decide initially whether there was a mistaken belief entertained by one or both parties to the contract in dispute and, if so, the resultant legal significance.

A contractual mistake "is a belief that is not in accord with the facts". 1 Restatement Contracts, 2d, § 151, p 383. The erroneous belief of one or both of the parties must relate to a fact in existence at the time the contract is executed. That is to say, the belief which is found to be in error may not be, in substance, a prediction as to a future occurrence or non-occurrence.

The Court of Appeals concluded, after a *de novo* review of the record, that the parties were mistaken as to the income-producing capacity of the property in question. 98 Mich.App. 487-488, 295 N.W.2d 903. We agree. The vendors and the vendees each believed that the property transferred could be utilized as income-generating rental property. All of the parties subsequently learned that, in fact, the property was unsuitable for any residential use.

…

Having determined that when these parties entered into the land contract they were laboring under a mutual mistake of fact, we now direct our attention to a determination of the legal significance of that finding.

A contract may be rescinded because of a mutual misapprehension of the parties, but this remedy is granted only in the sound discretion of the court. *Harris v. Axline,* 323 Mich. 585, 36 N.W.2d 154 (1949). Appellants argue that the parties' mistake relates only to the quality or value of the real estate transferred, and that such mistakes are collateral to the agreement and do not justify rescission, citing *A & M Land Development Co. v. Miller,* 354 Mich. 681, 94 N.W.2d 197 (1959).

In that case, the plaintiff was the purchaser of 91 lots of real property. It sought partial rescission of the land contract when it was frustrated in its attempts to develop 42 of the lots because it could not obtain permits from the county health department to install septic tanks on these lots. This Court refused to allow rescission because the mistake, whether mutual or unilateral, related only to the value of the property.

Appellees contend, on the other hand, that in this case the parties were mistaken as to the very nature of the character of the consideration and claim that the pervasive and essential quality of this mistake renders rescission appropriate. They cite in support of that view *Sherwood v. Walker,* 66 Mich. 568, 33 N.W. 919 (1887), the famous “barren cow” case….

As the parties suggest, the foregoing precedent arguably distinguishes mistakes affecting the essence of the consideration from those which go to its quality or value, affording relief on a per se basis for the former but not the latter.

However, the distinctions which may be drawn from *Sherwood* and *A & M Land Development Co.* do not provide a satisfactory analysis of the nature of a mistake sufficient to invalidate a contract. Often, a mistake relates to an underlying factual assumption which, when discovered, directly affects value, but simultaneously and materially affects the essence of the contractual consideration. It is disingenuous to label such a mistake collateral.

Appellant and appellee both mistakenly believed that the property which was the subject of their land contract would generate income as rental property. The fact that it could not be used for human habitation deprived the property of its income-earning potential and rendered it less valuable. However, this mistake, while directly and dramatically affecting the property's value, cannot accurately be characterized as collateral because it also affects the very essence of the consideration. "The thing sold and bought [income generating rental property] had in fact no existence". *Sherwood v. Walker,* 66 Mich. 578, 33 N.W. 919.

We find that the inexact and confusing distinction between contractual mistakes running to value and those touching the substance of the consideration serves only as an impediment to a clear and helpful analysis for the equitable resolution of cases in which mistake is alleged and proven. Accordingly, the holdings of *A & M Land Development Co.* and *Sherwood* with respect to the material or collateral nature of a mistake are limited to the facts of those cases.

Instead, we think the better-reasoned approach is a case-by-case analysis whereby rescission is indicated when the mistaken belief relates to a basic assumption of the parties upon which the contract is made, and which materially affects the agreed performances of the parties.[1] Rescission is not available, however, to relieve a party who has assumed the risk of loss in connection with the mistake. [2]

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[1] [Restatement Second] Section 152 delineates the legal significance of a mistake.
"§ 152. When Mistake of Both Parties Makes a Contract Voidable
(1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in § 154.
(2) In determining whether the mistake has a material effect on the agreed exchange of performances, account is taken of any relief by way of reformation, restitution, or otherwise.
[2] § 154. When a Party Bears the Risk of a Mistake
"A party bears the risk of a mistake when
(a) the risk is allocated to him by agreement of the parties, or
(b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or

All of the parties to this contract erroneously assumed that the property transferred by the vendors to the vendees was suitable for human habitation and could be utilized to generate rental income. The fundamental nature of these assumptions is indicated by the fact that their invalidity changed the character of the property transferred, thereby frustrating, indeed precluding, Mr. and Mrs. Pickles' intended use of the real estate. Although the Pickleses are disadvantaged by enforcement of the contract, performance is advantageous to the Messerlys, as the property at issue is less valuable absent its income-earning potential. Nothing short of rescission can remedy the mistake. Thus, the parties' mistake as to a basic assumption materially affects the agreed performances of the parties.

Despite the significance of the mistake made by the parties, we reverse the Court of Appeals because we conclude that equity does not justify the remedy sought by Mr. and Mrs. Pickles.

Rescission is an equitable remedy which is granted only in the sound discretion of the court. A court need not grant rescission in every case in which the mutual mistake relates to a basic assumption and materially affects the agreed performance of the parties.

In cases of mistake by two equally innocent parties, we are required, in the exercise of our equitable powers, to determine which blameless party should assume the loss resulting from the misapprehension they shared.[3] Normally that can only be done by drawing upon our "own notions of what is reasonable and just under all the surrounding circumstances".

Equity suggests that, in this case, the risk should be allocated to the purchasers. We are guided to that conclusion, in part, by the standards announced in § 154 of the Restatement of Contracts 2d, for determining when a party bears the risk of mistake. See fn 12. Section 154(a) suggests that the court should look first to whether the parties have

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(c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so."

[3] This risk-of-loss analysis is absent in both A & M Land Development Co and Sherwood, and this omission helps to explain, in part, the disparate treatment in the two cases. Had such an inquiry been undertaken in Sherwood, we believe that the result might have been different. Moreover, a determination as to which party assumed the risk in A & M Land Development Co would have alleviated the need to characterize the mistake as collateral so as to justify the result denying rescission. Despite the absence of any inquiry as to the assumption of risk in those two leading cases, we find that there exists sufficient precedent to warrant such an analysis in future cases of mistake.

agreed to the allocation of the risk between themselves. While there is no express assumption in the contract by either party of the risk of the property becoming uninhabitable, there was indeed some agreed allocation of the risk to the vendees by the incorporation of an "as is" clause into the contract which, we repeat, provided:

"Purchaser has examined this property and agrees to accept same in its present condition. There are no other or additional written or oral understandings."

That is a persuasive indication that the parties considered that, as between them, such risk as related to the "present condition" of the property should lie with the purchaser. If the "as is" clause is to have any meaning at all, it must be interpreted to refer to those defects which were unknown at the time that the contract was executed. Thus, the parties themselves assigned the risk of loss to Mr. and Mrs. Pickles.

We conclude that Mr. and Mrs. Pickles are not entitled to the equitable remedy of rescission and, accordingly, reverse the decision the Court of Appeals.

WIL-FRED'S INC. , v. THE METROPOLITAN SANITARY DISTRICT OF GREATER CHICAGO, 372 N.E.2d 94 (Ill. App. Ct. 1978)

In response to an advertisement published by the Metropolitan Sanitary District of Greater Chicago (hereinafter Sanitary District) inviting bids for rehabilitation work at one of its water reclamation plants, Wil-Fred's Inc. submitted a sealed bid and, as a security deposit to insure its performance, a $ 100,000 certified check. After the bids were opened, Wil-Fred's, the low bidder, attempted to withdraw. The Sanitary District rejected the request and stated that the contract would be awarded to Wil-Fred's in due course. Prior to this award, Wil-Fred's filed a complaint for preliminary injunction and rescission. After hearing testimony and the arguments of counsel, the trial court granted rescission and ordered the Sanitary District to return the $ 100,000 bid deposit to Wil-Fred's. The Sanitary District seeks to reverse this judgment order.

The Sanitary District's advertisement was published on November 26, 1975, and it announced that bids on contract 75-113-2D for the rehabilitation of sand drying beds at the District's West-Southwest plant in Stickney, Illinois, would be accepted up to January 6, 1976. This announcement specified that the work to be performed required the contractor to remove 67,500 linear feet of clay pipe and 53,200 cubic yards of gravel from the beds and to replace these items with plastic pipe and fresh filter material. Although plastic pipes were called for, the specifications declared that "all pipes * * * must be able * * * to withstand standard construction equipment."

The advertisement further stated that "[t]he cost estimate of the work under Contract 75-113-2D, as determined by the Engineering Department of the * * * Sanitary District * * * is $ 1,257,000.00."

A proposal form furnished to Wil-Fred's provided:

> "The undersigned hereby certifies that he has examined the contract documents * * * and has examined the site of the work, * * *.
> The undersigned has also examined the Advertisement, the 'bidding requirements,' has made the examinations and investigation therein required, * * *.
> * * *
> The undersigned hereby accepts the invitation of the Sanitary District to submit a proposal on said work *with the understanding that this proposal will not be cancelled or withdrawn*.
> *It is understood that in the event the undersigned is awarded a contract for the work herein mentioned, and shall fail or refuse to execute the same and furnish the specified bond within thirteen (13) days after receiving notice of the award of said contract, then the sum of One Hundred Thousand Dollars ($ 100,000.00), deposited herewith, shall be retained by the Sanitary District as liquidated damages* and not as a penalty, it being understood that said sum is the fair measure of the amount of damages that said Sanitary District will sustain in such event." (Emphasis added.)

On December 22, 1975, the Sanitary District issued an addendum that changed the type of sand filter material which was to be supplied by the contractor. During the bidding period the District's engineering department discovered that the material originally specified in the advertisement was available only out of State and consequently

was extremely expensive. This addendum changed the filter material to a less expensive type that could be obtained locally.

On January 6, 1976, Wil-Fred's submitted the low bid of $ 882,600 which was accompanied by the $ 100,000 bid deposit and the aforementioned proposal form signed on behalf of the company by Wil-Fred's vice president. Eight other companies submitted bids on January 6. The next lowest bid was $ 1,118,375, and it was made by Greco Contractors, Inc.

On January 8, 1976, Wil-Fred's sent the Sanitary District a telegram which stated that it was withdrawing its bid and requested return of its bid deposit. This telegram was confirmed by a subsequent letter mailed the same day.

On January 12, 1976, Wil-Fred's, at the request of the Sanitary District, sent a letter setting forth the circumstances that caused the company to withdraw its bid. The letter stated that upon learning the amount by which it was the low bidder, Wil-Fred's asked its excavating subcontractor, Ciaglo Excavating Company, to review its figures; that excavation was the only subcontracted trade in Wil-Fred's bid; that the following day Ciaglo informed Wil-Fred's that there had been a substantial error in its bid, and therefore it would have to withdraw its quotation since performing the work at the stated price would force the subcontractor into bankruptcy; that Wil-Fred's then checked with other excavation contractors and confirmed that Ciaglo's bid was in error; that Wil-Fred's had used Ciaglo as an excavating subcontractor on many other projects in the past, and Ciaglo had always honored its previous quotations; that Ciaglo had always performed its work in a skillful fashion; that because of these facts Wil-Fred's acted reasonably in utilizing Ciaglo's quoted price in formulating its own bid; and that with the withdrawal of Ciaglo's quotation Wil-Fred's could not perform the work for $ 882,600.

On February 2, 1976, Wil-Fred's received a letter from Thomas W. Moore, the Sanitary District's purchasing agent. Moore's letter stated that in his opinion the reasons cited in Wil-Fred's letter of January 12 did not justify withdrawal of the bid. For this reason Moore said that he would recommend to the Sanitary District's general superintendent that the contract be awarded to Wil-Fred's at the original bid price.

At a February 20 meeting between representatives of the Sanitary District and Wil-Fred's, the company was informed that the District's board of trustees had rejected its

withdrawal request, and that it would be awarded the contract. In response to this information, Wil-Fred's filed its complaint for preliminary injunction and rescission on February 26, 1976. The complaint alleged that the company would be irreparably injured if required to perform the contract at such an unconscionably low price or if forced to forfeit the $ 100,000 bid deposit. The hearing on this complaint commenced on March 10, 1976.

At the hearing William Luxion, president of Wil-Fred's testified that the company had been in business for 18 years; that Wil-Fred's did 13 to 14 million dollars worth of business in 1975; that 95% of the company's work was done on a competitive bid basis; that Wil-Fred's never had withdrawn a competitive bid in the past; and that he personally examined the company's bid prior to its submission. Luxion further stated that he told Wil-Fred's chief estimator to review the company's quotation immediately after he was notified on January 6 that Wil-Fred's bid was more that $ 235,000 below the next lowest bid. At this time he also requested that Ciaglo Company review its figures.

The reexamination by the chief estimator revealed that there was no material error in the portion of the bid covering work to be done by Wil-Fred's. However, the president of Ciaglo contacted Luxion on January 8 and stated that his bid was too low on account of an error and that, because of this, he was withdrawing his quotation. Upon receiving this information, Luxion sent the Sanitary District the telegram and letter in which he informed the District of this error, withdrew Wil-Fred's bid and requested a return of the company's bid deposit.

Lastly, Luxion testified that a loss of the $ 100,000 security deposit would result in the company's loss of bonding capacity in the amount of two to three million dollars; that Wil-Fred's decided not to attempt to force Ciaglo to honor its subcontract because the company felt that Ciaglo was not financially capable of sustaining a $ 150,000 loss; and that he was aware of the Sanitary District's cost estimate before Wil-Fred's submitted its bid. However, Luxion stated that he took the addendum changing the filter material into account when calculating the price of the bid and concluded that this alteration would result in a cost savings of over $ 200,000.

Dennis Ciaglo, president of Ciaglo Excavating, Inc., also testified on behalf of Wil-Fred's and stated that prior to January 6, 1976, his company submitted a quote of $

205,000 for the removal of the existing material in the sand beds, for digging trenches for the new pipe and for spreading the new filter materials. Ciaglo further stated that a representative] of Wil-Fred's called him on January 6 and asked him to review his price quotation. During his examination the witness discovered that he underestimated his projected costs by $ 150,000. Ciaglo said that this error was caused by his assumption that heavy equipment could be driven into the beds to spread the granular fill. Although he was aware that plastic pipes were to be used in the beds, Ciaglo still presumed that heavy equipment could be employed because the specifications called for the utilization of standard construction equipment. Ciaglo first learned that the plastic pipes would not support heavy equipment when, as part of his review of the price quote, he contacted the pipe manufacturer.

Ciaglo testified additionally that his company probably would have to file for bankruptcy if forced to take a $ 150,000 loss; that Ciaglo Excavating Co. had never before withdrawn a price quotation given to Wil-Fred's or any other company; and that in his opinion the change in the filter material called for by the second addendum would cause a $ 300,000 reduction in "the cost of the material for the bids * * *."

Only one witness testified for the Sanitary District. Leslie Dombai, a registered structural engineer for the District, stated that the Sanitary District's cost estimate was based directly upon the expense of the material specified in the advertisement, and he confirmed that the filter material was changed because the type initially called for was expensive and was not available locally. However, Dombai claimed that this substitution increased the District's original cost estimate by $40,000.

By bidding on the Sanitary District's rehabilitation project, Wil-Fred's made a binding commitment. Its bid was in the nature of an option to the District based upon valuable consideration: the assurance that the award would be made to the lowest bidder. The option was both an offer to do the work and a unilateral agreement to enter into a contract to do so. When the offer was accepted, a bilateral contract arose which was mutually binding on Wil-Fred's and the Sanitary District. (P*eople ex rel. Department of Public Works & Buildings v. South East National Bank* (1st Dist. 1971), 131 Ill. App. 2d 238, 240, 266 N.E.2d 778, 779-80; 11 Williston on Contracts ß 1441 (3d ed. Jaeger 1968).) When Wil-Fred's attempted to withdraw its bid, it became subject to the condition

incorporated in the proposal form furnished by the Sanitary District. Under this condition, the company's bid deposit was forfeited when it refused to execute the contract within the specified time period.

The principal issue, therefore, is whether Wil-Fred's can obtain rescission of its contract with the Sanitary District because of its unilateral mistake. Wil-Fred's argues that the mistake was material to the contract; that this error was directly caused by the Sanitary District's misleading specifications; that the Sanitary District did not alter its position in reliance upon the erroneous bid because the company promptly notified the District of the mistake; and that under these circumstances it would be unconscionable to enforce the contract or to allow the Sanitary District to retain the security deposit.

As a general rule, it is often said that relief will not be granted if but one party to a contract has made a mistake. (*People ex rel. Department of Public Works & Buildings v. South East National Bank*; Restatement of the Law of Contracts ß 503 (1932).) However, Professor Williston in his treatise on contracts indicates that unilateral mistake may afford ground for rescission where there is a material mistake and such mistake is so palpable that the party not in error will be put on notice of its existence. 13 Williston on Contracts ß 1578 (3d ed. Jaeger 1970).

In Illinois the conditions generally required for rescission are: that the mistake related to a material feature of the contract; that it occurred notwithstanding the exercise of reasonable care; that it is of such grave consequence that enforcement of the contract would be unconscionable; and that the other party can be placed *in statu quo. (People ex rel. Department of Public Works & Buildings v. South East National Bank*.) Evidence of these conditions must be clear and positive. *Winkelman v. Erwin* (1929), 333 Ill. 636, 640, 165 N.E. 205, 207.

If Ciaglo's misestimation was established by competent evidence, it is apparent that the error was material. This determination is based on the fact that the $ 150,000 mistake represents approximately 17% of Wil-Fred's bid. See *People ex rel. Department of Public Works & Buildings v. South East National Bank*.

However, the Sanitary District contends that Wil-Fred's failed to support its claim of materiality with clear and positive evidence. The District points out that neither of the plaintiff's two witnesses described the proper method for spreading the new filter material

on the plastic pipes, and it argues that because of this omission Wil-Fred's failed to introduce sufficient evidence to substantiate Dennis Ciaglo's conclusion that the correct procedure would have cost $ 150,000 more than the system he had planned to use.

We do not find this argument persuasive. It is manifest from the trial court's judgment order that the trier of fact decided that Ciaglo's mistake related to a material feature of the rehabilitation contract and that this condition was supported by clear and positive evidence. After carefully examining the record, we are in agreement with this finding.

Dennis Ciaglo testified that he gave Wil-Fred's a price quotation of $ 205,000 for his work allotment, and he indicated that the amount of this bid was based directly upon his incorrect assumption that heavy trucks could be driven into the sand drying beds and onto the plastic pipes. This testimony is corroborated by the subcontractor's price estimate sheet which was introduced into evidence by the Sanitary District.

It is true, nevertheless, that plaintiff's witnesses failed to describe the correct spreading method, and that Ciaglo made only a conclusionary statement to the effect that employment of the proper procedure would have increased his original quotation by $ 150,000. However, the District did not cross-examine the subcontractor concerning this matter, and it failed to produce any evidence, testimonial or otherwise, that contravened his statement. Consequently, Ciaglo's conclusion stands uncontradicted.

Furthermore, it is our opinion that the accuracy of the estimated error is supported by the fact that Ciaglo had eight years experience in the excavating business and by the fact that he confirmed this figure by checking with other contractors who had submitted bids on the same portion of the project. Under these particular circumstances we feel that Wil-Fred's produced sufficient evidence to sustain its claim of a $ 150,000 error.

In addition to satisfying the first condition for rescission, Wil-Fred's has decidedly fulfilled two of the three remaining requirements. The consequences of Ciaglo's error were grave. Since the subcontractor was not capable of sustaining a $ 150,000 loss, Wil-Fred's stood to lose the same amount if it performed the contract for $ 882,600. Wil-Fred's will forfeit $ 100,000 if the contract is enforced. A loss of $ 100,000 will decrease the plaintiff's bonding capacity by two to three million dollars. It is evident, therefore, that either deprivation will constitute substantial hardship. The Sanitary District was not

damaged seriously by the withdrawal of the bid. When the subcontractor's mistake was discovered 48 hours after the bid opening, Wil-Fred's promptly notified the District by telegram and declared its intention to withdraw. The rehabilitation contract had not been awarded at this time. Accordingly, the District suffered no change in position since it was able, with no great loss other than the windfall resulting from Ciaglo's error, to award the contract to the next lowest bidder, Department of Public Works.

The central question, therefore, is whether the error occurred despite the use of reasonable care. The Sanitary District asserts that the mistake itself evidences Wil-Fred's failure to use ordinary care in the preparation of its bid and argues that rescission is not warranted under such circumstances.

We cannot agree with this contention. Wil-Fred's unquestionably exercised due care when it selected Ciaglo Excavating Company as its subcontractor. Ciaglo Excavating Company had been in business for five years; its president had eight years experience in the excavating field; the company had worked for Wil-Fred's on 12 previous occasions; it had never failed to honor a prior quotation; and it had always performed its assignments in a highly skilled manner. Also, Dennis Ciaglo testified that prior to submitting his bid to Wil-Fred's, he inspected the jobsite and carefully examined the specifications with plaintiff's estimators. Taking into account the experience and preparations of the subcontractor, the prior business dealings between the two companies and the high quality of Ciaglo Excavating Company's past performance, we conclude that Wil-Fred's was justified in relying on the subcontractor's quotation in formulating its own bid.

Similarly, we feel that Wil-Fred's exercised reasonable care in the preparation of its portion of the total bid. The plaintiff made two separate reviews of its price quotation. The first was conducted prior to the bid's submission, and it took into account the addendum that substituted a cheaper filter material for the type originally called for by the specifications. The second examination was made immediately after Wil-Fred's president learned that his company's bid was the lowest quotation. It revealed that plaintiff had not erred in estimating expenses for its part of the rehabilitation project.

The question of due care is a factual question to be determined by the trial court, and such determination will not be disturbed unless it is against the manifest weight of

the evidence. (*Santucci Construction Co. v. County of Cook* (1st Dist. 1974), 21 Ill. App. 3d 527, 532, 315 N.E.2d 565, 569.) For the aforementioned reasons we feel that the record supports the trial court's finding of due care on the part of Wil-Fred's.

The Sanitary District asserts that even if due care was exercised by Wil-Fred's, Illinois courts have granted relief only in cases where the bid has contained a clerical or mathematical error. Defendant argues that the trial court's grant of rescission should not be upheld because Ciaglo's mistake was not a factual error but an error in business judgment.

Regarding the District's argument, it is the opinion of this court that Ciaglo's error amounts to a mixed mistake of judgment and fact. Ciaglo's belief that the plastic pipes would support heavy trucks was judgmental in nature and in this narrow sense his mistake was one of business judgment. However, his belief was predicated on a misunderstanding of the actual facts occasioned, at least in part, by his reliance on the Sanitary District's misleading specifications which stated that all pipes had to be able to withstand standard construction equipment.

Generally, relief is refused for errors in judgment and allowed for clerical or mathematical mistakes. Nonetheless, we believe, in fairness to the individual bidder, that the facts surrounding the error, not the label, i.e. "mistake of fact" or "mistake of judgment," should determine whether relief is granted. *White v. Berrenda Mesa Water District* (1970), 7 Cal. App. 3d 894, 907, 87 Cal. Rptr. 338, 347-48.

The testimonial evidence reveals that Wil-Fred's acted in good faith and that Ciaglo's error occurred notwithstanding the exercise of reasonable care. Furthermore, it was established that Wil-Fred's quotation was $ 235,775 lower than the next lowest bid. It is apparent that such a sizable discrepancy should have placed the Sanitary District on notice that plaintiff's bid contained a material error. (See *Santucci*.) Accordingly equity will not allow the District to take advantage of Wil-Fred's low offer.

We are aware of the importance of maintaining the competitive bidding system which is used in the letting of municipal construction contracts. Consequently we do not mean to imply by affirming the trial court's order that a bidder who has submitted the lowest quotation on a municipal contract may cavalierly disregard the contract's irrevocability clause and seek rescission. Allowing such action would be unfair to the

other bidders and would result in the destruction of the system's integrity. However, we are certain that the courts of this State are capable of preventing such a result by refusing to grant rescission where, unlike the present circumstances, the facts do not justify relieving the lowest bidder from his bid. See *Calnan Co. v. Talsma Builders, Inc.* (1977), 67 Ill. 2d 213, 367 N.E.2d 695, in which our supreme court, although not dealing with a municipal construction contract, recently denied rescission of a plumbing subcontract where the subcontractor failed to include the cost of the entire water supply system in its bid, a concededly material feature of the subcontract. The supreme court held that the subcontractor had not exercised reasonable care by failing to utilize its own bid preparation review system and by not discovering its error until four months after acceptance of its bid. The court also found that the general contractor could not be placed *in statu quo* since work had begun and the general contractor had no options; it either had to account for the error ($ 31,000) or had to negotiate another subcontract, at a greater cost with lack of continuity in work….

Affirmed

BOLLINGER v. CENTRAL PENNSYLVANIA QUARRY STRIPPING & CONSTR. CO., 425 Pa. 430, 229 A.2d 741 (Pa. 1967)

MUSMANNO, Justice.

Mahlon Bollinger and his wife, Vinetta C. Bollinger, filed an action in equity against the Central Pennsylvania Quarry Stripping Construction Company asking that a contract entered into between them be reformed so as to include therein a paragraph alleged to have been omitted by mutual mistake and that the agreement, as reformed, be enforced.

The agreement, as executed, provided that the defendant was to be permitted to deposit on the property of the plaintiffs, construction waste as it engaged in work on the Pennsylvania Turnpike in the immediate vicinity of the plaintiffs' property. The Bollingers claimed that there had been a mutual understanding between them and the defendant that, prior to depositing such waste on the plaintiffs' property, the defendant would remove the topsoil of the plaintiffs' property, pile on it the waste material and then

restore the topsoil in a way to cover the deposited waste. The Bollingers averred that they had signed the written agreement without reading it because they assumed that the condition just stated had been incorporated into the writing.

When the defendant first began working in the vicinity of the plaintiffs' property, it did first remove the topsoil, deposited the waste on the bare land, and then replaced the topsoil. After a certain period of time, the defendant ceased doing this and the plaintiffs remonstrated. The defendant answered there was nothing in the written contract which required it to make a sandwich of its refuse between the bare earth and the topsoil. It was at this point that the plaintiffs discovered that that feature of the oral understanding had been omitted from the written contract. The plaintiff husband renewed his protest and the defendant's superintendent replied he could not remove the topsoil because his equipment for that operation had been taken away. When he was reminded of the original understanding, the superintendent said, in effect, he couldn't help that.

The plaintiffs then filed their action for reformation of the contract, the Court granted the requested relief, and the defendant firm appealed. We said in Bugen v. New York Life Insurance Co., 408 Pa. 472: "A court of equity has the power to reform the written evidence of a contract and make it correspond to the understanding of the parties. * * * However, the mistake must be mutual to the parties to the contract."

The fact, however, that one of the parties denies that a mistake was made does not prevent a finding of mutual mistake. Kutsenkow v. Kutsenkow, 414 Pa. 610, 612, 202 A.2d 68.

Once a person enters into a written agreement he builds around himself a stone wall, from which he cannot escape by merely asserting he had not understood what he was signing. However, equity would completely fail in its objectives if it refused to break a hole through the wall when it finds, after proper evidence, that there was a mistake between the parties, that it was real and not feigned, actual and not hypothetical.

The Chancellor, after taking testimony, properly concluded:

"We are satisfied that plaintiffs have sustained the heavy burden placed upon them. Their understanding of the agreement is corroborated by the undisputed evidence.

The defendant did remove and set aside the top soil on part of the area before depositing its waste and did replace the top soil over such waste after such depositing. It follows it would not have done so had it not so agreed. Further corroboration is found in the testimony that it acted similarly in the case of plaintiffs' neighbor Beltzner."

Decree affirmed, costs on the appellant.

Hypothetical

In 1981 the petitioners, defendants below, acquired from the State of Arizona agricultural development leases covering 2,262 acres of unimproved desert land near Yuma. The petitioners made no attempt to develop the property themselves, but instead decided to sell their interest in the land. The respondents, plaintiffs below, were residents of the state of Washington interested in the large scale commercial cultivation of jojoba [NOTE: Jojoba is a shrub which produces valuable seeds and oil]. The respondents and their agent, who was familiar with commercial jojoba development, were shown the petitioners' property and became interested in purchasing it. The property appeared to be ideal for the respondents' purposes; the soil and climate were good and both parties were of the opinion that sufficient water was available beneath the land to sustain jojoba production. The respondents made it clear that they were interested in the property only for jojoba production and required adequate water supplies.

The respondents decided to buy the leases and on June 5, 1981, executed a Real Estate Purchase Contract to that effect. Respondents agreed to pay $ 222,200 for the leases, and paid petitioners $ 80,200 as a down payment, the remainder to be paid in annual installments. In November of 1981 respondents began development of the property for jojoba production. As part of the development process the respondents had five test wells drilled, none of which produced water of sufficient quantity or quality for commercial jojoba cultivation. After spending approximately $ 229,000 developing the land respondents determined that the aquifer underlying the property was inadequate for commercial development of jojoba. At this point the project was abandoned and the respondents sued to rescind the purchase contract

Renner v. Kehl, 150 Ariz. 94, 96 (Ariz. 1986)

UNCONSCIONABILITY

SITOGUM HOLDINGS, INC. v. PHYLLIS E. ROPES, 352 N.J. Super. 555; 800 A.2d 915 (2002)

FISHER, P.J.Ch.

The common law doctrine of unconscionability has proved difficult to define and has been rarely invoked undoubtedly because, other than in exceptional cases, it has been largely viewed as grossly interfering with the freedom to contract. Notwithstanding this philosophical discomfort, the surrounding circumstances regarding defendant's desire to sell her property provided fertile ground for, and did in fact result in, a one-sided agreement which this court finds unconscionable.

I

Defendant Phyllis E. Ropes ("Mrs.Ropes") and her husband, John M. Ropes, Jr., were the owners of waterfront property in Brielle, New Jersey. This was their principal residence although they also owned a winter home in the Cayman Islands. It was in the Cayman Islands that John M. Ropes, Jr. died suddenly on January 3, 2000.

Grief-stricken, Mrs. Ropes, then 81 years old, took a number of rapid and inconsistent steps regarding the Brielle property. Apparently, not long before his death, it had been her and Mr. Rope's desire to sell the property. With his death, Mrs. Ropes almost immediately executed two separate powers of attorney on the same day--January 13, 2000; one in favor of third-party defendant Marlene Van Noord and the other in favor of Linda Dowhan. On January 26, 2000 another power of attorney, prepared by plaintiff Sitogum Holdings, Inc. ("Sitogum"), was also executed by Mrs. Ropes in favor of Ms. Van Noord. The next day, Ms. Van Noord executed an option to purchase the Brielle property in favor of Sitogum. This option contract, which Mrs. Ropes now claims is unconscionable, provided Sitogum--an entity which would not even be incorporated for another six days --with the right to purchase the Brielle property, within eight months, for $ 800,000. Sitogum agreed to pay $ 1000 per month for this option.

A February, 2000 appraisal suggested the Brielle property was worth between $ 1,500,000 and $ 1,750,000. Apparently recognizing the windfall about to come its way, Sitogum claims to have prepaid six of its monthly $ 1000 payments on or about February 28, 2000.

Apparently, at the same time, efforts were being made to market the property through Mrs. Ropes' other attorney-in-fact. Sitogum may have become aware of this since it recorded a "Memorandum of Option to Purchase Real Property" on or about April 11, 2000. On April 13, 2000, Mrs. Ropes executed a contract for the sale of the Brielle property to another party for $ 1,500,000. Upon learning of this, Sitogum, on April 28, 2000, exercised its option to purchase. Notwithstanding, Mrs. Ropes advised that she would not transfer the property to Sitogum. As a result, on May 19, 2000, Sitogum filed this suit to compel specific performance of the January 27, 2000 option agreement. Mrs. Ropes now moves for summary judgment.

II

…The only issue which is ripe for summary judgment is Mrs. Ropes' claim that the option contract is unconscionable.

A

The power of a court to relieve parties from unconscionable contracts has ancient roots. In *Earl of Chesterfield v. Janssen,* plaintiff borrowed 5000 pounds in exchange for his agreement to pay 20,000 pounds upon the death of his then 70-year old grandmother. In referring to the agreement as "unconscientious," the Chancellor described the power to set it aside, which still has traces in the doctrine currently applied by modern courts:

It may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his sense and not under a delusion would make on the one hand, and as no honest man would accept on the other; which are unequitable and unconscientious bargains, and of such even the common law take notice. [2 *Ves. Sr.* 125, 155, 28 *Eng. Rep.* 82, 100 (1750).]

The Supreme Court of the United States recognized this common law authority in the nineteenth century [1] and courts of equity have traditionally refused their assistance to parties who obtain such one-sided bargains.[2]

Notwithstanding its venerable history, the application of the doctrine has always been viewed as controversial and it would appear, judging from the paucity of reported decisions, that its use has been infrequent. The reason for this is undoubtedly over a heightened concern that its uncertain parameters "increase[] the potential for unreasoned or arbitrary decisions based on personal value judgments." Hillman, "Debunking Some Myths about Unconscionability: A New Framework for *U.C.C.* Section 2-302," 67 Cornell L. Rev. 1, 15 (1981). Courts normally examine challenges to the validity of contracts by first recognizing the parties' freedom to contract and by applying the principle that the execution of a contract manifests an intent to be bound by all its terms. As a result, the principle that courts "should not rewrite contracts," is often intoned in such disputes. Regardless, however, of the unease which its potential use produces, the doctrine of unconscionability has a place in our jurisprudence so that grossly unfair or one-sided contracts may be properly "policed." White & Summers, *Uniform Commercial Code* (4th ed., 1995) 206.

Considering the rapid evolution of the implied covenant of good faith and fair dealing in New Jersey --allowing for the watchful examination of the *bona fides* of the *performance* of valid contracts--it is plain to see that the application of the doctrine of unconscionability to the *bona fides* of the *creation* of contracts should not be viewed as a relic, as labelled by one commentator. Brown, "The Uncertainty of U.C.C. Section 2-302: Why Unconscionability Has Become A Relic," 105 Com. L. J. 287 (2000). In appropriate cases, the doctrine of unconscionability provides a more than proper and valid basis for interdicting an inequitable result which would otherwise flow from the cold enforcement of the terms of a contract.

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[1] *See, Eyre v. Potter*, 56 U.S. 42, 45, 15 How. 42, 14 L. Ed. 592 (1853) ("A disposition of property so revolting to common sense and natural affection ought to be looked upon with suspicion"); *Hume v. United States*, 132 U.S. 406, 411, 10 S. Ct. 134, 33 L. Ed. 393 (1889) (quoting *Earl of Chesterfield, supra* with approval).

[2] In *Campbell Soup Co. v. Wentz*, 172 F.2d 80, 83-84 (3d Cir. 1948), Judge Goodrich emphasized this point: "We think it is too hard a bargain and too one-sided an agreement to entitle the plaintiff to relief in a court of conscience.... We do think, however, that a party who has offered and succeeded in getting an agreement as tough as this one is, should not come to a chancellor and ask ... help in the enforcement of its terms. That equity does not enforce unconscionable bargains is too well established to require elaborate citation." *See also*, 4 Pomeroy, *Equity Jurisprudence* (5th ed., 1941), § 1405a; 5 Williston, *Contracts*, § 1425 (Rev.ed., 1937)

B

Besides existing at common law, the doctrine of unconscionability was included within the Uniform Commercial Code, becoming, as Professor Hawkland said, "undoubtedly the most controversial section in the entire Code." Hawkland, *A Transactional Guide to the U.C.C.,* Vol. I, § 1.16 at p. 44 (1964). The Uniform Commercial Code ("the Code") handles the issue in two interesting ways. First, the Code "assigns the issue of unconscionability exclusively to the judge." White & Summers, *Uniform Commercial Code* (2d ed.,1980) 151. Second, the Code provision contains no helpful definition or parameters, stating only:

"If the court as a matter of law finds the contract of any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." [*N.J.S.A.* 12A:2-302(1).]

The Code's official comments, intended to explain the meaning of this provision, also do not lend any great insight into what constitutes an unconscionable contract. Rather, the comment states that the "basic test" requires an examination into the general commercial background and seeks the "prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power."

The leading commentators refer to section 2-302 and the official comments as "unintelligible and abstract." Leff, "Unconscionability and the Code--The Emporer's New Clause, 115 U. Pa. L. Rev. 485, 488-89 (1967). Professors White and Summers observed that: "Experimentation with even a single case shows this litmus to be useless; in no sense is the comment an objective definition of the word. It is simply a string of hopelessly subjective synonyms ladened with a heavy "value" burden: "oppression, " "unfair," or "one-sided." [White & Summers, *supra,* at 151.]

See also, Spanogle, "Analyzing Unconscionability Problems," 117 U.Pa.L.Rev. 931, 942 (1969) ("The terms 'unfair surprise' and 'oppression' are no more concretely definable than the term

'unconscionable' so the Comment seems to offer slogan words rather than an explanation of the purposes behind the statute").[3]

While this criticism may be accurate, in this court's view it erroneously suggests that the imprecise defining of unconscionability is a weakness. In short, the critics' "reproof is something too round." Shakespeare, *Henry V:* 4.1.202 (1598-99). Unquestionably the common law rule, the Code's controversial section 2-302 and the Restatement's descriptions are general and abstract, but they also possess wisdom--the wisdom of understanding that the bright-line rule sought by the leading commentators is not only utterly elusive but also quite undesirable.[4] Instead, the erecting of parameters has been left to the courts to consider in light of their general experience with contract disputes and upon an understanding of the particular facts of each case. In short, the lawmakers undoubtedly anticipated that the skeletal unconscionability framework would be filled out through case-by-case determinations. While the risk of defining the doctrine through such a case-by-case approach is the possible loss of restraint and consistency, the advantage is a device inherently governed by the particular circumstances of each case measured against the experiences of past and present judges, the lifeblood of the common law.

C

Raising other questions about unconscionability is the fact that this case-by-case process, which began in earnest in the mid--1960's, slowed soon thereafter. Most of the decisions of note concerning the Code's unconscionability provision took place in the District of Columbia, New York and New Jersey. Unlike the present case, those decisions generally involved contracts where, due to unsophistication or lack of education, the consumer entered into a grossly unfair agreement. White & Summers, *supra*, at 149-50. The most important of these was *Williams v. Walker-Thomas Furniture Co.*, 121 U.S.App.D.C. 315, 350 F.2d 445 (D.C. Cir. 1965), where the consumer

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[3] The *Restatement (Second) of Contracts,* § 208 (1981) uses language similar to the Code. The case at hand is not governed by the Code because it concerns a contract involving a transfer of real estate and not a sale of goods. *See, N.J.S.A.* 12A-2-102. Nevertheless, because there is no reason to believe that the definition of unconscionability would have a different scope outside the parameters of the Code, it is helpful to consider the cases emanating from all areas. Indeed, section 2-302 has been fairly described by one commentator as being nothing more than a "restatement of common law." Davenport, "Unconscionability and the Uniform Commercial Code," 22 U. Miami L. Rev. 121, 123 (1967).

[4] While critical of the phrasing of 2-302 and the Code's comments, Professors White and Summers also recognize that such criticism is unrealistic: "It is not possible to define unconscionability. It is not a concept, but a determination to be made in light of a variety of factors not unifiable into a formula." White & Summers, supra, at 151.

purchased on installment a number of household items at different times. A provision in the contract cross-collateralized all past and present purchases so that no item was ever fully paid off until the last payment was made on the last item. When a default occurred the seller sought to repossess everything. The court found this unconscionable because of an "absence of meaningful choice" at the inception of the contract coupled with contractual terms "unreasonably favorable to the other party." *Id.* at 449.

For the most part, the unconscionability cases follow *Williams v. Walker--Thomas* and look for two factors: (1) unfairness in the formation of the contract, and (2) excessively disproportionate terms. Professor Leff labelled these two elements as "procedural" and "substantive" unconscionability. Leff, *supra,* 115 *U. Pa. L.Rev.* at 487. The first factor--procedural unconscionability--can include a variety of inadequacies, such as age, literacy, lack of sophistication, hidden or unduly complex contract terms, bargaining tactics, and the particular setting existing during the contract formation process. The second factor--substantive unconscionability--simply suggests the exchange of obligations so one-sided as to shock the court's conscience. *See, e.g., State ex rel. Lefkowitz v. ITM, Inc.*, 52 Misc.2d 39, 275 N.Y.S.2d 303 (Sup Ct. 1966) (purchase price/market value ratio approximately 2 1/2 times).

Most courts have looked for a sufficient showing of both factors in finding a contract unconscionable. Other courts have been satisfied merely by proof of substantive unconscionability, *i.e.*, an excessively disproportionate exchange of material promises. *See, e.g., Ahern v. Knecht*, 202 Ill.App.3d 709, 150 Ill.Dec. 660, 563 N.E.2d 787, 792 (1990) ("[g]ross excessiveness of price alone can make an agreement unconscionable"). Still other courts have determined that the two elements need not have equal effect but work together, [*566] creating a "sliding scale" of unconscionability. *Funding Systems Leas. Corp. v. King Louie Intern.*, 597 S.W.2d 624, 634 (Mo. Ct. App. 1979) ("if there exists gross procedural unconscionability then not much be needed by way of substantive unconscionability, and that the same 'sliding scale' be applied if there be great substantive unconscionability but little procedural unconscionability")

D

In *Kugler v. Romain*, 58 N.J. 522, 279 A.2d 640 (1971), the Court considered the validity of contracts for the door-to-door sale of education books and materials for two and a half times a reasonable price. Speaking for the Court, Justice Francis observed, as discussed earlier, that unconscionability is not defined by the Code, and described unconscionability as:

"an amorphous concept obviously designed to establish a broad business ethic. The framers of the Code naturally expected the courts to interpret it liberally so as to effectuate the public purpose, and to pour content into it on a case-by-case basis. In that way a substantial measure of predictability will be achieved and professional sellers of consumer goods as well as draftsmen of contracts for their sale to ordinary consumers will become aware of the abuses the court have declared unacceptable and will avoid them. The intent of the clause is not to erase the doctrine of freedom of contract, but to make realistic the assumption of the law that the agreement has resulted from real bargaining between parties who had freedom of choice and understanding and ability to negotiate in a meaningful fashion. Viewed in that sense, freedom to contract survives, but marketers of consumer goods are brought to an awareness that the restraint of unconscionability is always hovering over their operations and that courts will employ it to balance the interests of the consumer public and those of the sellers."[*Id.* at 543-44, 279 A.2d 640.]

While the Court did not refer to procedural and substantive unconscionability in those terms, there is little question but that the Court acknowledged the importance of both: "We have no doubt that an exorbitant price ostensibly agreed to by a purchaser of the type involved in this case--but in reality unilaterally fixed by the seller and not open to negotiation--constitutes an unconscionable bargain from which such a purchaser should be relieved." *Id.* at 544-45, 279 A.2d 640. Within that statement, the Court included not only the need for proof of an "exorbitant price" but also the presence of a "purchaser of the type involved in this case" (*i.e.*, a financially distressed person), and a contract "unilaterally fixed" and "not open to negotiation." In short, the Court clearly included both the procedural and substantive unconscionability concepts….

The one aspect which went unmentioned in *Kugler v. Romain* was whether the two factors of procedural and substantive unconscionability operate on the sliding scale suggested by a few courts (and mentioned above). There is a good deal of sense to the adoption of such an approach. The clear import of the doctrine of unconscionability has been its flexibility or, as Justice Francis said in *Kugler v. Romain,* its "amorphous" nature. 58 N.J. at 543, 279 A.2d 640. That being so, this

court fails to see why such a claim should be barred if some unknown barrier for both factors is not surpassed instead of allowing such a claim to succeed when one factor is greatly exceeded, while the other only marginally so.

III

Against this flexible standard, the court must canvass the factual record to determine whether the option contract was the product of both procedural and substantive unconscionability. Since the factual contentions of the parties are not in dispute--except for the ultimate fact as to whether this contract was unconscionable--and since both parties acknowledged during oral argument they had no other facts or information to provide on this issue, the matter is ripe for summary judgment.

A

The concept of procedural unconscionability arises in this case in an unusual way. That is, Mrs. Ropes' situation does not fit the pattern seen in most of the cases cited above. She was not financially vulnerable nor does it appear she was either illiterate or of limited education. But, the events in question came immediately upon her husband's unexpected death and, thus, it is fair to say that Mrs. Ropes was vulnerable to an unfair transaction, albeit in a different sense from the consumer in *Williams v. Walker--Thomas* and most other such cases. Certainly, the law, and particularly courts of equity, have shown special solicitude to persons of Mrs. Ropes' age and situation.

Also, while it may have been her own voluntary way of approaching the sale of her Brielle property, Mrs. Ropes was not directly involved in the transaction because she had given a power of attorney to Ms. Van Noord. While it is recognized that the question of Mrs. Ropes' competency or vulnerability to influence cannot be resolved on this motion, the fact that more than one power of attorney was executed at the same time adds further procedural irregularities to the transaction. In addition, while Sitogum had the assistance of counsel (indeed, Sitogum appears to be made up of a consortium of attorneys), neither Mrs. Ropes nor Ms. Van Noord appeared to have received any sound advice from counsel. While counsel on the Cayman Islands assisted in the preparation and execution of certain documents, there admittedly was no advice rendered as to the appropriate steps

to be taken in securing the highest and best price. And the rationale behind simultaneously appointing two different attorneys-in-fact, as occurred here, both with the power to sell the same property on Mrs. Ropes' behalf--with the potential for different contracts concerning the same property--has not been explained or justified….

So many questions arise from these events. Most notable is the curious fact that Mrs. Ropes did not sign the option contract, but only signed a power of attorney which authorized Ms. Van Noord to sign the option contract. Why would she first sign a power of attorney in favor of Ms. Van Noord on one day, in the presence of an attorney, allowing Ms. Van Noord to sign an option contract the next day, apparently outside the presence of an attorney, when, according to Ms. Van Noord, the option contract had already been seen and reviewed by Mrs. Ropes? Clearly, if Ms. Van Noord's version is accurate, the events in question must be found to be quite irregular. And, most incredibly, nearly all these events appeared to occur in the presence of attorneys apparently engaged to assist in Mrs. Ropes' efforts to sell the Brielle property. Accepting as true all the facts asserted by Sitogum in opposition to this motion, the court must conclude that the transactions in question, leading up to the creation of the option contract, were most unusual and made in the absence of the meaningful representation of counsel. Neither Mrs. Ropes nor those acting on her behalf obtained the type of zealous and careful advocacy required by aged persons or, for that matter, any other person in Mrs. Ropes' situation. While the present record does not yet suggest sufficient irregularity about the procedural events as to rise to the level of fraud, at best Mrs. Ropes' attorney-in-fact exhibited only some desultory interest in obtaining fair value for the property. The court is satisfied that a sufficient degree of procedural unconscionability is present to permit examination into the substantive fairness of the contract.

B

Most startling about this transaction is the size of the purchase price locked in by the option contract. As indicated, Ms. Van Noord entered into the option contract without having engaged professional assistance for determining the value of the Brielle property. As a result, the price set by the option contract was $ 800,000, a figure apparently discussed and considered by Mrs. Ropes' husband prior to his untimely death. However, as later revealed, the Brielle property's true value was approximately twice that amount. An appraisal rendered by Diane Turton Realtors, at the

request of Mrs. Ropes' current counsel, opined that the value of the property ranged between $ 1,500,000 and $ 1,750,000 and, in fact, the property was ultimately sold for $ 1,500,000. The great disparity between the $ 800,000 at which Sitogum had gained the right to purchase the property for and the later appraisal and the ultimate sale of the property to others for nearly twice that much demonstrates the substantive unconscionability of the option contract.

In seeking to defeat the claim of substantive unconscionability, Sitogum observes that Ms. Van Noord believed Mrs. Ropes was more concerned about disposing of the property than the price. In her answers to interrogatories, Ms. Van Noord swore to the following facts:

"[Mrs. Ropes] was adamant that she wanted the "Brielle property off my back." [Ms. Van Noord] counseled [Mrs. Ropes] in the presence of everyone to not do anything rash, to be patient. [Mrs. Ropes] kept stating that she wanted the property off her back, regardless of the content of house--regardless of the price--just sell it. [Ms. Van Noord] accompanied [Mrs. Ropes] to at least three or four meetings with Mr. Broadbent [the first of the two Cayman Island attorneys mentioned earlier]. During each of those conversations, I remember that there was a desire by [Mrs. Ropes] to get rid of, to just sell the Brielle property in New Jersey."

If those facts are true--as the court presently assumes--it becomes apparent that Ms. Van Noord did not act consistently with that goal. Not only did she obligate Mrs. Ropes to sell for approximately half the property's value, but she failed to "get the property off" Mrs. Ropes' back. Instead, Ms. Van Noord entered into an option contract which had the potential of tying up the property for eight months, without any guarantee of it actually being sold. Within that eight month period, Sitogum could unilaterally determine whether it would purchase the property; if Sitogum chose to walk away, Mrs. Ropes would be left where she started. And, if Sitogum decided to purchase within the initial eight month period, the transaction need not actually occur for yet another 90 days. So, the result of the option contract was to require Mrs. Ropes to potentially wait for as long as 11 months to be "rid" of the property at an unreasonably low price. The contention that this option contract is not unconscionable because Mrs. Ropes allegedly did not care about the price (so long as it was at least $ 800,000) if the property could be gotten rid of quickly is proved fallacious in light of the terms of the option contract. And the option contract appears all the more unconscionable when it is observed that Mrs. Ropes received no consideration for tying up the property for potentially eight months (and possibly eleven months) if Sitogum ultimately decided to

purchase because the option payments--which were either never sent, sent but not received, or received by Ms. Van Noord but lost, purloined, or at least never given to Mrs. Ropes --were to be deducted from the purchase price. On the other hand, if Sitogum determined not to exercise the option, then Mrs. Ropes would only have benefitted to the meagre tune of $ 1000 per month, and still would not have been rid of the property.

While the existing case law does not precisely define what exchange of promises might be classified as "substantively unconscionable," certainly a price $ 700,000 less than what the property ultimately sold for meets this court's definition of unconscionability.

IV

For the foregoing reasons, Mrs. Ropes' motion for summary judgment will be granted, declaring the option contract void *ab initio.*

An appropriate order has been entered.

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AMOCO OIL CO. v. ASHCRAFT, 791 F.2d 519, 524 (7th Cir. 1986)

POSNER, Circuit Judge.

Amoco brought this diversity suit to collect a debt of $62,000 from the Charles Bowlby Oil Company. It joined as additional defendants the Ashcrafts, who had guaranteed Bowlby Oil Company's debts, and Mr. and Mrs. Bowlby, who had done likewise. Apparently neither the Bowlby company nor the Bowlbys have any assets, although they remain as parties defendant in the district court. The Ashcrafts counterclaimed against Amoco for fraud and breach of contract. The district judge granted Amoco's motion for summary judgment against the Ashcrafts, and entered judgment in its favor for the full $62,000 and dismissed the counterclaims. …The Ashcrafts have appealed, raising interesting questions of contract law which the parties agree are governed by the common law of Indiana.

In 1981 Bowlby Oil Company was a franchised wholesaler of Amoco products, mainly home heating oil and gasoline, in Shelby County, Indiana. The company had fallen on evil

days, and owed Amoco more than $200,000, though its credit limit was only $100,000. Glyndon Ashcraft, a successful small businessman -- the sole owner of a trucking firm that had $5 million in annual sales -- bought Bowlby Oil Company for $150,000. A few days after the deal closed, Ashcraft and his wife signed a document entitled "Unlimited Guaranty." In it they "Unconditionally Guarantee[d] Payment When Due . . . of any and all indebtedness, including interest thereon, of [Bowlby Oil Company] to [Amoco], howsoever such indebtedness may arise, whether as principal, guarantor, indorser or otherwise, now or hereafter existing . . . ." According to Mr. Ashcraft's affidavits and deposition, which we must treat as truthful for purposes of deciding whether summary judgment for Amoco was proper, Amoco's local manager, Warrick, had told Ashcraft that he and his wife must sign the guaranty to continue doing business with Amoco and that it was only a guaranty of debts arising out of Ashcraft's operation of the company, not of the preexisting debt of $200,000.

Under Ashcraft's management Bowlby Oil Company managed to reduce its debt to Amoco -- at one point to as low as $44,000. But the improvement was temporary. Although Amoco extended fresh credit to Bowlby Oil Company, the company continued to flounder, and after only six months of operation Ashcraft abandoned it, with Bowlby Oil Company owing Amoco $62,000; this suit followed. It seems that Mr. Bowlby had misrepresented the financial health of his company when he sold it to Ashcraft, for he later agreed to return the purchase price in exchange for a release of any claims that Ashcraft might have against him for misrepresentation.

The Ashcrafts make three arguments why it was wrong for the district judge to grant summary judgment for Amoco.

…

[U]nconscionability is indeed the third ground on which the Ashcrafts seek to avoid their obligations under the guaranty. They do not allege any physical or mental incapacity that prevented them from appreciating the significance of the document that they signed, or claim that Amoco had fiduciary obligations to them; they appeal to a more amorphous though influential conception of unconscionability, a conception used to void obligations felt somehow to have been unfairly imposed by a strong on a weak party. "A bargain is not unconscionable merely because the parties to it are unequal in bargaining position, nor even because the inequality results in an allocation of risks to the weaker party. But gross

inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may confirm indications that the transaction involved elements of deception or compulsion, or may show that the weaker party had no meaningful choice, no real alternative, or did not in fact assent or appear to assent to the unfair terms." Restatement, *supra*, § 208, comment d; see Farnsworth, Contracts § 4.28, at pp. 314-16 (1982).

There can be no objection to using the one-sidedness of a transaction as evidence of deception, lack of agreement, or compulsion, none of which has been shown here. The problem with unconscionability as a legal doctrine comes in making sense out of lack of "meaningful choice" in a situation where the promisor was not deceived or compelled and really did agree to the provision that he contends was unconscionable. Suppose that for reasons unrelated to any conduct by the promisee the promisor has very restricted opportunities. Maybe he is so poor that he can be induced to sell the clothes off his back for a pittance, or is such a poor credit risk that he can be made (in the absence of usury laws) to pay an extraordinarily high interest rate to borrow money that he wants desperately. Does he have a "meaningful choice" in such circumstances? If not he may actually be made worse off by a rule of nonenforcement of hard bargains; for, knowing that a contract with him will not be enforced, merchants may be unwilling to buy his clothes or lend him money. Since the law of contracts cannot compel the making of contracts on terms favorable to one party, but can only refuse to enforce contracts with unfavorable terms, it is not an institution well designed to rectify inequalities in wealth.

This may be why Indiana is so unfriendly to the defense of unconscionability. ….The only reported case where it was accepted also involved Amoco, *Weaver v. American Oil Co.*, 257 Ind. 458, 276 N.E.2d 144 (1971), but that is the only resemblance to this case. Weaver had quit high school after only a year and a half and had never worked other than as a laborer until he leased a gas station from Amoco. The lease contained a clause, untitled, in fine print, whereby the lessee guaranteed the lessor against the consequences of the lessor's own negligence. Amoco's representative told Weaver to sign the lease, but did not tell him to read it, and Weaver did not read it. The Indiana Supreme Court held that it was unconscionable to enforce the clause against him. Amoco was taking advantage of Weaver's ignorance and inexperience by configuring the clause in a manner calculated to make it unintelligible to the uneducated and inexperienced person with whom it was dealing. Even if he had read the lease,

Weaver probably would not have understood the significance of a clause requiring that he indemnify Amoco for the consequences of the latter's negligence -- would not have realized that he was being made an insurer of conduct over which he had little or no control and which could visit staggering financial burdens on him. The costs of information to Weaver were prohibitive -- and known to be such by Amoco and indeed made so in party by Amoco's deliberate conduct.

There is nothing like that in this case. The guaranty was not in fine print, was clearly labeled, was emphatically worded, was embodied in a separate document of which it was the central clause, and was in fact read by Ashcraft, an experienced businessman with a high-school education.

It is true of course that Ashcraft is less sophisticated than Amoco and that he is a little person and Amoco is a giant corporation, and it may be true that he had little choice in signing the guaranty because Bowlby Oil Company was over its credit limit and thus vulnerable to an immediate termination of the Amoco franchise that was its most valuable asset. … [T]here is evidence in the record that Amoco did insist on the separate guaranty as a precondition of extending credit, and the conflict in the evidence cannot be cleared up on summary judgment.

To extract a concession by threatening a deliberate breach of a clear contractual undertaking can be duress. See, e.g., *Selmer Co. v. Blakeslee-Midwest Co.*, 704 F.2d 924 (7th Cir. 1983). But Ashcraft does not argue that this is what Amoco did. His argument is simply that the transaction over the separate guaranty was one-sided; that he and his wife had no choice but to sign the guaranty, since if they did not do so Amoco could (how it could is unclear, given the contract between Amoco and The Bowlby Oil Company, but we shall let this pass) terminate the franchise because of the unpaid debt. But an apparently one-sided transaction is merely a predicate for invoking the doctrine of unconscionability; it is not unconscionable per se. Indiana does not conceive it to be a proper judicial function to rewrite commercial contracts entered into by fully adult, fully consenting, fully competent business people.

This precept is particularly relevant in a case such as this where the party who is trying to get out of a contract on the ground that it is one-sided was responsible for its being so. No one made Ashcraft buy out the Bowlby's. No one made him close with them before finding out what additional guaranties Amoco might demand. He bought Bowlby Oil Company knowing

that it was in default to Amoco, so that its franchise was in jeopardy. He could before closing have gone to Amoco and asked for an assurance of continued support without a personal guaranty and if Amoco had refused he could have walked away from the deal and gone back to his main business of operating a trucking company; his livelihood was not at stake. He did not seek to negotiate better terms. He put himself over a barrel; the courts will not pull him upright. He gambled that at the price he was paying for Bowlby Oil Company he would be able to pay off its debt to Amoco and make a profit for himself. He threw a pair of balanced dice, and lost, and that is the end of it so far as Indiana law is concerned. If the courts let him off the hook, it would just make it more difficult for people in his position to strike deals they believe are advantageous -- that indeed are advantageous when made, though given the inevitable uncertainties of commercial life (of life, period) a certain percentage go awry. The less protection Amoco has, the less willing it will be to extend credit. Ashcraft counted on that credit when he bought Bowlby Oil Company. The credit was extended, and launched him on a course that he hoped would prove successful; that it was not is one of the unavoidable incidents of our nation's (relatively) free market system, from which Ashcraft in his other ventures has benefited. Indiana has resisted thus far the tug to a more paternalistic conception of the judicial role in enforcing contracts.

AFFIRMED.

Hypothetical

Appellee, Walker-Thomas Furniture Company, operates a retail furniture store in the District of Columbia. During the period from 1957 to 1962 each appellant in these cases purchased a number of household items from Walker-Thomas, for which payment was to be made in installments. The terms of each purchase were contained in a printed form contract which set forth the value of the purchased item and purported to lease the item to appellant for a stipulated monthly rent payment. The contract then provided, in substance, that title would remain in Walker-Thomas until the total of all the monthly payments made equaled the stated value of the item, at which time appellants could take title. In the event of a default in the payment of any monthly installment, Walker-Thomas could repossess the item.

The contract further provided that "the amount of each periodical installment payment to be made by [purchaser] to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by [purchaser] under such prior leases, bills or accounts; and *all payments now and hereafter made by [purchaser] shall be credited pro rata on all outstanding leases, bills and accounts* due the Company by [purchaser] at the time each such payment is made." Emphasis added.) The effect of this rather obscure provision was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated. As a result, the debt incurred at the time of purchase of each item was secured by the right to repossess all the items previously purchased by the same purchaser, and each new item purchased automatically became subject to a security interest arising out of the previous dealings.

On April 17, 1962, appellant Williams bought a stereo set of stated value of $514.95. She defaulted shortly thereafter, and appellee sought to replevy all the items purchased since December, 1957. At the time of this purchase her account showed a balance of $164 still owing from her prior purchases. The total of all the purchases made over the years in question came to $1,800. The total payments already made amounted to $1,400.

Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 447 (D.C. Cir. 1965)

STANDARD FORM CONTRACTS

K. D. v. EDUCATIONAL TESTING SERVICE, 386 N.Y.S.2d 747 (N.Y.Sup. 1976)
ARNOLD GUY FRAIMAN, Justice:

This is a motion to dismiss the complaint, pursuant to CPLR Rule 3211(a) pars. 1, 7 and subd. (c) on the grounds that there is a defense founded upon documentary evidence and that the complaint fails to state a cause of action.

Plaintiff is a 37 year old college graduate, having entered college at the age of 32. Seeking to attend law school, he took the Law School Admission Test (LSAT) twice within a four month period in 1973-74. Defendant is a non-profit corporation engaged in the business of preparing and administering various well-known educational tests, including the LSAT, for use by colleges and graduate schools throughout the nation. It has administered the LSAT since 1954. The LSAT is an objective test designed to measure general aptitude for the study of law of candidates seeking admission to law school. It consists of approximately 130 so-called multiple choice questions and it also has a section of about 70 questions of a similar nature designed to test writing ability. Defendant administers the LSAT for the Law School Admissions Council (LSAC), a non-profit membership association of graduate schools of law. The LSAC sets policy for administration of the examinations and the reporting of scores.

Test scores play an important role in determining whether a candidate will be admitted to law school. To insure that they accurately reflect the candidate's own effort, the administration of the tests are carefully monitored, and after they are scored, individual scores are checked by computer against any previous scores by the same candidate. Where an increase of more than 150 points (out of a total of 800) is found, defendant conducts an investigation before the candidate's score is reported to the law schools.

Each candidate who applies to take the LSAT is sent a booklet entitled ‘Law School Admissions Bulletin’ and a registration form. Upon receipt of the completed form, defendant sends the candidate an admission card to take the examination on a specified date at a designated testing center. The registration form requires the applicant to write out in longhand the following statement and to sign it: “. . . I accept the conditions set forth in the Bulletin concerning the administration of the test and the reporting of information to law schools.”

Plaintiff took the examination in December 1973 and again in April 1974. Before each examination, he was sent a copy of the Bulletin and completed in his own handwriting the statement above on his registration forms. The Bulletins received by plaintiff each contained the following language under the heading ‘Scores Cancelled by ETS':

> “We are concerned with reporting only valid scores. On rare occasions, misconduct . . . or circumstances beyond the candidate's control . . . may render scores invalid. If doubts are raised about your score because of these or other circumstances, we will expect you to cooperate in our investigation. We reserve the right to cancel any test score if, in our sole opinion, there is adequate reason to question its validity. Before exercising this right, we will offer you an opportunity to take the test again at no additional fee.
>
> If we cancel a score, we will notify the law schools that received, or were to receive, the scores as well as the schools receiving subsequent reports.”

On his December, 1973 examination plaintiff received a score of 399 on the LSAT portion and 26 on the writing ability portion. His April, 1974 LSAT score was 637, or 238 points higher, and his writing ability score was 62. The 238 point discrepancy between the two LSAT scores prompted an investigation by defendant which disclosed striking similarities between plaintiff's answers and the answers of one ‘KL,’ the candidate seated adjacent to plaintiff. Plaintiff answered 39 of the 130 multiple choice questions on the LSAT portion of the test incorrectly. Of these, 27 were the same incorrect answers as those selected by KL. The significance of this correlation is made evident from an analysis by defendant of the answer sheets of ten other candidates taking the same LSAT who obtained scores in the same range as plaintiff and KL. Comparing their incorrect answers with plaintiff's, discloses that, on average, there were only 7 incorrect responses identical to plaintiff's. Of the ten other answer sheets analyzed, the most incorrect responses on any one answer sheet which were identical to those of plaintiff was 11. A comparison and analysis of plaintiff's writing ability answer sheet with KL's and the ten other candidates disclosed a similar result.

On the basis of the foregoing, defendant wrote to plaintiff requesting that he furnish any information which he believed was relevant to his questioned scores. In addition, he was offered an opportunity to take the examination again at a regularly scheduled time at no cost. If he elected to do so, and his retest score came within 50 points of the questioned score, defendant stated that the questioned score would be forwarded to the law schools. On the other hand, if the retest score failed to confirm the questioned score, or if plaintiff refused to take the retest, defendant indicated that it would cancel the questioned score and notify the law schools that plaintiff's score was cancelled 'due to serious doubt as to (its) authenticity.'

In response to this letter, plaintiff submitted a sworn statement that he did not cheat on the examination. However, he refused to take a retest. He then commenced the instant action for a declaratory judgment and an injunction restraining defendant from cancelling his April, 1974 test score; from notifying the law schools that this action was taken because of the score's doubtful authenticity; and compelling defendant to report the April, 1974 score to the law schools as a valid score.

In support of its motion to dismiss the complaint, defendant alleges that plaintiff is barred by the contract he entered into when he agreed on his registration forms to accept the conditions set forth in the Bulletin concerning the administration of the test and the reporting of results to the law schools. Defendant contends that its actions are in full accord with the following provisions in the Bulletin:

> "We reserve the right to cancel any test score if, in our sole opinion, there is adequate reason to question its validity. . . . If we cancel a score, we will notify the law schools that . . . were to receive the score …"
>
> …

Plaintiff, in opposition to the motion, contends that the agreement relied upon by defendant is void as a contract of adhesion. …

We turn now to a consideration of that portion of the injunctive relief sought by plaintiff wherein he seeks to restrain defendant from cancelling his April, 1974 test scores and to compel it to forward the scores to the law schools. As noted above, the right to cancel any test score if in its opinion there was adequate reason to question its validity was expressly reserved to itself by defendant in the Bulletin, and plaintiff accepted that as well as all other conditions

set forth in the Bulletin when he completed his registration form. Nevertheless, plaintiff contends that he is not bound by his agreement, because, he argues, his contract with defendant is a contract of adhesion, and therefore void. A contract of adhesion is one entered into between parties with unequal bargaining power. They are typically standard contracts which are offered by the party with strong bargaining power to the weaker party on a take it or leave it basis. The instant agreement would appear to fit this description. Almost every accredited law school in the United States requires a candidate for admission to take the LSAT. Thus, when plaintiff decided to attend law school he had no alternative but to accept the standard conditions fixed by defendant for all test takers. Plaintiff could neither contract with a party other than defendant to take a law school aptitude test, since no such entity exists, or indicate to defendant that the terms contained in the Bulletin were not acceptable to him. In the latter case it is clear that if he had done so he would not have been permitted to take the examination.

However, while plaintiff's description of the agreement herein as a contract of adhesion may be justified, his conclusion that it is therefore void, is not. Where the court finds that an agreement is a contract of adhesion, effort will frequently be made to protect the weaker party from the agreement's harsher terms by a variety of pretexts, while still keeping the elementary rules of the law of contracts intact. Kessler, ‘Contracts of Adhesion-Some Thoughts about Freedom of Contract’, 43 Col.L.Rev. 629 (1943) at p. 633. The Court may, for example, find the obnoxious clause ‘ambiguous', even where no ambiguity exists, and then construe it against its author; or it may find the clause to be against public policy and declare it unenforceable; or finally, the court may hold that although the offending clause prohibits a recovery by plaintiff Ex contractu, it does not prohibit a recovery in tort.

Thus, the issue in the instant case is whether the clause reserving to defendant itself the right to cancel plaintiff's test score if there is a question about its validity, and requiring him to take a retest in such event, is so unfair and unreasonable that the court, having found it a part of a contract of adhesion, will disregard it by means of one or more of the pretexts above. The issue as thus stated must be answered in the negative. To the extent that defendant can accurately predict the aptitude of a candidate for law school by means of its test results, it performs a highly valuable service not only to the law schools but to the public as well. Moreover, the accuracy of its predictions is defendant's sole stock in trade. The less accurate

as a forecaster its tests are, the less value they have to the law schools. Thus, if defendant reasonably believed that the test scores of plaintiff as scored on the April, 1974 test, did not accurately reflect his aptitude for law school, it acted within its right to protect its own image as well as its obligation to the schools who are its clients in cancelling plaintiff's scores and requiring him to take a retest. …

In the instant case, the evidence that plaintiff did not achieve his scores on the April, 1974 LSAT unaided was sufficient to justify the action contemplated by defendant. Moreover, its offer of a free retest under normal testing conditions with the understanding that it would forward plaintiff's April, 1974 scores if the retest score came within 50 points of the earlier scores was eminently fair and reasonable under the circumstances. …

For all the foregoing reasons, the motion to dismiss so much of the complaint as seeks to enjoin defendant from cancelling plaintiff'sApril, 1974 test scores, and to compel it to forward those scores to the law schools is granted.

C & J FERTILIZER, INC. v. ALLIED MUT. INS. CO., 227 N.W.2d 169 (Iowa 1975)
REYNOLDSON, Justice.

This action to recover for burglary loss under two separate insurance policies was tried to the court, resulting in a finding plaintiff had failed to establish a burglary within the policy definitions. Plaintiff appeals from judgment entered for defendant. We reverse and remand.

Trial court made certain findings of fact in support of its conclusion reached. Plaintiff operated a fertilizer plant in Olds, Iowa. At time of loss, plaintiff was insured under policies issued by defendant and titled ‘BROAD FORM STOREKEEPERS POLICY’ and ‘MERCANTILE BURGLARY AND ROBBERY POLICY.’ Each policy defined ‘burglary’ as meaning,

“‘* * * the felonious abstraction of insured property (1) from within the premises by a person making felonious entry therein by actual force and violence, of which force and violence there are visible marks made by tools, explosives, electricity or chemicals upon, or physical damage to, the exterior of the premises at the place of such entry * * *.”

On Saturday, April 18, 1970, all exterior doors to the building were locked when plaintiff's employees left the premises at the end of the business day. The following day, Sunday, April 19, 1970, one of plaintiff's employees was at the plant and found all doors locked and secure. On Monday, April 20, 1970, when the employees reported for work, the exterior doors were locked, but the front office door was unlocked.

There were truck tire tread marks visible in the mud in the driveway leading to and from the plexiglas door entrance to the warehouse. It was demonstrated this door could be forced open without leaving visible marks or physical damage.

There were no visible marks on the exterior of the building made by tools, explosives, electricity or chemicals, and there was no physical damage to the exterior of the building to evidence felonious entry into the building by force and violence.

Chemicals had been stored in an interior room of the warehouse. The door to this room, which had been locked, was physically damaged and carried visible marks made by tools. Chemicals had been taken at a net loss to plaintiff in the sum of $9,582. Office and shop equipment valued at $400.30 was also taken from the building.

Trial court held that policy definition of ‘burglary’ was unambiguous, there was nothing in the record ‘upon which to base a finding that the door to plaintiff's place of business was entered feloniously, by actual force and violence,‘ and, applying the policy language, found for defendant.

Certain other facts in the record were apparently deemed irrelevant by trial court because of its view the applicable law required it to enforce he policy provision. Because we conclude different rules of law apply, we also consider those facts.

The ‘BROAD FORM STOREKEEPERS POLICY’ was issued April 14, 1969; the ‘MERCANTILE BURGLARY AND ROBBERY POLICY’ on April 14, 1970. Those policies are in evidence. Prior policies apparently were first purchased in 1968. The agent, who had power to bind insurance coverage for defendant, was told plaintiff would be handling farm chemicals. After inspecting the building then used by plaintiff for storage he made certain suggestions regarding security. There ensued a conversation in which he pointed out there had to be visible evidence of burglary. There was no testimony by anyone that plaintiff was then or thereafter informed the policy to be delivered would define burglary to require ‘visible

marks made by tools, explosives, electricity or chemicals upon, or physical damage to, the exterior of the premises at the place of * * * entry.'

The import of this conversation with defendant's agent when the coverage was sold is best confirmed by the agent's complete and vocally-expressed surprise when defendant denied coverage. From what the agent saw (tire tracks and marks on the interior of the building) and his contacts with the investigating officers '* * * the thought didn't enter my mind that it wasn't covered * * *.' From the trial testimony it was obvious the only understanding was that there should be some hard evidence of a third-party burglary vis-a-vis an 'inside job.' The latter was in this instance effectively ruled out when the thief was required to break an interior door lock to gain access to the chemicals.

The agent testified the insurance was purchased and 'the policy was sent out afterwards.' The president of plaintiff corporation, a 37-year-old farmer with a high school education, looked at that portion of the policy setting out coverages, including coverage for burglary loss, the amounts of insurance, and the 'location and description.' He could not recall reading the fine print defining 'burglary' on page three of the policy.

Trial court's 'findings' must be examined in light of our applicable rules. Ordinarily in a law action tried to the court its findings of fact having adequate evidentiary support shall not be set aside unless induced by an erroneous view of the law. It follows, the rule does not preclude inquiry into the question whether, conceding the truth of a finding of fact, the trial court applied erroneous rules of law which materially affected the decision. Beneficial Finance Company of Waterloo v. Lamos, 179 N.W.2d 573, 578 (Iowa 1970) and citations.

Extrinsic evidence that throws light on the situation of the parties, the antecedent negotiations, the attendant circumstances and the objects they were thereby striving to attain is necessarily to be regarded as relevant to ascertain the actual significance and proper legal meaning of the agreement. Hamilton v. Wosepka, 261 Iowa 299, 306, 154 N.W.2d 164, 168 (1967); 3 Corbin on Contracts, 1971 pocket part s 543AA, pp. 91-95.

The question of *Interpretation*, i.e., the meaning to be given contractual words, is one to be determined by the court unless the interpretation depends on extrinsic evidence or on a choice among reasonable inferences to be drawn from extrinsic evidence. See Restatement (Second) of Contracts §238, p. 543 (Student Ed., Tent. Drafts Nos. 1-7, 1973). *Construction* of a contract means determination of its legal operation-its effect upon the action of the courts.

"(C)onstruction (of a contract) is always a matter of law for the court.' 3 Corbin on Contracts §554, p. 227. '(C)ourts in construing and applying a standardized contract seek to effectuate the reasonable expectations of the average member of the public who accepts it.' Restatement (Second) of Contracts, supra, §237, comment E, p. 540.

…

There is nothing about trial court's factual findings which precludes this court from construing said contract to arrive at a proper determination of its legal operation as between these parties, or from considering whether the decision appealed from resulted from the application of an erroneous rule of law. And if the definition of 'burglary' in defendant's policy is not enforceable here, then trial court's finding there was no evidence of forcible entry through an outside door is not controlling in the disposition of this case.

Plaintiff's theories of recovery ……must be viewed in light of accelerating change in the field of contracts.

I. Revolution in formation of contractual relationships.

Many of our principles for resolving conflicts relating to written contracts were formulated at an early time when parties of equal strength negotiated in the historical sequence of offer, acceptance, and reduction to writing. The concept that both parties assented to the resulting document had solid footing in fact.

Only recently has the sweeping change in the inception of the document received widespread recognition:

> "Standard form contracts probably account for more than ninety-nine percent of all contracts now made. Most persons have difficulty remembering the last time they contracted other than by standard form; except for casual oral agreements, they probably never have. But if they are active, they contract by standard form several times a day. Parking lot and theater tickets, package receipts, department store charge slips, and gas station credit card purchase slips are all standard form contracts….
>
> The contracting still imagined by courts and law teachers as typical, in which both parties participate in choosing the language of their entire agreement, is no longer of much more than historical importance."
>
> -W. Slawson, Standard Form Contracts and Democratic Control of Lawmaking Power, 84 Harv.L.Rev. 529 (1971).

With respect to those interested in buying insurance, it has been observed that:

> "His chances of successfully negotiating with the company for any substantial change in the proposed contract are just about zero. The insurance company tenders the insurance upon a 'take it or leave it' basis…. Few persons solicited to take policies understand the subject of insurance or the rules of law governing the negotiations, and they have no voice in dictating the terms of what is called the contract. They are clear upon two or three points which the agent promises to protect, and for everything else they must sign ready-made applications and accept ready-made policies carefully concocted to conserve the interests of the company. * * * The subject, therefore, is Sui generis, and the rules of a legal system devised to govern the formation of ordinary contracts between man and man cannot be mechanically applied to it." 7 Williston on Contracts s 900, pp. 29-30 (3d Ed. 1963).

It is generally recognized the insured will not read the detailed, cross-referenced, standardized, mass-produced insurance form, nor understand it if he does. 7 Williston on Contracts § 906B, p. 300 ('But where the document thus delivered to him is a contract of insurance the majority rule is that the insured is not bound to know its contents'); 3 Corbin on Contracts §559, pp. 265-66 ('One who applies for an insurance policy * * * may not even read the policy, the number of its terms and the fineness of its print being such as to discourage him'); Note, Unconscionable Contracts: The Uniform Commercial Code, 45 Iowa L.Rev. 843, 844 (1960) ('It is probably a safe assertion that most involved standardized form contracts are never read by the party who 'adheres' to them. In such situations, the proponent of the form is free to dictate terms most advantageous to himself'); .

The concept that persons must obey public laws enacted by their own representatives does not offend a fundamental sense of justice: an inherent element of assent pervades the process.

But the inevitable result of enforcing all provisions of the adhesion contract, frequently, as here, delivered subsequent to the transaction and containing provisions never assented to, would be an abdication of judicial responsibility in face of basic unfairness and a recognition that persons' rights shall be controlled by private lawmakers without the consent, express or implied, of those affected. A question is also raised whether a court may constitutionally allow that power to exist in private hands except where appropriate safeguards are present, including a right to meaningful judicial review.

…

The mass-produced boiler-plate ‘contracts,‘ necessitated and spawned by the explosive growth of complex business transactions in a burgeoning population left courts frequently frustrated in attempting to arrive at just rsults by applying many of the traditional contract-construing stratagems. As long as fifteen years ago Professor Llewellyn, reflecting on this situation in his book “The Common Law Tradition-Deciding Appeals,” pp. 362-71 wrote

> “What the story shows thus far is first, scholars persistently off-base while judges grope over well-nigh a century in irregular but dogged fashion for escape from a recurring discomfort of imbalance that rests on what is in fact substantial nonagreement despite perfect semblance of agreement. (pp. 367-368)….
>
> ‘The answer, I suggest, is this: Instead of thinking about ‘assent’ to boiler-plate clauses, we can recognize that so far as concerns the specific, there is no assent at all. What has in fact been assented to, specifically, are the few dickered terms, and the broad type of transaction, and but one thing more. That one thing more is a blanket assent (not a specific assent) to any not unreasonable or indecent terms the seller may have on his form, which do not alter or eviscerate the reasonable meaning of the dickered terms. The fine print which has not been read has no business to cut under the reasonable meaning of those dickered terms which constitute the dominant and only real expression of agreement, but much of it commonly belongs in.”(p. 370)

II. Reasonable expectations.

This court adopted the doctrine of reasonable expectations in Rodman v. State Farm Mutual Ins. Co., 208 N.W.2d 903, 905-908 (Iowa 1973). The Rodman court approved the following articulation of that concept:

“The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.”-208 N.W.2d at 906.

Corbin on Contracts §1, p. 2 (‘That portion of the field of law that is classified and described as the law of contracts attempts the realization of reasonable expectations that have been induced by the making of a promise’); 7 Williston on Contracts §900, pp. 33-34 (‘Some courts, recognizing that very few insureds even try to read and understand the policy or

application, have declared that the insured is justified in assuming that the policy which is delivered to him has been faithfully prepared by the company to provide the protection against the risk which he had asked for. * * * Obviously this judicial attitude is a far cry from the old motto ‘caveat emptor.“).

At comment F to §211 of Restatement (Second) of Contracts, we find the following analysis of the reasonable expectations doctrine:

> “Although customers typically adhere to standardized agreements and are bound by them without even appearing to know the standard terms in detail, they are not bound to unknown terms which are beyond the range of reasonable expectation. A debtor who delivers a check to his creditor with the amount blank does not authorize the insertion of an infinite figure. Similarly, a party who adheres to the other party's standard terms does not assent to a term if the other party has reason to believe that the adhering party would not have accepted the agreement if he had known that the agreement contained the particular term. Such a belief or assumption may be shown by the prior negotiations or inferred from the circumstances. Reason to believe may be inferred from the fact that the term is bizarre or oppressive, from the fact that it eviscerates the non-standard terms explicity agreed to, or from the fact that it eliminates the dominant purpose of the transaction. The inference is reinforced if the adhering party never had an opportunity to read the term, or if it is illegible or otherwise hidden from view. This rule is closely related to the policy against unconscionable terms and the rule of interpretation against the draftsman.”

Nor can it be asserted the above doctrine does not apply here because plaintiff knew the policy contained the provision now complained of and cannot be heard to say it reasonably expected what it knew was not there. A search of the record discloses no such knowledge.

The evidence does show, as above noted, a ‘dicker’ for burglary insurance coverage on chemicals and equipment. The negotiation was for what was actually expressed in the policies' ‘Insuring Agreements': the insurer's promise ‘To pay for loss by burglary or by robbery of a watchman, while the premises are not open for business, of merchandise, furniture, fixtures and equipment within the premises * * *.’

In addition, the conversation included statements from which the plaintiff should have understood defendant's obligation to pay would not arise where the burglary was an ‘inside job.’ Thus the following exclusion should have been reasonably anticipated:

“Exclusions

‘This policy does not apply:* * *

‘(b) to loss due to any fraudulent, dishonest or criminal act by any Insured, a partner therein, or an officer, employee, trustee or authorized representative thereof ***.”

But there was nothing relating to the negotiations with defendant's agent which would have led plaintiff to reasonably anticipate defendant would bury within the definition of ‘burglary’ another exclusion denying coverage when, no matter how extensive the proof of a third-party burglary, no marks were left on the exterior of the premises. This escape clause, here triggered by the burglar's talent (an investigating law officer, apparently acquainted with the current modus operandi, gained access to the steel building without leaving any marks by leaning on the overhead plexiglas door while simultaneously turning the locked handle), was never read to or by plaintiff's personnel, nor was the substance explained by defendant's agent.

Moreover, the burglary ‘definition’ which crept into this policy comports neither with the concept a layman might have of that crime, nor with a legal interpretation….

The most plaintiff might have reasonably anticipated was a policy requirement of visual evidence (abundant here) indicating the burglary was an ‘outside’ not an ‘inside’ job. The exclusion in issue, masking as a definition, makes insurer's obligation to pay turn on the skill of the burglar, not on the event the parties bargained for: a bonafide third party burglary resulting in loss of plaintiff's chemicals and equipment.

...

IV. Unconscionability.

Plaintiff is also entitled to a reversal because the liability-avoiding provision in the definition of the burglary is, in the circumstances of this case, unconscionable.

We have already noted the policies were not even before the negotiating persons when the protection was purchased. The fair inference to be drawn from the testimony is that the understanding contemplated only visual evidence of bona-fide burglary to eliminate the risk of an ‘inside job.’

The policies in question contain a classic example of that proverbial fine print (six point type as compared with the twenty-four point type appearing on the face of the policies: ‘BROAD FORM STOREKEEPERS POLICY’ and ‘MERCANTILE BURGLARY AND ROBBERY POLICY’) which ‘becomes visible only after the event.’ Such print is additionally suspect when, instead of appearing logically in the ‘exclusions' of the policies, it poses as a part of an esoteric definition of burglary. A similar contract containing a vast volume of printed conditions neither mentioned nor discussed between the parties once elicited the following comment from this court,

‘It is enough at this time to say that, if it be a contract it is like the Apostle's conception of the human frame, ‘fearfully and wonderfully made,‘ and one upon the construction and effect of which a competent and experienced lawyer may spend days of careful study, without exhausting its possibilities.’ -New Prague Flouring Mill Co. v. Spears, 194 Iowa 417, 438-39, 189 N.W. 815, 824 (1922).

The situation before us plainly justifies application of the unconscionability doctrine: “Standardized contracts such as insurance policies, drafted by powerful commercial units and put before individuals on the ‘accept this or get nothing’ basis, are carefully scrutinized by the courts for the purpose of avoiding enforcement of ‘unconscionable’ clauses.”-6A Corbin on Contracts §1376, p. 21.

…

The resources of a court to avoid unconscionable provisions are not exhausted after a determination of inapplicability of the Contra proferentum rule: ‘Even in such a case, the court may refuse to enforce an unconscionable provision and may give such remedy as justice requires * * *. A contractor may defeat his own ends by the use of complex printed forms devised with intent to get the most and to give the least.’ 3 Corbin on Contracts §559, pp. 270-71.

…

A policy of relying solely on traditional techniques of construction in an effort to avoid the effect of unconscionable provisions ultimately compounds the problem:

> "First, since they (such techniques) all rest on the admission that the clauses in question are permissible in purpose and content, they invite the draftsman to recur to the attack. Give him time, and he will make the grade. Second, since they do not face the issue, they fail to accumulate either experience or authority in the needed direction: that of making out for any given type of transaction what the Minimum decencies are which a court will insist upon as essential to an enforceable bargain of a given type, or as being inherent in a bargain of that type. Third, since they purport to construe, and do not really construe, nor are intended to * * * they seriously embarrass later efforts * * * to get at the true meaning of those wholly legitimate contracts and clauses which call for their meaning to be got at instead of avoided."-Llewellyn, Book Review, 52 Harv.L.Rev. 700, 703 (1939).

Commentators suggest a court considering a claim of unconscionability should examine the factors of assent, unfair surprise, notice, disparity of bargaining power and substantive unfairness. W. Slawson, supra at 564, and citations, n. 79. We have already touched on those considerations in the factual discussions, above. In addition, it would seem appropriate, in every trial when the unconscionability of a contractual provision is a viable issue, to permit either party the right granted by s 554.2302(2), The Code:

'When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.'

In the case Sub judice, plaintiff's evidence demonstrated the definitional provision was unconscionable. Defendant never offered any evidence, let alone evidence which might support a conclusion the provision in issue, considered in its commercial setting, was either a reasonable limitation on the protection it offered or should have been reasonably anticipated by plaintiff.

Trial court's decision must be reversed because the above provision is unconscionable in view of all the circumstances, including the initial negotiations of these parties.

We reverse and remand for judgment in conformance herewith.

Reversed and remanded.

LeGRAND, Justice (dissenting).

I dissent from the result reached by the majority because it ignores virtually every rule by which we have heretofore adjudicated such cases and affords plaintiff ex post facto insurance coverage which it not only did not buy but which it knew it did not buy.

…

While it may be very well to talk in grand terms about ‘mass advertising’ by insurance companies and ‘incessant’ assurances as to coverage which mislead the ‘unwary,‘ particularly about ‘fine-print’ provisions, such discussion should somehow be related to the case under review. Our primary duty, after all, is to resolve this dispute for these litigants under this record.

There is total silence in this case concerning any of the practices the majority finds offensive; nor is there any claim plaintiff was beguiled by such conduct into believing it had more protection than it actually did.

The record is even stronger against the majority's fine-print argument, the stereotype accusation which serves as a coup de grace in all insurance cases. Except for larger type on the face sheet and black (but not larger) print to designate divisions and sub-headings, the entire policies are of one size and style of print. To compare the Face sheet with the body of the policy is like comparing a book's jacket cover with the narrative content; and the use of black type or other means of emphasis to separate one part of an instrument from another is an approved editorial expedient which serves to Assist, not Hinder, readability. In fact many of our opinions, including that of the majority in the instant case, resort to that device.

Tested by any objective standard, the size and style of type used cannot be fairly described as ‘fine print.’ The majority's description, right or wrong, of the plight of consumers generally should not be the basis for resolving the case now before us.

Like all other appeals, this one should be decided on what the record discloses-a fact which the majority concedes but promptly disregards.

GELBMAN v VALLEYCREST PRODUCTION, LTD., 732 N.Y.S.2d 528 (2001)

This action involves the television game show "Who Wants to be a Millionaire" (the Game). The plaintiff, Robert Gelbman commenced this action for breach of contract, and negligent and intentional infliction of severe emotional distress after being eliminated from the game for incorrectly answering a question which, according to Gelbman, was ambiguous. The defendants, Valleycrest Productions, LTD (Valleycrest), the Walt Disney Company (Disney) and American Broadcasting Company (ABC) have moved for dismissal on the grounds that plaintiff has failed to state a cause of action, signed a release indemnifying the defendants from any suit by the plaintiff, and upon documentary evidence.

Background

On August 18, 1999, Gelbman was a contestant on the game. It consists of players answering a series of questions for money. The player is given a question and four possible correct answers and the player must decide which of the four possibilities he or she believes is the correct answer. Each correct answer raises the level of monetary award, i.e., the first question is worth $ 100, the second $ 200, the third $ 300, the fourth $ 500 and so on. If the player answers 15 questions correctly the prize is $ 1,000,000. The game ends if any question is answered incorrectly and depending on how many question the player has answered correctly he or she may win nothing, $ 1,000 or $ 32,000. The player may stop at any time prior to answering a question incorrectly, in which case he or she wins the amount assigned to the last correctly answered question.

Gelbman answered the first nine questions correctly. The tenth question he was asked, "Beginning in January, which of the following signs of the Zodiac comes last?" The possible answers were "A) Aquarius, B) Aries, C) Leo or D) Scorpio." Plaintiff answered A) Aquarius, while defendants indicated that the correct answer was D) Scorpio and Gelbman was eliminated from the game and awarded $ 1,000. Gelbman maintains that the question was ambiguous. Gelbman felt that the question did not clearly state whether they were asking which sign came last in the calendar year or the Zodiac year. Since the Zodiac year begins with the sign Aries, Aquarius would be that last sign. The producers of the show maintained

that the question was not ambiguous and declined to change their decision despite Gelbman's complaints.

Before the show, Gelbman signed two documents, the Contest Release and Eligibility Form (release) on August 17, 1999, and the Official Rules (rules) on August 18, 1999, the day of the taping. Both the release and the rules expressly state that the decisions concerning all matters of the game, including questions and answers, of the producers and ABC are final. The release also holds Valleycrest Production and all others involved in the production of Who wants to be a Millionaire harmless from "any and all claims arising out of injury and damage to [plaintiff] in any way resulting from [plaintiff's] participation in the Contest and/or Program."

Gelbman claims that by not being allowed to continue in the game after incorrectly answering an ambiguous question with two possible answers, the defendants have breached the contract and damaged Gelbman and by their actions have caused him emotional distress. The defendants allege that there is no contract, and that in the alternative no breach has occurred since the terms of the release bar the action. In addition, they allege that Gelbman's claim of emotional distress is also barred by the release and does not meet the standard for such an action.

Discussion

In deciding whether to dismiss a complaint [t]he Court must accept the facts as alleged by the plaintiff as true. ... In suing for breach of contract, the plaintiff must allege an agreement, a breach of the agreement and damages. This Court finds that the plaintiff has failed to make such a showing.

The defendants assert that there was no contract. However, the traditional elements of a contact - offer, acceptance and consideration - have been sufficiently pleaded. The defendants offer potential contestants on their show a chance to win large sums of money in return for their appearance on the show. In addition, the defendants provide round trip air fare to New York, free lodging and a per diem allowance. Gelbman accepted this offer by applying to be a contestant and successfully fulfilling all the screening requirements. Undoubtedly, Gelbman received consideration having an objective value. Defendants received some value as well.

Without contestants there is no show, and therefore it is arguably consideration. The plaintiff has sufficiently demonstrated a contract for purposes of this motion.

Plaintiff has failed to specify what terms of the agreement were breached. Essentially, he alleges that the defendants breached the contract by asking, in the course of the contest, a question that was "ambiguous and misleading". However, both the release and the rules contain clauses in which defendants reserve final judgment in all matters concerning the contest. The release states, "VCP's and ABC Broadcast Standards and Practices decisions on all discretionary matters (including the playing of the game and all decisions relative thereto) shall be final." The rules state, "By entering, each player accepts and agrees to be bound by these rule and by the decisions of ABC Broadcast Standards and Practices and Valleycrest Productions Ltd. which are final and binding on all matters relating to all aspects of the game, including questions and answers.".

Generally, courts have upheld contract clauses reserving final judgment of the rules and results of a contest, to the producers of the contest. (See, Johnson v. New York Daily News, 97 A.D.2d 458, 467 N.Y.S.2d 665 [2d Dept 1983]. "The decisions of the contest judges should not be interfered with by the courts.") Further, the possibility of two correct answers to a question does not invalidate a clause reserving final judgement to the producers of a contest. .... Having a question with two possible answers is not a breach of any provision of the contract that plaintiff signed. In fact, the plaintiff's main complaint seeks to penalize the defendants for enforcing an express provision of the contract which give them sole discretion to decide which is the correct answer.

The plaintiff maintains that the clause conferring final judgment to the defendants is not applicable because the defendants' actions were in bad faith. (See, Johnson v. New York Daily News, 97 A.D.2d at 458, finding that the rules will be enforced unless there has been a fraud, intentional or gross mistake, irregularity or lack of good faith; Furgiele v. Disabled American Veterans Serv. Found., 116 F. Supp. at 376.) Plaintiff argues that the defendants have acted in bad faith by propounding an unfair contest question with two correct answers, and failing to judge the answers impartially, rationally and non-arbitrarily. However, this argument is no different in essence than the argument made by the plaintiff in Furgiele, where the plaintiff contended "that the defendant acted arbitrarily and in violation of the rules of the contest in not accepting [his] suggested words." The Court held that the plaintiff had failed to support

this contention. Plaintiff has stated in his complaint and affidavit that both his and the defendants' answers were correct. Therefore, the point of contention is that the plaintiff disagrees with the defendants' answer and, as stated above, that is not a breach of the contract that the plaintiff signed.

Plaintiff further alleges that the contract itself was one of adhesion and therefore inherently unfair. Adhesion is found where the party seeking to enforce the contract used high pressure tactics or deceptive language in the contract, where there is inequality of bargaining power between the parties and the contract inflicts substantive unfairness on the weaker party. Unfairness can be construed if the terms of the contract are not within the reasonable expectations of the party, or because its terms are unduly oppressive, unconscionable, or contrary to public policy.

Assuming arguendo that there was unfair bargaining power, in that the plaintiff was told to sign the contract or they would get someone else, without a showing of unfairness there is no argument for adhesion. Plaintiff contends that the contract was unfair because he was not given a complete set of the rules to sign until just before the taping began. He claims that there were initially three pages missing, including the page with the clause reserving final judgment on answers and questions to the defendants, and that when pointed out to the producers of the show, the producers explained that they forgot to copy the backside of the pages and subsequently provided them, telling contestants, including plaintiff, to sign the papers immediately or they would be replaced.

Because of this, plaintiff claims that he did not have time to read the rules before the contest due to the high pressure tactics of the defendants. However, the clause reserving final judgment to the defendants is contained in both the rules and the release. The plaintiff signed the release the day before the contest. At the very top of the release is the caption, "DO NOT SIGN THIS UNTIL YOU HAVE READ IT." In addition, the release contains the language, "I have been given ample opportunity to read, and have carefully read, this entire Agreement. Plaintiff cannot claim, in the face of this documentary evidence, that he did not have the opportunity to read the clause in the contract reserving the right of final judgment to the defendants. Therefore, he cannot claim that said term was not within reasonable expectation.

There is no reasonable argument that the contract was oppressive, unconscionable or contrary to public policy. Plaintiff was given free round trip tickets for two to New York, free

travel and accommodations during his stay, a per diem spending allowance and the opportunity to win vast sums of money (of which he won $ 1,000.00) and all the plaintiff was to give in return was to appear on the show (which is something he clearly wanted to do).

Accordingly, it is ordered that the defendant motion is granted and the action is dismissed in its entirety.

MARYBETH ARMENDARIZ et al., v. FOUNDATION HEALTH PSYCHCARE SERVICES, INC., 6 P.3d 669 (Cal. S.Ct. 2000)

In this case, we consider a number of issues related to the validity of a mandatory employment arbitration agreement, i.e., an agreement by an employee to arbitrate wrongful termination or employment discrimination claims rather than filing suit in court, which an employer imposes on a prospective or current employee as a condition of employment. The employees in this case claim that employees may not be compelled to arbitrate antidiscrimination claims brought under the California Fair Employment and Housing Act (FEHA) (Gov. Code, § 12900 et seq.) We conclude that such claims are in fact arbitrable *if* the arbitration permits an employee to vindicate his or her statutory rights. As explained, in order for such vindication to occur, the arbitration must meet certain minimum requirements, including neutrality of the arbitrator, the provision of adequate discovery, a written decision that will permit a limited form of judicial review, and limitations on the costs of arbitration.

The employees further claim that several provisions of the arbitration agreement are unconscionable, both because they fail to meet these minimum requirements and because the arbitration agreement is not bilateral. We conclude that the agreement possesses a damages limitation that is contrary to public policy, and that it is unconscionably unilateral.

Finally, the employees contend that the presence of these unconscionable provisions renders the entire arbitration agreement unenforceable. The employer argues that even if some of the provisions are unconscionable or contrary to public policy, the proper remedy is to strike or restrict those clauses pursuant to Civil Code section 1670.5, and to enforce the rest of the arbitration agreement. The trial court chose the employees' preferred solution of refusing

to enforce the arbitration agreement, but the Court of Appeal sided with the employer and enforced the agreement minus the one provision it found unconscionable. We conclude, for reasons explained below, that the arbitration agreement is unenforceable and that therefore the Court of Appeal's judgment must be reversed.

FACTS

Marybeth Armendariz and Dolores Olague-Rodgers (hereafter the employees) filed a complaint for wrongful termination against their former employer, Foundation Health Psychcare Services, Inc. (hereafter the employer). In July and August of 1995, the employer hired the employees in the "Provider Relations Group" and they were later given supervisory positions with annual salaries of $ 38,000. On June 20, 1996, they were informed that their positions were being eliminated and that they were being terminated. During their year of employment, they claim that their supervisors and coworkers engaged in sexually based harassment and discrimination. The employees alleged that they were "terminated . . . because of their perceived and/or actual sexual orientation (heterosexual)."

Both employees had filled out and signed employment application forms, which included an arbitration clause pertaining to any future claim of wrongful termination. Later, they executed a separate employment arbitration agreement, containing the same arbitration clause. The clause states in full: "I agree as a condition of my employment, that in the event my employment is terminated, and I contend that such termination was wrongful or otherwise in violation of the conditions of employment or was in violation of any express or implied condition, term or covenant of employment, whether founded in fact or in law, including but not limited to the covenant of good faith and fair dealing, or otherwise in violation of any of my rights, I and Employer agree to submit any such matter to binding arbitration pursuant to the provisions of title 9 of Part III of the California Code of Civil Procedure, commencing at section 1280 et seq. or any successor or replacement statutes. I and Employer further expressly agree that in any such arbitration, my exclusive remedies for violation of the terms, conditions or covenants of employment shall be limited to a sum equal to the wages I would have earned from the date of any discharge until the date of the arbitration award. I understand that I shall not be entitled to any other remedy, at law or in equity, including but not limited to reinstatement and/or injunctive relief."

The employees' complaint against the employer alleges a cause of action for violation of the FEHA and three additional causes of action for wrongful termination based on tort and contract theories of recovery. The complaint sought general damages, punitive damages, injunctive relief, and the recovery of attorney fees and costs of suit.

The employer countered by filing a motion for an order to compel arbitration. The trial court denied the motion on the ground that the arbitration provision in question was an unconscionable contract. The trial court first found that the arbitration agreement was an "adhesion contract." It also found that several of the provisions of the contract are "so one-sided as to 'shock the conscience.' " In particular, it singled out the fact that only employees who file claims against an employer are required to arbitrate their claims, but not vice versa. Second, the agreement limits damages to backpay, precluding damages available for statutory antidiscrimination claims and tort damages, such as punitive damages. It concluded: "Given the overall unfairness of the provision," this was not an appropriate case for striking the unlawful provisions of the arbitration agreement; instead it invalidated the entire agreement.

After the employer filed a timely appeal, the Court of Appeal reversed. The court concluded that the contract was indeed one of adhesion and that the damages provision was unconscionable and contrary to public policy. But for reasons elaborated below, the Court of Appeal held, contrary to the trial court, that the rest of the arbitration agreement should be enforced.

We granted review…..

[II] *General Principles of Unconscionability*

In this part, we will consider objections to arbitration that apply more generally to any type of arbitration imposed on the employee by the employer as a condition of employment, regardless of the type of claim being arbitrated. These objections fall under the rubric of unconscionability.

We explained the judicially created doctrine of unconscionability in *Scissor-Tail*, *supra*, 28 Cal. 3d 807. Unconscionability analysis begins with an inquiry into whether the contract is one of adhesion."The term [contract of adhesion] signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (*Neal v. State Farm Ins. Cos.*

(1961) 188 Cal. App. 2d 690, 694 [10 Cal. Rptr. 781].) If the contract is adhesive, the court must then determine whether "other factors are present which, under established legal rules--legislative or judicial--operate to render it [unenforceable]." (*Scissor-Tail*, *supra*, 28 Cal. 3d at p. 820, fn. omitted.) "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. The second--a principle of equity applicable to all contracts generally--is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' " (*Ibid.*) Subsequent cases have referred to both the "reasonable expectations" and the "oppressive" limitations as being aspects of unconscionability. (*A & M Produce Co. v. FMC Corp.* (1982) 135 Cal. App. 3d 473, 486-487 [186 Cal. Rptr. 114, 38 A.L.R.4th 1]

In 1979, the Legislature enacted Civil Code section 1670.5, which codified the principle that a court can refuse to enforce an unconscionable provision in a contract. (*Perdue v. Crocker National Bank* (1985) 38 Cal. 3d 913, 925 [216 Cal. Rptr. 345, 702 P.2d 503].) As section 1670.5, subdivision (a) states: "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."

As explained in *A & M Produce Co.*, *supra*, 135 Cal. App. 3d 473, " unconscionability has both a 'procedural' and a 'substantive' element," the former focusing on " 'oppression' " or " 'surprise' " due to unequal bargaining power, the latter on " 'overly harsh' " or " 'one-sided' " results. (*Id.* at pp. 486-487.) "The prevailing view is that [procedural and substantive unconscionability] must *both* be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability." (*Stirlen v. Supercuts, Inc.*, *supra*, 51 Cal. App. 4th at p. 1533 (*Stirlen*).) But they need not be present in the same degree. "Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves." (15 Williston on

Contracts (3d ed. 1972) § 1763A, pp. 226-227; see also *A & M Produce Co.*, *supra*, 135 Cal. App. 3d at p. 487.) In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.

[A] Unconscionability and Mandatory Employment Arbitration

Applying the above principles to this case, we first determine whether the arbitration agreement is adhesive. There is little dispute that it is. It was imposed on employees as a condition of employment and there was no opportunity to negotiate.

Moreover, in the case of preemployment arbitration contracts, the economic pressure exerted by employers on all but the most sought-after employees may be particularly acute, for the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement. While arbitration may have its advantages in terms of greater expedition, informality, and lower cost, it also has, from the employee's point of view, potential disadvantages: waiver of a right to a jury trial, limited discovery, and limited judicial review. Various studies show that arbitration is advantageous to employers not only because it reduces the costs of litigation, but also because it reduces the size of the award that an employee is likely to get, particularly if the employer is a "repeat player" in the arbitration system. (Bingham, *Employment Arbitration: The Repeat Player Effect* (1997) 1 Employee Rts. & Employment Poly. J. 189; Schwartz, *supra*, 1997 Wis. L.Rev. at pp. 60-61.) It is perhaps for this reason that it is almost invariably the employer who seeks to compel arbitration. (See Schwartz, *supra*, 1997 Wis. L.Rev. at pp. 60-63.)

Arbitration is favored in this state as a voluntary means of resolving disputes, and this voluntariness has been its bedrock justification. As we stated recently: "[P]olicies favoring the efficiency of private arbitration as a means of dispute resolution must sometimes yield to its fundamentally contractual nature, and to the attendant requirement that arbitration shall proceed as the parties themselves have agreed." (*Vandenberg v. Superior Court*, *supra*, 21 Cal. 4th at p. 831, italics omitted.) Given the lack of choice and the potential disadvantages that even a fair arbitration system can harbor for employees, we must be particularly attuned

to claims that employers with superior bargaining power have imposed one-sided, substantively unconscionable terms as part of an arbitration agreement. "Private arbitration may resolve disputes faster and cheaper than judicial proceedings. Private arbitration, however, may also become an instrument of injustice imposed on a 'take it or leave it' basis. The courts must distinguish the former from the latter, to ensure that private arbitration systems resolve disputes not only with speed and economy but also with fairness." (*Engalla, supra*, 15 Cal. 4th at p. 989 (conc. opn. of Kennard, J.).) With this in mind, we turn to the employees' specific unconscionability claims.

[T]he employees contend that the agreement is substantively unconscionable because it requires only employees to arbitrate their wrongful termination claims against the employer, but does not require the employer to arbitrate claims it may have against the employees. In asserting that this lack of mutuality is unconscionable, they rely primarily on the opinion of the Court of Appeal in *Stirlen, supra*, 51 Cal. App. 4th 1519. The employee in that case was hired as a vice-president and chief financial officer; his employment contract provided for arbitration " 'in the event there is any dispute arising out of [the employee's] employment with the Company,' " including "the termination of that employment." (*Stirlen, supra*, 51 Cal. App. 4th at p. 1528.) The agreement specifically excluded certain types of disputes from the scope of arbitration, including those relating to the protection of the employer's intellectual and other property and the enforcement of a postemployment covenant not to compete, which were to be litigated in state or federal court. (*Ibid.*) The employee was to waive the right to challenge the jurisdiction of such a court. (*Ibid.*) The arbitration agreement further provided that the damages available would be limited to " 'the amount of actual damages for breach of contract, less any proper offset for mitigation of such damages.' " (*Id.* at p. 1529.) When an arbitration claim was filed, payments of any salary or benefits were to cease " 'without penalty to the Company,' " pending the outcome of the arbitration. (*Id.* at p. 1528.)

The *Stirlen* court concluded that the agreement was one of adhesion, even though the employee in question was a high-level executive, because of the lack of opportunity to negotiate. (*Stirlen, supra*, 51 Cal. App. 4th at pp. 1533-1534.) The court then concluded that the arbitration agreement was substantively unconscionable. (*Id.* at p. 1541.) The court relied in part on *Saika v. Gold* (1996) 49 Cal. App. 4th 1074 [56 Cal. Rptr. 2d 922] (*Saika*)), in which the court had refused to enforce a provision in an arbitration agreement between a

doctor and a patient that would allow a "trial de novo" if the arbitrator's award was $ 25,000 or greater. The *Saika* court reasoned that such a clause was tantamount to making arbitration binding when the patient lost the arbitration but not binding if the patient won a significant money judgment. *Stirlen* concluded that the Supercuts agreement lacked even the "modicum of bilaterality" that was present in *Saika*. (*Stirlen, supra*, 51 Cal. App. 4th at p. 1541.) The employee pursuing claims against the employer had to bear not only with the inherent shortcomings of arbitration--limited discovery, limited judicial review, limited procedural protections--but also significant damage limitations imposed by the arbitration agreement. (*Id.* at pp. 1537-1540.) The employer, on the other hand, in pursuing its claims, was not subject to these disadvantageous limitations and had written into the agreement special advantages, such as a waiver of jurisdictional objections by the employee if sued by the employer. (*Id.* at pp. 1541-1542.)

The *Stirlen* court did not hold that all lack of mutuality in a contract of adhesion was invalid. "We agree a contract can provide a 'margin of safety' that provides the party with superior bargaining strength a type of extra protection for which it has a legitimate commercial need without being unconscionable. However, unless the 'business realities' that create the special need for such an advantage are explained in the contract itself, which is not the case here, it must be factually established." (*Stirlen, supra*, 51 Cal. App. 4th at p. 1536.) The *Stirlen* court found no "business reality" to justify the lack of mutuality, concluding that the terms of the arbitration [**692] clause were " ' "so extreme as to appear unconscionable according to the mores and business practices of the time and place." ' " (*Id.* at p. 1542.)

We conclude that *Stirlen* [was] correct in requiring this "modicum of bilaterality" in an arbitration agreement. Given the disadvantages that may exist for plaintiffs arbitrating disputes, it is unfairly one-sided for an employer with superior bargaining power to impose arbitration on the employee as plaintiff but not to accept such limitations when it seeks to prosecute a claim against the employee, without at least some reasonable justification for such one-sidedness based on "business realities." As has been recognized " 'unconscionability turns not only on a "one-sided" result, but also on an absence of "justification" for it.' " (*A & M Produce Co., supra*, 135 Cal. App. 3d at p. 487.) If the arbitration system established by the employer is indeed fair, then the employer as well as the employee should be willing to submit claims to arbitration. Without reasonable justification for this lack of mutuality,

arbitration appears less as a forum for neutral dispute resolution and more as a means of maximizing employer advantage. Arbitration was not intended for this purpose. (See *Engalla, supra*, 15 Cal. 4th at p. 976.)

The employer cites a number of cases that have held that a lack of mutuality in an arbitration agreement does not render the contract illusory as long as the employer agrees to be bound by the arbitration of employment disputes. (*Michalski v. Circuit City Stores, Inc.* (7th Cir. 1999) 177 F.3d 634; *Johnson v. Circuit City Stores* (4th Cir. 1998) 148 F.3d 373, 378.) We agree that such lack of mutuality does not render the contract illusory, i.e., lacking in mutual consideration. We conclude, rather, that in the context of an arbitration agreement imposed by the employer on the employee, such a one-sided term is unconscionable. Although parties are free to contract for asymmetrical remedies and arbitration clauses of varying scope, *Stirlen* [is] correct that the doctrine of unconscionability limits the extent to which a stronger party may, through a contract of adhesion, impose the arbitration forum on the weaker party without accepting that forum for itself.

...

We agree with the *Stirlen* court that the ordinary principles of unconscionability may manifest themselves in forms peculiar to the arbitration context. One such form is an agreement requiring arbitration only for the claims of the weaker party but a choice of forums for the claims of the stronger party. The application of this principle to arbitration does not disfavor arbitration. It is no disparagement of arbitration to acknowledge that it has, as noted, both advantages and disadvantages. The perceived advantages of the judicial forum for plaintiffs include the availability of discovery and the fact that courts and juries are viewed as more likely to adhere to the law and less likely than arbitrators to "split the difference" between the two sides, thereby lowering damages awards for plaintiffs. (See Haig, *Corporate Counsel's Guide: Legal Development Report on Cost-Effective Management of Corporate Litigation* (1999) 610 PLI/Lit. 177, 186-187 ["a company that believes it has a strong legal and factual position may want to avoid arbitration, with its tendency to 'split the difference,' in favor of a judicial forum where it may be more likely to win a clear-cut victory"]. An employer may accordingly consider a court to be a forum superior to arbitration when it comes to vindicating its own contractual and statutory rights, or may consider it advantageous to have a choice of arbitration or litigation when determining how best to pursue a claim

against an employee. It does not disfavor arbitration to hold that an employer may not impose a system of arbitration on an employee that seeks to maximize the advantages and minimize the disadvantages of arbitration for itself at the employee's expense.....

Applying these principles to the present case, we note the arbitration agreement was limited in scope to employee claims regarding wrongful termination. Although it did not expressly authorize litigation of the employer's claims against the employee, as was the case in *Stirlen*, such was the clear implication of the agreement. Obviously, the lack of mutuality can be manifested as much by what the agreement does not provide as by what it does.

This is not to say that an arbitration clause must mandate the arbitration of all claims between employer and employee in order to avoid invalidation on grounds of unconscionability. Indeed, as the employer points out, the present arbitration agreement does not require arbitration of all conceivable claims that an employee might have against an employer, only wrongful termination claims. But an arbitration agreement imposed in an adhesive context lacks basic fairness and mutuality if it requires one contracting party, but not the other, to arbitrate all claims arising out of the same transaction or occurrence or series of transactions or occurrences. The arbitration agreement in this case lacks mutuality in this sense because it requires the arbitration of employee--but not employer--claims arising out of a wrongful termination. An employee terminated for stealing trade secrets, for example, must arbitrate his or her wrongful termination claim under the agreement while the employer has no corresponding obligation to arbitrate its trade secrets claim against the employee.

The unconscionable one-sidedness of the arbitration agreement is compounded in this case by the fact that it does not permit the full recovery of damages for employees, while placing no such restriction on the employer. Even if the limitation on FEHA damages is severed as contrary to public policy, the arbitration clause in the present case still does not permit full recovery of ordinary contract damages. The arbitration agreement specifies that damages are to be limited to the amount of backpay lost up until the time of arbitration. This provision excludes damages for prospective future earnings, so-called front pay, a common and often substantial component of contractual damages in a wrongful termination case. (See 4 Wilcox, Cal. Employment Law (2000) § 60.08 [3][b], p. 60-102; *id.*, § 60.08[2][b][iii], p. 60-97.) The employer, on the other hand, is bound by no comparable limitation should it pursue a claim against its employees.

The employer in this case, as well as the Court of Appeal, claim the lack of mutuality was based on the realities of the employees' place in the organizational hierarchy. As the Court of Appeal stated: "We . . . observe that the wording of the agreement most likely resulted from the employees' position within the organization and may reflect the fact that the parties did not foresee the possibility of any dispute arising from employment that was not initiated by the employee. Plaintiffs were lower-level supervisory employees, without the sort of access to proprietary information or control over corporate finances that might lead to an employer suit against them."

The fact that it is unlikely an employer will bring claims against a particular type of employee is not, ultimately, a justification for a unilateral arbitration agreement. It provides no reason for categorically exempting employer claims, however rare, from mandatory arbitration. Although an employer may be able, in a future case, to justify a unilateral arbitration agreement, the employer in the present case has not done so.

[B] *Severability of Unconscionable Provisions*

The employees contend that the presence of various unconscionable provisions or provisions contrary to public policy leads to the conclusion that the arbitration agreement as a whole cannot be enforced. The employer contends that, insofar as there are unconscionable provisions, they should be severed and the rest of the agreement enforced.

As noted, Civil Code section 1670.5, subdivision (a) provides that "[i]f the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." Comment 2 of the Legislative Committee comment on section 1670.5, incorporating the comments from the Uniform Commercial Code, states: "Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to

avoid unconscionable results." (Legis. Com. com., 9 West's Ann. Civ. Code (1985 ed.) foll. § 1670.5, p. 494 (Legislative Committee comment).)

Thus, the statute appears to give a trial court some discretion as to whether to sever or restrict the unconscionable provision or whether to refuse to enforce the entire agreement. But it also appears to contemplate the latter course only when an agreement is "permeated" by unconscionability. We could discover no published cases in California that address directly the question of when a trial court abuses its discretion by refusing to enforce an entire agreement, as the trial court did in this case, nor precisely what it means for an agreement to be permeated by unconscionability.

The basic principles of severability that emerge from Civil Code section 1599 and the case law of illegal contracts appear fully applicable to the doctrine of unconscionability. Courts are to look to the various purposes of the contract. If the central purpose of the contract is tainted with illegality, then the contract as a whole cannot be enforced. If the illegality is collateral to the main purpose of the contract, and the illegal provision can be extirpated from the contract by means of severance or restriction, then such severance and restriction are appropriate.

That Civil Code section 1670.5 follows this basic model is suggested by the Legislative Committee comment quoted above, which talks in terms of contracts not being enforced if "permeated" by unconscionability, and of clauses being severed if "so tainted or . . . contrary to the essential purpose of the agreement." (Leg. Com. com., 9 West's Ann Civ. Code, *supra*, foll. § 1670.5, p. 494.)

In this case, two factors weigh against severance of the unlawful provisions. First, the arbitration agreement contains more than one unlawful provision; it has both an unlawful damages provision and an unconscionably unilateral arbitration clause. Such multiple defects indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage. In other words, given the multiple unlawful provisions, the trial court did not abuse its discretion in concluding that the arbitration agreement is permeated by an unlawful purpose.

Second, in the case of the agreement's lack of mutuality, such permeation is indicated by the fact that there is no single provision a court can strike or restrict in order to remove the unconscionable taint from the agreement. Rather, the court would have to, in effect, reform

the contract, not through severance or restriction, but by augmenting it with additional terms. Civil Code section 1670.5 does not authorize such reformation by augmentation, nor does the arbitration statute. Code of Civil Procedure section 1281.2 authorizes the court to refuse arbitration if grounds for revocation exist, not to reform the agreement to make it lawful. Nor do courts have any such power under their inherent limited authority to reform contracts. Because a court is unable to cure this unconscionability through severance or restriction and is not permitted to cure it through reformation and augmentation, it must void the entire agreement.

Moreover, whether an employer is willing, now that the employment relationship has ended, to allow the arbitration provision to be mutually applicable, or to encompass the full range of remedies, does not change the fact that the arbitration agreement as written is unconscionable and contrary to public policy. Such a willingness "can be seen, at most, as an offer to modify the contract; an offer that was never accepted. No existing rule of contract law permits a party to resuscitate a legally defective contract merely by offering to change it." (*Stirlen*, *supra*, 51 Cal. App. 4th at pp. 1535-1536, fn. omitted.)

III. DISPOSITION

The judgment of the Court of Appeal upholding the employer's petition to compel arbitration is reversed, and the cause is remanded to the Court of Appeal with directions to affirm the judgment of the trial court.

Hancock v. AT&T Co. 701 F.3d 1248 (10th Cir. 2012)

MATHESON, Circuit Judge.

Gayen Hancock, David Cross, Montez Mutzig, and James Bollinger (collectively "Plaintiffs") seek to represent a class of customers dissatisfied with "U-verse," a digital telecommunications service. The United States District Court for the Western District of Oklahoma dismissed their claims based on forum selection and arbitration clauses in the U-verse terms of service. Plaintiffs appeal the dismissal of their claims.

Exercising jurisdiction pursuant to 28 U.S.C. § 1291, we affirm.

I. BACKGROUND

A. Factual History

1. U-verse and Terms of Service

U-verse is the brand name for a telecommunications service that includes digital television (″TV″), voice-over Internet protocol (″Voice″), and high-speed Internet (″Internet″). At the time Plaintiffs purchased U-verse, customers could receive TV alone or bundle it with Voice and/or Internet for a discounted rate. One set of terms of service governs U-verse TV and Voice services (″TV/Voice terms″). The TV/ Voice terms have a forum selection provision stating that, in the event of litigation, AT&T and U-verse customers ″agree to submit to the . . . jurisdiction of the courts located within the county of Bexar County, Texas″ (″Forum Selection Clause″). Aplt. Appx. at 1007.

Different terms of service govern U-verse Internet service (″Internet terms″). The Internet terms include an arbitration provision stating that AT&T and the customer ″agree to arbitrate all disputes and claims . . . based in whole or in part upon the [Internet service]″ (″Arbitration Clause″). Id. at 778.

2. Parties

Plaintiffs are individuals who purchased U-verse in either Florida or Oklahoma. Their complaint names 13 defendants and alleges that U-verse is ″plagued by defects and deficiencies.″ Id. at 26. Plaintiffs seek to represent a class of U-verse customers who experienced similar problems with U-verse.

This appeal principally involves three defendants: AT&T Operations, Inc. ("AT&T"); Southwestern Bell Telephone Company (″Southwestern Bell″); and BellSouth

Telecommunications, Inc. (″BellSouth″) (collectively ″Defendants″). AT&T ″is the entity ultimately responsible for . . . U-verse in the areas provisioned by Southwestern Bell . . . and BellSouth.″ Id. at 1051. Southwestern Bell and BellSouth are AT&T regional affiliates who install and provide U-verse services.

B. Procedural History

1. Complaint and Motions to Dismiss

Plaintiffs filed their class action complaint on July 30, 2010, in the U.S. District Court for the Western District of Oklahoma. They asserted claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961 et seq., as well as various claims under state law.

In October 2010, AT&T and Southwestern Bell filed two motions to dismiss Plaintiffs' claims. ….The second motion cited the Arbitration Clause and moved to dismiss Plaintiffs' Internet-related claims and to compel arbitration. BellSouth and the other 10 named defendants joined AT&T and Southwestern Bell's two motions.

To show that Plaintiffs accepted the TV/Voice terms and Internet terms—including the corresponding Forum Selection Clause and Arbitration Clause—Defendants proffered declarations from AT&T employees. The declarations recount the standard practice for customer acceptance of U-verse TV/Voice and Internet terms (the "standard practice").

a. Standard Practice for Acceptance of TV/Voice Terms

According to the declarations, the following standard practice applies to customer acceptance of the TV/Voice terms. When a customer orders U-verse TV/Voice service, the order is sent to AT&T's Global Craft Access System (″GCAS″). A technician reviews the order and responds to install the TV/Voice service. The technician provides the customer with a Welcome Kit, which contains a printed copy of the TV/Voice terms. The technician gives the customer an opportunity to review the TV/Voice terms before installation.

The technician then displays an acceptance form on the technician's laptop through the GCAS web application. The acceptance form has a check box next to ″Terms Of Service.″ Below the check box, the form states in all capital letters: ″Before acknowledging below, please review the appropriate documents pertaining to your new AT&T service(s). By

selecting 'I Acknowledge' below, you are acknowledging that you have read, understand, and agree to the content of the documents checked above." Id. at 883. The customer must click an "I Acknowledge" button below this statement to accept the TV/Voice terms.

The acceptance form is then populated with the customer's name, order number, account number, and date of acceptance and stored on an AT&T server. For customers who prefer a written acceptance form, technicians provide paper copies. Technicians do not install U-verse TV/Voice service until customers accept the terms of service.

According to AT&T's records, Plaintiffs Mutzig, Bollinger, and Hancock "completed the installation of . . . U-verse services and acceptance of the TV/Voice [terms] on the GCAS web application." Id. at 879-80.

AT&T was unable to find records confirming that Plaintiff Cross was a U-verse customer. But one of the declarations explains that because Plaintiff Cross is an Oklahoma resident, he would have received U-verse from Southwestern Bell, the sole provider in that state. And because Southwestern Bell's "U-verse activation and acceptance procedures are uniform and mandatory," Plaintiff Cross would have accepted the TV/Voice terms in the same manner as other U-verse cusomers. Id. at 997.

b. Standard Practice for Acceptance of Internet Terms

An AT&T senior product manager for U-verse Internet customer registration and activation described the following standard practice for customer acceptance of U-verse Internet terms. A new U-verse Internet customer is required to complete an online registration process to activate the service. During the registration process, the customer is presented with a screen that displays AT&T's Internet terms in a scrolling text box. Below the text box are three buttons labeled "Exit Registration," "I Reject," and "I Agree." The customer must click the "I Agree" button to continue with the registration. "Until this process is completed, the new customer will automatically be directed to the U-verse registration page every time he or she attempts to connect to the Internet using a web browser over his or her U-verse High Speed Internet connection." Id. at 339.

AT&T's records indicate that Plaintiffs Mutzig, Bollinger, and Hancock completed the U-verse Internet registration process. Plaintiffs Bollinger and Hancock received

U-verse Internet when its terms of service included the Arbitration Clause. Plaintiff Mutzig's U-verse Internet registration date was September 29, 2008, before the Internet terms incorporated the Arbitration Clause. In October 2008, AT&T sent an e-mail to customers notifying them of changes to the Internet terms, including the addition of the Arbitration Clause. The e-mail states that ″[b]y continuing to use the Service, [customers] signify [their] continued agreement to the terms and conditions set forth in the Terms of Service document.″ Id. at 427. It is undisputed that Plaintiff Mutzig received this e-mail.

2. Hancock Affidavit

In response to the motions to dismiss, Plaintiffs provided an affidavit from Plaintiff Hancock. He averred that he "did not 'click on' ANY acceptance of U-verse's 'Terms of Service' when [he] bought U-verse, and the salesman never told [him] about any 'Terms of Service.'″ Id. at 1802. Plaintiff Hancock further stated that he ″was never aware of the fact that there were actually multiple terms of service for TV, [Voice,] and Internet services.″ Id.

3. District Court's Orders

In separate orders tailored to each Plaintiff, the district court granted Defendants' motion to dismiss/transfer venue on the TV/Voice-related claims and their motion to dismiss/compel arbitration on the Internet-related claims. Concluding that the Forum Selection Clause was mandatory and unambiguous, the court dismissed Plaintiffs' TV/Voice-related claims without prejudice. The court dismissed with prejudice Plaintiffs' Internet-related claims and compelled arbitration of those claims, holding that the Arbitration Clause governed and was enforceable under the Federal Arbitration Act and state law.

With respect to the remaining named defendants, the district court held that all of Plaintiffs' TV/ Voice- and Internet-related claims were ″intertwined with, subject to, and dependent upon″ the U-verse terms of service. Id. at 2141, 2146. Accordingly, the court dismissed Plaintiffs' claims against all remaining defendants as subject to the Forum Selection and Arbitration Clauses.

Plaintiffs filed a timely appeal from the district court's orders of dismissal.

II. DISCUSSION

Plaintiffs argue the district court erred in dismissing their claims on the basis of the Forum Selection and Arbitration Clauses. They do not challenge the language of the clauses. Instead, Plaintiffs assert they did not knowingly accept the TV/Voice and Internet terms, and therefore the Forum Selection and Arbitration Clauses cannot be enforced against them.

….Plaintiffs contend that under Defendants' described standard practice, customers cannot knowingly accept the U-verse TV/Voice and Internet terms. This argument focuses on whether, as a matter of law, Defendants' standard practice gives U-verse customers adequate disclosure of the terms and an adequate opportunity to re-view and accept them.

A. Defendants' Standard Practice and Customer Acceptance of Terms

Defendants use "clickwrap" agreements as part of their standard practice for customer acceptance of the TV/Voice and Internet terms. Clickwrap is a commonly used term for agreements requiring a computer user to ″consent to any terms or conditions by clicking on a dialog box on the screen in order to proceed with [a] . . . transaction.″ Feldman v. Google, Inc ., 513 F. Supp. 2d 229, 236 (E.D. Pa. 2007).

Plaintiffs do not dispute that courts generally uphold clickwrap agreements. But they argue that the process through which customers agree to U-verse terms of service, including Defendants' use of clickwrap agreements, is ″so byzantine and confusing that Plaintiffs could not possibly have knowingly consented to the arbitration and forum selection clauses.″ Aplt. Br. at 2. Plaintiffs therefore dispute whether Defendants' standard practice for customer acceptance of U-verse terms can form binding contracts as a matter of law. See id. at 21-22 (″[T]he U-verse process … is so lengthy, confusing, and reliant on critical interactions between the installer and the customer that it cannot, as a matter of law, comply with standard contract principles of offer and acceptance.″).

We apply state law principles to determine whether a contract has been formed. See First Options of Chicago, Inc. v. Kaplan , 514 U.S. 938, 944, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995). Here, the parties agree that Florida law and Oklahoma law apply because

Plaintiffs obtained U-verse services in those states. The parties agree that we review de novo whether, as a matter of law, Defendants' standard practice provides sufficient notice of and an opportunity to agree to the terms of service. See Elliot v. Turner Const. Co ., 381 F.3d 995, 1001 (10th Cir. 2004) (″[W]hether a legal conclusion based upon undisputed facts is correct is a matter of law.″); see also Effron v. Sun Line Cruises, Inc ., 67 F.3d 7, 9 (2d Cir. 1995) (explaining that reasonable notice of a forum selection clause is a question of law reviewed de novo).

We first address whether Defendants' use of clickwrap agreements creates binding contracts under Florida and Oklahoma law. We then address Plaintiffs' additional challenges to Defendants' standard practice for customer acceptance of U-verse terms.

1. Clickwrap Agreements

Clickwrap agreements are increasingly common and ″have routinely been upheld.″ Smallwood v. NCsoft Corp ., 730 F. Supp. 2d 1213, 1226 (D. Haw. 2010). Federal and state courts typically evaluate clickwrap agreements by applying state law contract principles. See, e.g., Specht v. Netscape Commc'ns Corp ., 306 F.3d 17, 28-32 (2d Cir. 2002) (applying California law); Serrano v. Cablevision Sys. Corp ., 863 F. Supp. 2d 157, 164 (E.D.N.Y. 2012) (″'[C]lick-wrap' contracts are enforced under New York law as long as the consumer is given a sufficient opportunity to read the end-user license agreement, and assents thereto after being provided with an unambiguous method of accepting or declining the offer.″); Jallali v. Nat'l Bd. of Osteopathic Med. Examiners, Inc ., 908 N.E.2d 1168, 1173 (Ind. Ct. App. 2009) (upholding clickwrap agreement under general contract principles). Courts evaluate whether a clickwrap agreement's terms were clearly presented to the consumer, the consumer had an opportunity to read the agreement, and the consumer manifested an unambiguous acceptance of the terms. See, e.g., Specht , 306 F.3d at 28-32; Serrano , 863 F. Supp. 2d at 164; Guadagno v. E*Trade Bank , 592 F. Supp. 2d 1263, 1271 (C.D. Cal. 2008); Feldman , 513 F. Supp. 2d at 236.

Except for a few brief references to clickwrap agreements, Florida and Oklahoma courts have not discussed them in depth. See Leatherwood v. Cardservice Int'l, Inc ., 929 So. 2d 616, 617 (Fla. Dist. Ct. App. 2006) (per curiam); Segal v. Amazon.com, Inc ., 763 F.

Supp. 2d 1367, 1369 (S.D. Fla. 2011); Rogers v. Dell Computer Corp ., 2005 OK 51, 138 P.3d 826, 834 (Okla. 2005).

But basic contract law principles in Florida and Oklahoma indicate that if a clickwrap agreement gives a consumer reasonable notice of its terms and the consumer affirmatively manifests assent to the terms, the consumer is bound by the terms. See Rocky Creek Ret. Props., Inc. v. Estate of Fox ex rel. Bank of Am., N.A ., 19 So. 3d 1105, 1108 (Fla. Dist. Ct. App. 2009) ("A party normally is bound by a contract that the party signs unless the party can demonstrate that he or she was prevented from reading it or induced by the other party to refrain from reading it." (quotations omitted)); First Nat'l Bank & Trust Co. of El Reno v. Stinchcomb , 1987 OK CIV APP 1, 734 P.2d 852, 854 (Okla. 1987) (noting that acceptance of a contract's terms may be overcome if there is a "fraud or some equally valid excuse for . . . ignorance" of the terms).

In both states, a contract cannot be formed without the parties' mutual assent to the essential terms of the agreement. See Gibson v. Courtois , 539 So. 2d 459, 460 (Fla. 1989); Sam Rodgers Props., Inc. v. Chmura , 61 So. 3d 432, 437 (Fla. Dist. Ct. App. 2011); Dunbar Eng'g Corp. v. Rhinosystems, Inc ., 2010 OK CIV APP 49, 232 P.3d 931, 935 n.8 (Okla. 2010). A party who manifests assent to a contract's terms is bound by them, and failure to read the terms is no excuse. See Consol. Res. Healthcare Fund I, Ltd. v. Fenelus , 853 So. 2d 500, 504 (Fla. Dist. Ct. App. 2003); Stinchcomb , 734 P.2d at 854.

Plaintiffs argue that Defendants' clickwrap agreements do not give customers notice of and a meaningful opportunity to assent to the U-verse terms of service. Their argument relies primarily on the Second Circuit's decision in Specht. In that case, the Second Circuit concluded that plaintiffs who downloaded a software ″plug-in″ called "SmartDownload" could not have reasonably known of the software's associated license terms, which included an arbitration provision. 306 F.3d at 31. To download the software, the plaintiffs visited a webpage and clicked on a "Start Download" button. Id . at 22-23. The ″sole reference to . . . license terms on the . . . webpage was located in text that would have become visible to plaintiffs only if they had scrolled down to the next screen.″ Id . at 23. In effect, the layout concealed the license terms in a ″submerged screen.″ Id . at 32.

The Specht court explained that ″[r]easonably conspicuous notice of the existence of contract terms and unambiguous manifestation of assent to those terms by consumers are essential if electronic bargaining is to have integrity and credibility.″ Id . at 35. The court held that the plaintiffs were not bound by the arbitration provision in the license terms because a reasonably prudent person downloading the free software ″would not have known or learned, prior to acting on the invitation to download, of the reference to . . . license terms hidden below the 'Download' button on the next screen.″ Id.

Plaintiffs' arguments notwithstanding, Defendants' clickwrap agreements comply with the principles set forth in Specht. Defendants' clickwrap agreements do not conceal the U-verse terms of service. Under Defendants' description of the standard practice, technicians present customers with a Welcome Kit containing a printed copy of the TV/Voice terms and give customers an opportunity to review the terms. Before technicians proceed with installation, customers must agree to the TV/Voice terms by clicking on an ″I Acknowledge″ button on the GCAS web application, which is presented on the technician's laptop. The GCAS web application displays a checkbox for "Terms Of Service" and a statement that the customer acknowledges that he has "read, understand[s], and agree[s] to the content of the documents checked above" Aplt. Appx. at 883.

Similarly, customers cannot access U-verse Internet service without going through a registration process on the customer's computer. The process gives the customer an opportunity to review the Internet terms in a scrolling text box. The customer must click an ″I Agree″ button to manifest assent to the Internet terms and to continue with the registration process and activation of U-verse Internet service.

Defendants' presentation of the U-verse TV/Voice and Internet terms is in stark contrast to the presentation of terms associated with the software download in Specht, where consumers had (1) no visible notice of accompanying terms, and (2) no indication that terms were being accepted. U-verse customers are given notice of the U-verse terms and must affirmatively manifest assent to the terms by clicking ″I Acknowledge″ and ″I Agree″ buttons. The Specht acknowledged that clickwrap agreements similar to Defendants' agreements are generally enforced. See 306 F.3d at 33-34 (citing cases in which clickwrap agreements were found to be enforceable, including where the agreement contained a scrolling text box with terms and an ″I Agree″ button).

Defendants' clickwrap agreements are of the type that are ″routinely . . . upheld.″ Smallwood , 730 F. Supp. 2d at 1226. We see no reason that such clickwrap agreements would not be valid and enforceable under Florida and Oklahoma law.

….

For the foregoing reasons, we affirm the district court's orders dismissing Plaintiffs' TV/Voice-related and Internet-related claims.

Hypothetical

In this case the appellee oil company presented to the appellant-defendant leasee, a filling station operator, a printed form contract as a lease to be signed by the defendant, which contained, in addition to the normal leasing provisions, a "hold harmless" clause which provided in substance that the leasee operator would hold harmless and also indemnify the oil company for any negligence of the oil company occurring on the leased premises. The litigation arises as a result of the oil company's own employee spraying gasoline over Weaver and his assistant and causing them to be burned and injured on the leased premises.

Clause three of the lease reads as follows:" Lessor, its agents and employees shall not be liable for any loss, damage, injuries, or other casualty of whatsoever kind or by whomsoever caused to the person or property of anyone (including Lessee) on or off the premises, arising out of or resulting from Lessee's use, possession or operation thereof or from defects in the premises whether apparent or hidden, or from the installation existence, use, maintenance, condition, repair, alteration, removal or replacement of any equipment thereon, whether due in whole or in part to negligent acts or omissions of Lessor, its agents or employees; and Lessee for himself, his heirs, executors, administrators, successors and assigns, hereby agrees to indemnify and hold Lessor, its agents and employees, harmless from and against all claims, demands, liabilities, suits or actions (including all reasonable expenses and attorneys' fees incurred by or imposed on the Lessor in connection therewith) for such loss, damage, injury or other casualty. Lessee also agrees to pay all reasonable expenses and attorneys' fees incurred by Lessor in the event that Lessee shall default under the provisions of this paragraph."

It will be noted that this lease clause not only exculpated the lessor oil company from its liability for its negligence, but also compelled Weaver to indemnify them for any damages or loss incurred as a result of its negligence.

The facts reveal that Weaver had left high school after one and a half years and spent his time, prior to leasing the service station, working at various skilled and unskilled labor oriented jobs. … The ceremonious activity of signing the lease consisted of nothing more than the agent of American Oil placing the lease in front of Mr. Weaver and saying "sign", which Mr. Weaver did. There is nothing in the record to indicate that Weaver read the lease; that the agent asked Weaver to read it; or that the agent, in any manner, attempted to call Weaver's attention to the "hold harmless" clause in the lease.

Each year following, the procedure was the same. The evidence showed that Weaver had never read the lease prior to signing and that the clauses in the lease were never explained to him in a manner from which he could grasp their legal significance.

Weaver v. American Oil Co., 257 Ind. 458 (Ind. 1971)

UNIFORM COMMERCIAL CODE

§ 1-205. Reasonable Time; Seasonableness

(a) Whether a time for taking an action required by [the Uniform Commercial Code] is reasonable depends on the nature, purpose, and circumstances of the action.

(b) An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

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

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

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

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

§ 2-302. Unconscionable Contract or Clause.

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce

the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Official Comment

Purposes:

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d

1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga.App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only ifthe seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law tobe negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a

whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

§ 2-307. Delivery in Single Lot or Several Lots.

Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot.

2-508. Cure by Seller of Improper Tender or Delivery; Replacement.

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

§ 2-601. Buyer's Rights on Improper Delivery.

Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the 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.

§ 2-602. Manner and Effect of Rightful Rejection.

(1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

§ 2-606. What Constitutes Acceptance of Goods.

(1) Acceptance of goods occurs when the buyer
(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
(b) fails to make an effective rejection (subsection (1) of Section 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

§ 2-607. Effect of Acceptance; Notice of Breach; Burden of Establishing Breach After

Acceptance; Notice of Claim or Litigation to Person Answerable Over.

(1) The buyer must pay at the contract rate for any goods accepted.
(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a non-conformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the non-conformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this Article for non-conformity.

(3) Where a tender has been accepted
(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and
(b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

§ 2-609. Right to Adequate Assurance of Performance.

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. 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.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

Official Comment

Purposes:

1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any

preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. …

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. …Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The law as to "dependence" or "independence" of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in "his account" with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller's expectation of due performance. Again, under the same test, a buyer who requires precision parts which he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs….

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance, or other commercially reasonable cure.

A fact situation such as arose in Corn Products Refining Co. v. Fasola, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2% off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10 day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, expressed willingness to make payments when due on the 30 day terms and insisted on further deliveries under the contract. Under this Article the rumors, although false, were enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. …

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This Act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to re-establish the security of expectation, results in a breach only "by repudiation" under subsection (4). Therefore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

§ 2-612. "Installment Contract"; Breach.

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) 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 or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

§ 2-615. Excuse by Failure of Presupposed Conditions.

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

COMMENTS

1. This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this Article, must be distinguished from the matter covered by this section.

…

3. The first test for excuse under this Article in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article.

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section.

5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather than the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting. (See Davis Co. v. Hoffmann-LaRoche Chemical Works, 178 App.Div. 855, 166 N.Y.S. 179 (1917) and International Paper Co. v. Rockefeller, 161 App.Div. 180, 146 N.Y.S. 371 (1914).) There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail.

In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. ….

8. The provisions of this section are made subject to assumption of greater liability by

agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

…

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one.

§ 2-703. Seller's Remedies in General**.**

(1) A breach of contract by the buyer includes the buyer's wrongful rejection or wrongful attempt to revoke acceptance of goods, wrongful failure to perform a contractual obligation, failure to make a payment when due, and repudiation.

(2) If the buyer is in breach of contract the seller, to the extent provided for by this Act or other law, may:

(a) withhold delivery of such goods;

(b) stop delivery of the goods under Section 2-705;

(c) proceed under Section 2-704 with respect to goods unidentified to the contract or

unfinished;

(d) reclaim the goods under Section 2-507(2) or 2-702(2);

(e) require payment directly from the buyer under Section 2-325(c);

(f) cancel;

(g) resell and recover damages under Section 2-706;

(h) recover damages for non-acceptance or repudiation under (Section 2-708(1) or in a proper case the price (Section 2-709);

(j) recover the price under Section 2-709;

(k) obtain specific performance under Section 2-716;

(l) recover liquidated damages under Section 2-718;

(m) in other cases, recover damages in any manner that is reasonable under the circumstances.

§ 2-706. Seller's Resale Including Contract for Resale.

(1)Under the conditions stated in Section 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

§ 2-708. Seller's Damages for Non-acceptance or Repudiation

(1) Subject to subsection (2) and to Section 2-723:

(a) the measure of damages for nonacceptance by the buyer is the difference between the contract price and the market price at the time and place for tender together with any incidental or consequential damages provided in Section 2-710, but less expenses saved in consequence of the buyer's breach; and

(b) the measure of damages for repudiation by the buyer is the difference between the contract price and the market price at the place for tender at the expiration of a commercially reasonable time after the seller learned of the repudiation, but no

later than the time stated in paragraph (a), together with any incidental or consequential damages provided in Section 2-710, less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

§ 2-709. Action for the Price.

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (Section 2-610), a seller that is held not entitled to the price under this section shall nevertheless be awarded damages for non-acceptance under the preceding section.

§ 2-710. Seller's Incidental Damages.

(1) Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

(2) Consequential damages resulting from the buyer's breach include any loss resulting from general or particular requirements and needs of which the buyer at the time of contracting had reason to know and which could not reasonably be prevented by resale or otherwise.

(3) In a consumer contract, a seller may not recover consequential damages from a consumer.

§ 2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods.

(1) A breach of contract by the seller includes the seller's wrongful failure to deliver or to perform a contractual obligation, making of a nonconforming tender of delivery or performance, and repudiation.

(2) If the seller is in breach of contract under subsection (1), the buyer, to the extent provided for by this Act or other law, may:

(a) in the case of rightful cancellation, rightful rejection, or justifiable revocation of acceptance, recover so much of the price as has been paid;

(b) deduct damages from any part of the price still due under Section 2-717;

(c) cancel;

(d) cover and have damages under Section 2-712 as to all goods affected whether or not they have been identified to the contract;

(e) recover damages for nondelivery or repudiation under Section 2-713;

(f) recover damages for breach with regard to accepted goods or breach with regard to a remedial promise under Section 2-714;

(g) recover identified goods under Section 2-502;

(h) obtain specific performance or obtain the goods by replevin or similar remedy under Section 2-716;

(i) recover liquidated damages under Section 2-718;

(j) in other cases, recover damages in any manner that is reasonable under the circumstances.

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt,

transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

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

(1) If the seller wrongfully fails to deliver or repudiates or the buyer rightfully rejects or justifiably revokes acceptance, the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

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

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

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

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

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

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

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

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. Section 2-719 determines the enforceability of a term that limits but does not liquidate damages.

(2) If the seller justifiably withholds delivery of goods or stops performance because of the buyer's breach or insolvency, the buyer is entitled to restitution of any amount by which the sum of the buyer's payments exceeds the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1)

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.

RESTATEMENT (SECOND) OF CONTRACTS

§ 14 Infants

Unless a statute provides otherwise, a natural person has the capacity to incur only voidable contractual duties until the beginning of the day before the person's eighteenth birthday.

§ 15 Mental Illness or Defect

(1) A person incurs only voidable contractual duties by entering into a transaction if by reason of mental illness or defect

(a) he is unable to understand in a reasonable manner the nature and consequences of the transaction, or

(b) he is unable to act in a reasonable manner in relation to the transaction and the other party has reason to know of his condition.

(2) Where the contract is made on fair terms and the other party is without knowledge of the mental illness or defect, the power of avoidance under Subsection (1) terminates to the extent that the contract has been so performed in whole or in part or the circumstances have so changed that avoidance would be unjust. In such a case a court may grant relief as justice requires.

§ 151 Mistake Defined

A mistake is a belief that is not in accord with the facts.

Comment:

a. *Belief as to facts*. In this Restatement the word "mistake" is used to refer to an erroneous belief. A party's erroneous belief is therefore said to be a "mistake" of

that party. … The word "mistake" is not used here, as it is sometimes used in common speech, to refer to an improvident act, including the making of a contract, that is the result of such an erroneous belief. This usage is avoided here for the sake of clarity and consistency. Furthermore, the erroneous belief must relate to the facts as they exist at the time of the making of the contract. A party's prediction or judgment as to events to occur in the future, even if erroneous, is not a "mistake" as that word is defined here.

§ 152 When Mistake of Both Parties Makes a Contract Voidable

(1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in § 154.
(2) In determining whether the mistake has a material effect on the agreed exchange of performances, account is taken of any relief by way of reformation, restitution, or otherwise.

§ 153 When Mistake of One Party Makes a Contract Voidable

Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake under the rule stated in § 154, and

(a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or

(b) the other party had reason to know of the mistake or his fault caused the mistake.

§ 154 When a Party Bears the Risk of a Mistake

A party bears the risk of a mistake when

(a) the risk is allocated to him by agreement of the parties, or

(b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or

(c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so.

§ 203 Standards of Preference in Interpretatio

In the interpretation of a promise or agreement or a term thereof, the following standards of preference are generally applicable:

(a) an interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect;

(b) express terms are given greater weight than course of performance, course of dealing, and usage of trade, course of performance is given greater weight than course of dealing or usage of trade, and course of dealing is given greater weight than usage of trade;

(c) specific terms and exact terms are given greater weight than general language;

(d) separately negotiated or added terms are given greater weight than standardized terms or other terms not separately negotiated.

§ 209 Integrated Agreements

(1) An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement.
(2) Whether there is an integrated agreement is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.
(3) Where the parties reduce an agreement to a writing which in view of its completeness and specificity reasonably appears to be a complete agreement, it is taken to be an integrated agreement unless it is established by other evidence that the writing did not constitute a final expression.

§ 210 Completely and Partially Integrated Agreements

(1) A completely integrated agreement is an integrated agreement adopted by the parties as a complete and exclusive statement of the terms of the agreement.
(2) A partially integrated agreement is an integrated agreement other than a completely integrated agreement.
(3) Whether an agreement is completely or partially integrated is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.

§ 211 Standardized Agreements

(1) Except as stated in Subsection (3), where a party to an agreement signs or otherwise manifests assent to a writing and has reason to believe that like writings are regularly used to embody terms of agreements of the same type, he adopts the writing as an integrated agreement with respect to the terms included in the writing.
(2) Such a writing is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing.

(3) Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement

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

(1) A binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them.
(2) A binding completely integrated agreement discharges prior agreements to the extent that they are within its scope.
(3) An integrated agreement that is not binding or that is voidable and avoided does not discharge a prior agreement. But an integrated agreement, even though not binding, may be effective to render inoperative a term which would have been part of the agreement if it had not been integrated.

§ 214 Evidence of Prior or Contemporaneous Agreements and Negotiations

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

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

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

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

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

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

§ 215 Contradiction of Integrated Terms

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

§ 216 Consistent Additional Terms

(1) Evidence of a consistent additional term is admissible to supplement an integrated agreement unless the court finds that the agreement was completely integrated.
(2) An agreement is not completely integrated if the writing omits a consistent additional agreed term which is

(a) agreed to for separate consideration, or

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

§ 217 Integrated Agreement Subject to Oral Requirement of a Condition

Where the parties to a written agreement agree orally that performance of the agreement is subject to the occurrence of a stated condition, the agreement is not integrated with respect to the oral condition.

§ 224 Condition Defined

A condition is an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due.

§ 225 Effects of the Non-Occurrence Of a Condition

(1) Performance of a duty subject to a condition cannot become due unless the condition occurs or its non-occurrence is excused.
(2) Unless it has been excused, the non-occurrence of a condition discharges the duty when the condition can no longer occur.
(3) Non-occurrence of a condition is not a breach by a party unless he is under a duty that the condition occur.

§ 234 Order of Performances

(1) Where all or part of the performances to be exchanged under an exchange of promises can be rendered simultaneously, they are to that extent due simultaneously, unless the language or the circumstances indicate the contrary.
(2) Except to the extent stated in Subsection (1), where the performance of only one party under such an exchange requires a period of time, his performance is due at an earlier time than that of the other party, unless the language or the circumstances indicate the contrary.

§ 237 Effect on Other Party's Duties of a Failure to Render Performance
Except as stated in § 240, it is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time.

§ 240 Part Performances as Agreed Equivalents

If the performances to be exchanged under an exchange of promises can be apportioned into corresponding pairs of part performances so that the parts of each pair are properly regarded as agreed equivalents, a party's performance of his part of such a pair has the same effect on the other's duties to render performance of the agreed equivalent as it would have if only that pair of performances had been promised.

§ 241 Circumstances Significant in Determining Whether a Failure Is Material

In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

(a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;

(b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;

(c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;

(d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;

(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

§ 242 Circumstances Significant in Determining When Remaining Duties Are Discharged

In determining the time after which a party's uncured material failure to render or to offer performance discharges the other party's remaining duties to render performance under the rules stated in §§ 237 and 238, the following circumstances are significant:

(a) those stated in § 241;

(b) the extent to which it reasonably appears to the injured party that delay may prevent or hinder him in making reasonable substitute arrangements;

(c) the extent to which the agreement provides for performance without delay, but a material failure to perform or to offer to perform on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.

§ 250 When a Statement or an Act Is a Repudiation

A repudiation is
(a) a statement by the obligor to the obligee indicating that the obligor will commit a breach that would of itself give the obligee a claim for damages for total breach under § 243, or
(b) a voluntary affirmative act which renders the obligor unable or apparently unable to perform without such a breach.

§ 251 When a Failure to Give Assurance May Be Treated as a Repudiation

(1) Where reasonable grounds arise to believe that the obligor will commit a breach by non-performance that would of itself give the obligee a claim for damages for total breach under § 243, the obligee may demand adequate assurance of due performance and may, if reasonable, suspend any performance for which he has not already received the agreed exchange until he receives such assurance.
(2) The obligee may treat as a repudiation the obligor's failure to provide within a reasonable time such assurance of due performance as is adequate in the circumstances of the particular case.

§ 252 Effect of Insolvency

(1) Where the obligor's insolvency gives the obligee reasonable grounds to believe that the obligor will commit a breach under the rule stated in § 251, the obligee may suspend any performance for which he has not already received the agreed exchange until he receives assurance in the form of performance itself, an offer of performance, or adequate security.
(2) A person is insolvent who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law.

§ 253 Effect of a Repudiation as a Breach and on Other Party's Duties

(1) Where an obligor repudiates a duty before he has committed a breach by non-performance and before he has received all of the agreed exchange for it, his repudiation alone gives rise to a claim for damages for total breach.
(2) Where performances are to be exchanged under an exchange of promises, one party's repudiation of a duty to render performance discharges the other party's remaining duties to render performance.

§ 256 Nullification of Repudiation or Basis for Repudiation

(1) The effect of a statement as constituting a repudiation under § 250 or the basis for a repudiation under § 251 is nullified by a retraction of the statement if notification of the retraction comes to the attention of the injured party before he materially changes his position in reliance on the repudiation or indicates to the other party that he cconsiders the repudiation to be final.
(2) The effect of events other than a statement as constituting a repudiation under § 250 or the basis for a repudiation under § 251 is nullified if, to the knowledge of the injured party, those events have ceased to exist before he materially changes his position in reliance on the repudiation or indicates to the other party that he cconsiders the repudiation to be final.

§ 261 Discharge by Supervening Impracticability

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

§ 265 Discharge by Supervening Frustration

Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

§347. Measure of Damages in General

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

(a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus
(b) any other loss, including incidental or consequential loss, caused by the breach, less
(c) any cost or other loss that he has avoided by not having to perform.

Comments:…
d. Cost or other loss avoided. Sometimes the breach itself results in a saving of some cost that the injured party would have incurred if he had had to perform. Furthermore, the injured party is expected to take reasonable steps to avoid further loss. See §350. Where he does this by discontinuing his own performance, he avoids incurring additional costs of performance. See Illustration 6. This cost avoided is subtracted from the loss in value caused by the breach in calculating his damages. If the injured party avoids further loss by making substitute arrangements for the use of his resources that are no longer needed to perform the contract, the net profit from such arrangements is also subtracted. The value to him of any salvageable materials that he has acquired for performance is also subtracted.

Illustrations....

6. A contracts to build a house for B for $100,000. When it is partly built, B repudiates the contract and A stops work. A would have to spend $60,000 more to finish the house. The $60,000 cost avoided by A as a result of not having to finish the house is subtracted from the $100,000 price lost in determining A's damages. A has a right to $40,000 in damages from B, less any progress payments that he has already received.

§350. AVOIDABILITY AS A LIMITATION ON DAMAGES

(1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden, or humiliation.
(2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

351. UNFORESEEABILITY AND RELATED LIMITATIONS ON DAMAGES
(**1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.**
(2) Loss may be foreseeable as a probable result of a breach because it follows from the breach

(**a) in the ordinary course of events, or**

(b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.
(3) A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.

Comments:
a. Requirement of foreseeability....It is enough, however, that the loss was foreseeable as a probable, as distinguished from a necessary, result of his breach. Furthermore, the party in breach need not have made a "tacit agreement" to be liable for the loss. Nor must he have had the loss in mind when making the contract, for the test is an objective one based on what he had reason to foresee. There is no requirement of foreseeability with respect to the injured party.

§352. UNCERTAINTY AS A LIMITATION ON DAMAGES

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

Comments:

b. Proof of profits.... If the breach prevents the injured party from carrying on a well established business, the resulting loss of profits can often be proved with sufficient certainty. Evidence of past performance will form the basis for a reasonable prediction as to the future.

However, if the business is a new one or if it is a speculative one that is subject to great fluctuations in volume, costs or prices, proof will be more difficult. Nevertheless, damages may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like.

§ 355 Punitive Damages

Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.

§ 371 Measure of Restitution Interest

If a sum of money is awarded to protect a party's restitution interest, it may as justice requires be measured by either

(a) the reasonable value to the other party of what he received in terms of what it would have cost him to obtain it from a person in the claimant's position, or

(b) the extent to which the other party's property has been increased in value or his other interests advanced.

§ 373 Restitution When Other Party Is in Breach

(1) Subject to the rule stated in Subsection (2), on a breach by non-performance that gives rise to a claim for damages for total breach or on a repudiation, the injured party is entitled to restitution for any benefit that he has conferred on the other party by way of part performance or reliance.
(2) The injured party has no right to restitution if he has performed all of his duties under the contract and no performance by the other party remains due other than payment of a definite sum of money for that performance.