

Contract Law

Contract Law

Rules, Cases, and Problems

SECOND EDITION

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To Talia, my partner in the greatest contract of life: marriage.

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I remain grateful to the American Law Institute for the use of the Restatement of the Law (Second) of Contracts:

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Any errors or omissions are, of course, my own—but I might blame ChatGPT.

Online Materials

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Preface

Welcome to Contract Law! I wrote this casebook to help you become a lawyer. Becoming a lawyer involves more than just memorizing rules. Although we will develop your ability to recall key doctrines so that you can identify when facts raise legal issues, technology now makes it easy to find out what the law is. What sets human lawyers apart is not their total recall but their capacity to spot issues, research questions, distinguish relevant facts, analyze arguments creatively yet rigorously, and propose solutions that achieve clients' goals. By focusing on these skills, this book treats law as a dynamic process rather than a static list of doctrines.

Contract Law is a great place to practice these future lawyering skills because contracts lie at the heart of so many legal practices. Whether you are drafting engagement letters, negotiating settlements, or advocating for labor rights under collective bargaining, you will encounter contracts everywhere. You will also see them in your personal life whenever you lease cars, order casebooks, or use websites. Studying how parties form, interpret, and enforce agreements reveals why creativity and rigorous analysis are both crucial. Through each chapter, you will develop the instincts and methods needed to tackle real-world legal problems in any field, and you will do this by viewing the issues through the lens of contract doctrine.

Typical bargain contracts arise through mutual assent and consideration. Bargains generally promote economic efficiency. But courts may also enforce some non-bargain agreements for reasons of fairness or reliance, or refuse to enforce other bargains for being unjust. Beyond determining whether a contract is enforceable, courts decide what evidence is admissible to explain what the parties intended. Judges usually prioritize written terms over extrinsic evidence. Even when parties agree on what a contract requires, they might argue over whether they must perform as promised. When a party fails to perform (a "breach"), courts provide remedies. This is contract law in a nutshell.

Memorizing key doctrines is necessary but not enough. You also need core legal skills so you can work with doctrines in real-world scenarios. To build these skills, this casebook invites you to read cases and statutes, break rules into simpler parts, and rebuild them into persuasive arguments. Engaging with this process trains you to think like a lawyer, preparing you for any practice area. You will see how a minor change of words or the framing of facts can alter a result. These analytical abilities will help you in other classes, on the bar exam, and throughout your career.

Studying with classmates will broaden your perspective. By exchanging ideas and feedback, you discover new insights and refine your arguments. This teamwork reflects how lawyers actually work. They collaborate with colleagues, clients, judges, and opposing counsel. Developing the habit of speaking and listening respectfully fosters the collegiality that is central to a successful legal career.

While this casebook is designed for first-year law students, it also establishes a foundation for upper-level studies by introducing theories of justice. Law is a philosophical balancing act, as symbolized by the scales of justice. Contract law, for instance, balances efficiency with fairness. Courts apply rules predictably so people can rely on them, and yet judges remain flexible to reach just outcomes. This tension reveals how law adapts to human needs. It explains why contract disputes can be both technical and personal. Seeing how courts navigate this balance will give you a deeper appreciation for law's larger role. Theories about law's purposes form law's foundation in our society. While this book is focused on analyzing the law as it stands, from time to time, we will specifically investigate how contract doctrines are supported by foundational theories of justice. This is not only philosophically interesting but also prepares you to make sophisticated arguments for how doctrine should change.

To succeed in this endeavor, you must engage actively with this book and your course materials. Each module starts with basic ideas and builds toward more advanced ones. For instance, the module on mutual assent explores the core requirement of a bargain before examining its specific elements, like offer and acceptance. Doctrinal scaffolding rises from the foundation of legal theory. As with any sound structure, this casebook's doctrine begins with fundamental framing, then adds increasing levels of complexity.

Cases bring this scaffolding to life by showing how courts apply legal theories to actual disputes. As you read them, notice how judges and lawyers highlight different facts, frame issues strategically, and apply rules in novel ways. Most cases feature two (or more) parties presenting opposing arguments, and it is not unusual to see a trial court's decision overturned by an appellate court, then possibly reversed again by a supreme court. This illustrates how real legal problems rarely have a single "right" answer. Law can feel nebulous compared to subjects with definitive true/false solutions. You may hear the joke that every legal answer is "it depends." Your task is to figure out *on what* it depends. Cases will help you see why some arguments gain traction while others fail, and they will show you how subtle factual distinctions or legal nuances can shift the outcome.

Problems will ask you to construct your own arguments and evaluations upon the structure of the rules you have learned. As you have seen from reading cases, there is no single right way to form a contract argument. That is why this book does not provide written answers to essay-style questions. Sometimes you might feel lost without a single correct solution, and that feeling can be daunting if you are used to academic work that prioritizes a final product over the process of getting there. But this uncertainty is intentional. Working through it helps you develop the skills of

self-assessment and the habits of mind required in real practice. Instead of matching your essay response to a “right” answer, compare your reasoning with the parties’ arguments in cited court decisions or with your classmates’ solutions. You will soon realize that more than one valid path can exist for the same dispute.

If you want to confirm your grasp of key doctrines, you can use the multiple-choice questions on the Carolina Academic Press Core Knowledge platform. They let you see where you stand on the basics and help you identify areas for further review. But the deeper learning will come from trying to reason through problems, sharing your ideas, and adjusting your arguments in light of feedback.

Active participation is key. Write out your analysis, ask questions, and mark places that confuse you. Talk with your classmates, learn from their perspectives, and refine your reasoning. Although this process can be challenging, it mirrors the reality of lawyering. Real disputes are not simple, but careful thinking can guide you to sound conclusions.

Remember that your professor, your classmates, and this casebook are here to support you. The work may feel tough, but it will also be rewarding. By the end of your studies, you will see how these doctrines, skills, and insights help you to handle the complexities of legal practice. Together, we will explore how contract law shapes daily life and how your future role as a lawyer can shape contract law.

Wishing you the best of luck in this course of study,

/s/ SETH C. ORANBURG

Contract Law

Chapter 1

What Is Contract Law?

Our study of contract law naturally begins by discussing the nature, purpose, history, and evolution of contract law. Contract law's purpose is the foundation upon which we will construct the scaffolding of contract doctrine.

Contract law is the law of promises. A promise is an expression of commitment to do (or not to do) something. Promises are the foundation of contract liability. Without a promise, there is no evidence of a voluntary agreement to be bound to. Contract law depends on this voluntariness. People create their own obligations under contract law. If you do not want to be liable, you can choose not to form a contract. Thus, there is no contract liability where there is no promise.

Its voluntary nature makes contract law different from other types of law. Public law governs the relationship between people and the government. Public law, such as criminal or tax law, applies to everyone, whether or not they agree. You cannot opt out of paying taxes or following criminal laws without facing consequences. Some tax protesters have refused to pay taxes, arguing they never consented to them. Courts have consistently rejected these arguments, and many tax protesters have been fined or jailed for tax evasion.

Contract law, by contrast, is part of private law. Private law governs relationships between people. It includes tort law, property law, and family law. Unlike public law, private law is mostly voluntary. Contract law is especially voluntary. It enforces only the obligations people freely choose to create.

This focus on promises allows contract law to play a unique role. It enables individuals to make agreements they can rely on. This reliability supports both personal relationships and large-scale economic activity.

As we study contract law, we will explore how promises create obligations, when they are binding, and how the law balances fairness with freedom. This will reveal why promises are essential and how contract law helps to structure modern society.

A. Origins of Contract Law

The law of contracts is ancient. It originated in several ancient civilizations across the world. It is not possible to determine which civilization was the “first” to develop a system for enforcing contracts. But, according to Professor Charles Auerbach, the oldest collection of contract law sources that are still used today was assembled by Rabbi Hillel in 200 B.C.E. The Jewish law of contract was derived from the five books of Moses (Genesis, Exodus, Leviticus, Numbers, and Deuteronomy) and Jewish oral tradition. Orthodox Jewish courts still apply these laws and principles today—although the Divine principles underlying Jewish law are sometimes quite different from the philosophical justifications for law that are accepted by modern nations.

The Roman law of contracts is no longer employed today, but, according to Professor Alan Watson, it forms the basis for the enforcement of private agreements in most of the Western world. The earliest embodiment of the Roman law of contracts is probably found in the Twelve Tables, a set of laws inscribed on twelve bronze tables that were created around 451 B.C.E. Those tables have apparently been destroyed, but their legacy survived. Some countries, such as South Africa, still base their legal system on the Roman *jus commune* (common law).

England, although it was influenced by Roman law, did not adopt the Roman law of contracts wholesale. Roman law was introduced to England, along with the French language and other Continental traditions, by the Norman Conquest of 1066. But



Figure 1.1. Moses and Aaron with the Ten Commandments. Painting by Aron de Chavez (circa 1675). Public domain work.

England, at that time, was not a legal *tabula rasa* (blank slate). Rather, commercial disputes were resolved in various local courts. This varied legal tradition, mixed with Franco-Roman influence, was first canonized by King Henry II, who pronounced a unified national common law in 1154. After the English *Magna Carta* (great charter) was instituted in 1215 to provide for basic civil liberties and restrict the power of the monarchy, the English Court of Common Pleas was established to adjudicate actions between people (as opposed to actions which concerned the state or the monarch).

The English Court of Common Pleas heard contract disputes for hundreds of years, until it was finally merged with the English King's Bench, the Court of Chancery, and the Exchequer by the Supreme Court Judicature Act of 1873—more than one hundred years after the American Revolution.

The American legal system is heavily influenced by its English predecessor. Prior to the Revolution, the British government claimed to have the sole power to create courts in the American colonies. Courts in the American colonies generally borrowed from English law. You will even find citations to the King's Bench and other English courts in some early American case law. But even in this early period, when the colonies were still under English rule, the American courts began to develop their own



Figure 1.2. Roman civilians examining the Twelve Tables.
Unknown author. Public domain work.

precedent and approach. As judges interpreted—and sometimes created—law to fit the needs of American commerce, a uniquely American common law of contracts began to develop.

B. Law and Equity

Contract law is historically rooted in two distinct legal systems: law and equity. While American state courts merged these systems during the 19th century—and the Federal Rules of Civil Procedure in 1938 unified legal and equitable claims in federal courts—important distinctions remain. For example, procedural rights, such as the entitlement to a jury trial, may depend on whether a claim is categorized as legal or equitable.

Beyond procedure, these systems embody different philosophies about the role of contract law. Like many areas of law, contract law grapples with a central tension: the rigid application of formal rules versus the pursuit of fairness and justice in specific circumstances. Understanding the history of law and equity offers valuable insight into this ongoing balancing act.

In 1215, King John of England signed the Magna Carta under pressure from rebellious barons. While the Magna Carta did not create English law—which arguably began in the Anglo-Saxon period (5th century) and evolved remarkably after the Norman Conquest (1066)—it codified the assertion that everyone, including the king, is subject to the law.

Though the document primarily addressed feudal and political issues, it also laid foundational principles for contract law. Notably, Chapter 41 provided protections for merchants, ensuring their freedom to move and trade without interference: “All merchants may enter or leave England unharmed and without fear, and may stay or travel within it, by land or water, for purposes of trade, free from all illegal exactions.” (Translated from Latin.)

By affirming that even the king was subject to legal constraints, the Magna Carta helped create an environment where contracts could be enforced consistently. These protections not only supported commerce but also set the stage for the development of the *lex mercatoria* (law of merchants), a precursor to modern commercial law.

Among the Magna Carta’s many provisions was Clause 17, which mandated that common pleas—civil disputes between private parties, a category we now refer to as private law—be heard in a fixed location rather than in the king’s itinerant court. This provision ensured greater consistency and accessibility in the administration of justice. It led to the establishment of the Court of Common Pleas at Westminster Hall, which became a central venue for resolving the disputes that defined medieval commerce and society.



Figure 1.3. King John reluctantly affixing his seal to the Magna Carta under the watchful eyes of his barons. This moment symbolizes the birth of the rule of law, which underpins the enforceability of contracts. Painting by Arthur C Michael (1945). Public domain work.

The Court of Common Pleas primarily handled cases involving property, contracts, and debts. It provided a structured forum for addressing breaches and enforcing obligations, playing a crucial role in standardizing legal principles for agreements. This standardization helped merchants grow commerce by providing predictability in contract enforcement. The court adhered strictly to procedural formalities and precedent, ensuring consistent and reliable outcomes. Its remedies, such as monetary damages, were central to the enforcement of contracts, offering a framework that supported trust and accountability in economic relationships.

The Court of Common Pleas also contributed significantly to the development of the common law, a body of judge-made legal principles established through court decisions. Additionally, the court intersected with the *lex mercatoria*. Despite its name (*lex* means law), the *lex mercatoria* was not a formal statute or guild regulation. Instead, it was a system of commercial customs and practices created and upheld by merchants themselves. These rules governed trade transactions across regions and were enforced informally through merchant courts and arbitration.

Unlike the common law, which developed through royal courts and relied on legal precedent, the *lex mercatoria* was designed for efficiency and practicality, addressing the immediate needs of merchants engaged in cross-border trade. As commerce expanded in medieval England, disputes between merchants increasingly found their way into the king's courts, including the Court of Common Pleas.

To address these cases, the Court of Common Pleas began incorporating elements of the *lex mercatoria* into its rulings. This integration helped bridge the gap between the informal, flexible customs of the merchant class and the more rigid procedural framework of the common law. By incorporating merchant practices, the court provided greater legal certainty for commercial transactions, laying the groundwork for standardized principles in contract and trade law. However, the court's strict adherence to formal rules and procedures often limited its ability to address the unique needs of merchants, particularly in cases requiring more flexible or equitable remedies.

The rigid structure and formal procedures of the Court of Common Pleas provided experienced merchants with certainty and predictability when resolving standard contractual disputes. However, not all cases fit neatly within this framework. When common law courts failed to offer adequate remedies—particularly in cases requiring flexibility or fairness, also known as “equity”—individuals turned to the king himself by petitioning him for justice.

As the number of these petitions grew, it became impractical for the monarch to address them personally. To manage this demand, the king delegated the responsibility to his chief minister, the Lord Chancellor. The Lord Chancellor, often referred to as the “keeper of the king's conscience,” reviewed these cases and provided relief based on principles of fairness rather than the rigid rules of common law.

Over time, this practice evolved into the establishment of the Court of Chancery. Operating under the Lord Chancellor's authority, the Court of Chancery became a formal institution, addressing cases where common law remedies—such as monetary damages—were insufficient to deliver justice. This court played a pivotal role in developing equitable principles, which remain integral to contract law today.

While the Court of Chancery addressed the shortcomings of the common law courts, its informality created challenges of its own. Unlike the structured procedures of the Court of Common Pleas, early Chancery proceedings relied heavily on the discretion of the Lord Chancellor, who often acted without clear guidelines or precedent. This informality sometimes resulted in inconsistent decisions, which made it difficult for parties to predict the outcomes of their cases.



Figure 1.4. The Court of Common Pleas at work. Unknown author. Public domain work.

Moreover, because the Lord Chancellor was not bound by the rules of the common law, critics viewed the court as arbitrary and overly subjective—which are hardly the hallmarks of equity. Petitioners often relied on their ability to frame their claims in moral or emotional terms, which raised concerns about fairness and impartiality. As the volume of cases increased, this lack of structure became increasingly problematic, highlighting the need for a more formal and systematic approach to equity.



Figure 1.5. The Court of Chancery during the reign of George I. Painting by Benjamin Ferrers (1732). Public domain work.

The early 16th century was a pivotal period for the Court of Chancery, marked by the contributions of two key figures: Cardinal Thomas Wolsey and Sir Thomas More. Both served as Lord Chancellor and were instrumental in formalizing the court's procedures and reinforcing its role in addressing cases where the rigid remedies of common law courts were insufficient. Their leadership helped shape the equitable principles that remain integral to modern contract law.

Cardinal Thomas Wolsey served as Lord Chancellor from 1515 to 1529. Though not a trained lawyer, Wolsey recognized the importance of fairness in delivering justice. By emphasizing fairness over strict legal rules, he helped to solidify the Court of Chancery's reputation as the forum for cases where legal remedies, such as monetary damages, were inadequate. However, Wolsey's broader responsibilities as a political and ecclesiastical figure limited his ability to implement lasting reforms in the court's operations.

Sir Thomas More—a lawyer and the humanist scholar who wrote the political novel *Utopia*—succeeded Wolsey as Lord Chancellor in 1529. More brought a new level of legal rigor to the Court of Chancery. His tenure focused on streamlining the court's processes and ensuring greater consistency in its decisions, addressing criticisms that Chancery had been arbitrary and overly informal.

More was a staunch defender of the court's equitable jurisdiction, particularly in cases involving contracts. He reinforced the use of remedies that common law courts could not provide, such as compelling parties to fulfill their contractual obligations. More established the foundations of modern contract law remedies, including specific performance to convey land, injunctions to prevent actions that cause irreparable harm, and rescission to cancel contracts formed under fraudulent or coercive circumstances. These remedies were essential in situations where monetary damages, the primary remedy in common law, could not achieve justice. More's contributions helped establish equity as a structured and reliable complement to common law, thus ensuring that contract law could address complex and unique disputes effectively and fairly.

The American colonies inherited England's dual system of law and equity, with separate courts handling distinct types of cases. Courts of law resolved disputes by applying strict legal rules and offered remedies such as monetary damages. Courts of equity, on the other hand, provided more flexible remedies grounded in fairness, including specific performance, injunctions, and rescission. This separation meant that both the remedies available and the causes of action a litigant could pursue depended on the system in which their case was filed.

After independence, some states maintained separate courts for law and equity, while others merged the two jurisdictions into a single court with the power to grant both legal and equitable remedies. Article III of the U.S. Constitution and the Judiciary Act of 1789 granted federal courts jurisdiction over both legal and equitable claims. Yet seeking equitable remedies required following different civil procedures until 1938, when the Federal Rules of Civil Procedure unified legal and equitable claims into a single procedural framework.



Figure 1.6. Portrait of Saint Thomas More (1523). Public domain work.

This historical context underscores how American courts have preserved and adapted the principles of law and equity to meet the evolving needs of society, thus ensuring that fairness and predictability remain central to the legal system. It also demonstrates how American federalism impacts the evolution of law. Each state establishes its own contract laws and even its own court systems. As of 2024, Delaware, Mississippi, and Tennessee maintain separate courts of equity, known as Chancery Courts. These courts handle matters such as trusts, estates, guardianships, and issues requiring equitable remedies like injunctions or specific performance. The most notable among them is Delaware, which specializes in handling corporate disputes and fiduciary litigation issues.

While the distinction between law and equity has thus been blurred, some differences remain. For example, equitable claims tend to require some element of justice, whereas a legal claimant may prevail merely by meeting the standards required by law. Many equitable remedies can also be limited as justice requires. The casebook will detail how this applies when we arrive at the remedies section.

Moreover, equitable claims and remedies remain exceptional and extraordinary, meaning that courts will prefer to find a legal remedy and will only resort to an equitable remedy to the extent that justice requires them to do so. Because courts still regard equitable remedies as exceptional, they will not be granted when a legal remedy is available. Students are encouraged to analyze legal claims and remedies first. Only explore equitable claims and remedies as a last resort, presenting arguments for why justice requires imposing an equitable remedy, even in the absence of a legal one.



Figure 1.7. A humble Missouri courtroom in the mid-19th century had jurisdiction over both legal and equitable claims. This reflects a pragmatic approach to administering justice with limited resources in the early United States. William Josiah Brickey (1852).

Credit: Smithsonian American Art Museum. Public domain work.

C. The Restatement of Contracts

America began as a British colony that imported British law, including the law of contracts. After the American Revolution and the formation of the United States of America, American law began drifting apart from English law. In the early days of the United States, states had a great deal more power relative to the federal government than they do today. State courts heard most contract claims, and contract law developed as a matter of state law. State law may vary, as one state is not bound to follow another state's precedent. Thus, contract law developed differently throughout the states.

The variations in contract law among states creates some challenges for interstate commerce. Whether having different state laws—and giving parties the right to choose among them—is good or bad for commerce and society is the subject of much debate in commercial law. Theory aside, there have been practical efforts to generalize and normalize contract law among the states, some of which have succeeded.

The leading effort to define (or create) a common law that is truly common throughout America has been conducted by the American Law Institute (ALI), an organization that was founded in 1923 to clarify, modernize, and otherwise improve the law. Today, the ALI drafts, discusses, revises, and publishes Restatements of the Law (which are treatises on what the law is), Model Codes (which are examples of what the law should be), and Principles of Law (which are studies of areas of law thought to need reform). The ALI's work is enormously influential in the courts and legislatures, as well as in legal scholarship and education. ALI Restatements are frequently cited by American courts as statements of black letter law, which are propounded to be statements of legal rules that are no longer subject to reasonable dispute.

The first Restatement of Contracts, drafted in the 1920s under the leadership of Harvard professor Samuel Williston, aimed to codify the common law of contracts with a focus on legal formalism. It presented contract law as a set of clear, objective rules, emphasizing certainty and predictability. However, as American courts increasingly moved away from strict formalism in favor of a more flexible, contextual approach, the first Restatement came to feel outdated. These shifts laid the groundwork for the development of the Restatement (Second) of Contracts (R2d), which embraced legal realism and sought to address the complexities of modern contracting.

The R2d was drafted and promulgated in 1979 as part of a movement known as "legal realism." This movement is based on the idea that law cannot be understood in a vacuum; rather, law is a product of humanity and society. Practically, this approach means that a court must look for the parties' actual intentions when they entered into a contract, even if the plain meaning of what they said or wrote would reasonably be interpreted by a third party to mean something else. The R2d was principally drafted by Arthur Linton Corbin, a professor at Yale Law School who is sometimes credited with creating the modern law school model. (The R2d was copyrighted in 1981, which is why you sometimes see the R2d dated as 1981.)

Despite the R2d's foundations in legal realism, it increasingly feels like a creation of an earlier age. For example, both Restatements were created when virtually no one owned their own computer. Now we walk around with computers in our pockets, on which we can purchase goods and offer services. As the R2d shows its increasing incompatibility with a digital age, a new Restatement may prove to be necessary sometime soon. In addition, some scholars and jurists criticize R2d for shaping and creating—instead of merely reporting—the law.

But the law changes slowly. At present, the R2d is still considered to be the best authority on what is the common law of contracts in America. We will rely heavily on the R2d to learn contract law principles. Just keep in mind that the law of contracts will change during your lifetime of practice in the law. As a common law doctrine, contract law can change as judges create new precedent by deciding new cases. By practicing contract law, you can be part of that change.

D. The Uniform Commercial Code

In addition to Restatements, which serve as highly persuasive treatises on what constitutes black letter common law, the ALI also produces Model Codes. These are designed as templates for state legislatures to use in drafting statutes. In the American legal system, most contract disputes are governed by state law, meaning that each state is free to craft its own legal doctrines without being bound by the precedents of other states. While this system encourages legal experimentation and local optimization, discrepancies between state laws can create confusion and increase costs for interstate commerce.

To address these challenges, the ALI developed the Uniform Commercial Code (UCC) in 1952, in collaboration with the National Conference of Commissioners on Uniform State Laws (NCCUSL). The UCC was created to harmonize commercial laws across the states, providing consistency for businesses operating nationally. The UCC covers much more than contract law. In fact, it is so expansive that each article could easily fill an entire law school course. This book, however, focuses exclusively on Article 2 of the UCC, which governs contracts for the sale of goods. Even there, it only discusses the UCC provisions that substantially change the common law as found in R2d. This avoids confusions and keeps the course streamlined.

Unlike the R2d, which is a persuasive authority used to clarify the common law, the UCC becomes binding law once enacted by state legislatures. All 50 states have adopted some version of the UCC, and, in doing so, have displaced earlier judicial doctrines that conflict with its provisions. Thus, while the R2d advises courts on what the law should be, the UCC dictates what the law is in its area of coverage. Courts are obligated to follow the UCC when adjudicating applicable disputes. The question, then, is whether the UCC applies to a given contract.

Article 2 of the UCC governs contracts for the sale of goods. UCC § 2-102. A “sale” is defined as the passing of title from the seller to the buyer for a price. UCC § 2-106(1). Sales are distinct from gifts, which involve the transfer of ownership without payment, and leases, which transfer possession and use of goods for a limited term without transferring ownership.

Goods are defined as items that are movable and identifiable at the time the contract is formed. UCC § 2-105(1). This includes tangible items like a ton of bricks or a barrel of monkeys. However, the UCC does not apply to services (e.g., laying the bricks or training the monkeys), nor does it apply to the sale of real estate (e.g., a brickworks or a zoo).

Yet even this seemingly straightforward rule gives rise to hard cases. Software, for instance, presents a challenge. Courts have traditionally interpreted the UCC’s requirement of “movable” to imply that goods must be tangible. Downloadable software, being intangible, has generally been excluded from the scope of Article 2. While a clever student might argue that downloading software involves the movement of electrons, courts reject this argument because the electrons themselves are

not the subject of the contract and are not identifiable as the specific content of the transaction.

However, what about software sold on a disc? Some courts hold that such software qualifies as a good because the disc is a tangible, movable object that embodies the software, much like a book is a tangible embodiment of the ideas within it. Other courts take a more formalistic approach, focusing on whether the predominant purpose of the transaction is the sale of the tangible medium or the licensing of the software. Still others adopt a more pragmatic view, considering how the parties structured the transaction and the relative value of the tangible and intangible elements. These differing approaches lead to inconsistent interpretations, demonstrating that, even under the “Uniform” Commercial Code, variations in interpretation among states preserve some federalism within contract law.

The UCC does occasionally resolve potential ambiguities through explicit provisions. For example, the UCC declares that the unborn young of animals and growing crops are goods, even though they may not be identifiable or movable at the time of contracting. This explicit inclusion avoids disputes over whether such items fall within the scope of Article 2.

A similar explicit resolution could be applied to software, but efforts to address this issue universally have failed so far. Attempts to expand the UCC to address software and other digital products (e.g., through the proposed Article 2B or the Uniform Computer Information Transactions Act) have been controversial and remain largely unadopted. Thus, the treatment of software and other digital goods continues to be shaped by state-by-state judicial interpretation.

The UCC was a groundbreaking effort to unify commercial law across the United States, and Article 2 remains central to contract law for the sale of goods. However, as the treatment of software demonstrates, the evolution of technology and commerce often outpaces legal frameworks. Students of contract law must navigate these complexities, understanding both the UCC’s provisions and the interpretive variations that arise in practice.

E. Why Does Contract Law Exist?

Contract law is private law. As discussed earlier, private law governs relationships between individuals, as opposed to public law, which addresses relationships between individuals and the state. The Roman jurist Domitius Ulpianus famously explained, “*privatum quod ad singulorum utilitatem*” (“private law exists for the benefit of the individual”). Contract law embodies this principle by enabling individuals to make binding agreements that enhance their lives through cooperation and trade.

However, the maxim “*pacta sunt servanda*”—“promises will be kept”—is not strictly true as a matter of law. While courts never impose contract liability without

some promise, not all broken promises result in legal liability. Why does the law enforce certain promises and not others? Legal scholars and courts have developed several theories to answer this question.

There are four core justifications for why contracts are enforced—economic efficiency, reliance, autonomy, and fairness. While there are many others, these four justifications provide a comprehensive understanding of contract law’s purpose.

1. Economic Efficiency

Economic efficiency is one of the main reasons why contract law enforces promises. Enforcing contracts helps people make voluntary trades that leave both sides better off. When people make agreements, they do so because they expect to benefit from the exchange. Contract law ensures either that promises are kept or that the party who breaks a promise compensates the other for their loss. This reliability makes trading and planning easier and more effective.

For example, imagine someone buying a loaf of bread at a bakery. Economics assumes the buyer values the bread more than the money they spend, while the bakery values the money more than the bread it sells. Both sides gain from the exchange; otherwise, they would not agree to it. This kind of mutually beneficial exchange is called a “gain through trade.” By enforcing promises, contract law facilitates gains through trade that would not otherwise occur. Everyone is made better off.

Not all trades happen immediately. Many agreements are performed over time, and this is where contract law becomes particularly important. Consider an apple farmer in Washington State and a walnut farmer in California. The Washington apple farmer’s harvest is ready in September, but the California walnut farmer’s harvest will not be ripe until late October. Without the rights and remedies of contract law, these farmers might not trust each other enough to trade. The apple farmer might worry about shipping apples in September without a guarantee that walnuts will arrive in October. Contract law solves this problem by making promises enforceable. If one farmer breaks the agreement, the other can go to court to recover the value of the deal. This assurance allows both farmers to trade confidently. The apple farmer avoids wasting surplus apples, and the walnut farmer enjoys fresh apples along with their nuts. Both are better off because contract law enables them to rely on their agreement.

Contract law does more than help individual farmers. It also encourages investments that benefit others. The apple farmer might plant more trees, knowing there is a reliable market for surplus apples. The walnut farmer might expand their orchard, confident they can trade extra walnuts in the future. These investments mean more crops are grown, fewer resources are wasted, and both farmers profit. By enforcing promises, contract law helps people exchange goods and services in ways that improve everyone’s quality of life. Economists would consider this an increase in social welfare, meaning that society as a whole becomes better off.

Economic efficiency does not justify enforcing all contracts, however. Other reasons may influence courts to enforce or not enforce promises.

2. Reliance

Reliance is another important justification for enforcing promises through contract law. Reliance theory focuses on protecting people who act in reliance on a promise, especially when breaking that promise actually causes harm. When someone makes a promise, and another person reasonably relies on that promise to their detriment, contract law can step in to prevent unfair outcomes. The focus is not on encouraging efficient promises but rather on compensating for harms caused by broken promises.

Imagine a homeowner hires a contractor to renovate their kitchen. The contractor promises to start work next month, so the homeowner tears out their old cabinets and appliances to prepare for the project. If the contractor does not show up, the homeowner is left with a torn-up kitchen and no way to cook. Reliance theory explains why the law might enforce the contractor's promise and give the homeowner a remedy. By protecting the homeowner from being harmed by the contractor's broken promise, the law makes it safer for people in the homeowner's position to rely on others' promises and to take significant actions based on them.

This protection is not limited to commercial transactions. Reliance theory also applies in everyday situations. For example, imagine a student promises to babysit for a family on Saturday night. Relying on this promise, the parents buy movie tickets and make dinner reservations. If the student cancels at the last minute, the family might lose the money they spent and have to change their plans. While this may seem like a small matter, reliance theory shows how even everyday promises can affect people's lives. Enforcing these promises, when appropriate, ensures fairness and prevents unnecessary harm.

Reliance theory is the main justification for the legal doctrine of promissory estoppel. As you will learn, promissory estoppel allows courts to enforce promises even when there is no formal bargained-for exchange and, thus, no gain through trade. For promissory estoppel to apply, the person seeking a remedy must prove they reasonably and foreseeably relied on a promise; that this reliance was detrimental to them in some way; and that justice requires enforcing the promise.

By protecting the interests of people who reasonably rely on promises, contract law creates stability and encourages trust. It allows people to take risks and make big plans without fear of being unfairly harmed by broken commitments. Reliance theory ensures that contract law serves not only economic goals but also the fundamental need for fairness in human relationships.

3. Fairness

Some view contract law as a means to ensure fair outcomes. This fairness-based justification for contract law focuses on preventing exploitation and protecting vulnerable parties. While other theories emphasize economic efficiency or the sanctity of promising, fairness theory seeks to ensure that agreements themselves do not lead to unjust harm.

The roots of fairness theory can be traced to the courts of equity. These courts were created to address cases where strict legal rules produced unfair results. Equity allowed judges to provide remedies based on principles of justice rather than rigid rules. Fairness theory follows this tradition. It allows courts to intervene when enforcing a contract would lead to an unjust outcome.

Consider a tenant who signs a lease with a landlord. The lease allows the landlord to evict the tenant without notice or cause. The tenant agrees because they have no other housing options. This agreement might be valid under strict legal rules, but fairness theory—like equity—would question whether it is just. A court could strike down the clause to ensure the tenant is not unfairly harmed.

Fairness theory is especially important in cases involving power imbalances. Large corporations often draft contracts that consumers cannot negotiate. These so-called “contracts of adhesion” are presented on a take-it-or-leave-it basis, with no ability to remove or adjust the terms. Fairness theory supports doctrines like unconscionability, which allows courts to refuse enforcement of one-sided terms. In this way, fairness protects weaker parties in contractual relationships.

Fairness and equity share a common goal: achieving justice. Both accept that flexibility is sometimes necessary to address unique cases. By prioritizing justice, fairness theory ensures that contract law serves society’s broader interests. It reminds us that contract law is not just about enforcing promises. It is also about ensuring that those promises align with principles of justice and equity.

4. Autonomy

Autonomy theory views contract law as a way to respect individual freedom and personal responsibility. It is rooted in classical liberalism, a philosophy that values personal liberty, individual rights, and limited government interference. Classical liberalism assumes that people are best equipped to make decisions about their own lives, including the commitments they choose to undertake. Autonomy theory applies these ideas to contract law, treating contracts as voluntary agreements that reflect personal choice and self-determination.

Autonomy theory treats the very act of promising as morally significant and as an expression of self. Honoring a promise respects both the dignity of the person making the promise and the person relying on it.

A key part of autonomy theory is mutual consent. Contracts are only valid when all parties voluntarily agree to the terms. This means the law will not enforce a contract formed through coercion, fraud, or deceit. For instance, if the artist was tricked into signing the agreement, autonomy theory would argue against enforcement. By requiring genuine consent, contract law protects individual freedom and ensures fairness in agreements.

5. Additional Theories

While the core theories of contract law—economic efficiency, reliance, fairness, and autonomy—provide foundational justifications for enforcing promises, additional perspectives offer important critiques and insights. These perspectives highlight the complexities of contractual relationships and the broader societal implications of contract law. Relational contract theory emphasizes the importance of context and relationships in contractual agreements. Relational theory considers contracts as part of ongoing relationships. Distributive justice theory focuses on how contract law affects social and economic inequalities. It argues that contract law should not only enforce private agreements but also consider the broader implications for fairness in society. Critical legal studies critiques contract law as a tool that reinforces existing power structures and privileges. It argues that the law often masks inequalities by treating parties as if they have equal bargaining power when they do not. Behavioral economics challenges the assumption that individuals always act rationally in making contracts. Cognitive biases, lack of information, and pressure can lead people to make decisions that are not in their best interest. Moral and ethical theories emphasize the intrinsic value of keeping promises. From a moral standpoint, breaking a promise is inherently wrong, regardless of economic or practical considerations. According to this view, contract law should reflect ethical values like trust, integrity, and mutual respect. Utilitarian theory argues that contract law should aim to maximize overall happiness or societal welfare. Enforcing contracts creates predictability and trust, which supports economic growth and cooperation. These perspectives enrich the understanding of contract law by addressing areas that the core theories may overlook.

6. Theory Meets Practice

Theories of contract law help explain why promises are enforced and how the law balances competing values. These theories reveal the deeper purposes behind legal rules, such as encouraging economic cooperation, protecting trust in relationships, and ensuring fairness in outcomes. While this book focuses on what contract law is, understanding these theories offers critical insights into its structure and evolution.

Theories also highlight the inherent trade-offs in contract law. Should the law prioritize predictability for businesses or fairness for individuals? Should it honor personal freedom or guard against exploitation? These questions are not always explicitly

addressed in court decisions, but the theories provide a lens for understanding how courts navigate these tensions. Lawyers who better understand these theories are better able to sway courts to resolve these tensions in favor of their clients.

F. Objectivity and Subjectivity

When courts interpret contracts, they must decide whether to focus on the external evidence of what the parties expressed or the internal understanding of what they intended. These two approaches, the objective view and the subjective view, reflect contrasting philosophies about the role of law in interpreting human relationships. They are called “views” rather than “theories” because they describe practical methods for interpreting agreements rather than broad explanations of why promises are enforced.

The objective view relies on external evidence—what the parties said, wrote, or did—to determine their agreement. Courts favor this approach because it promotes predictability and stability. If parties know their expressed words and actions will govern, they can draft contracts with greater confidence and avoid costly disputes. Written agreements, in particular, are often interpreted based on their plain meaning, with little room for evidence outside the four corners of the document. This approach simplifies the court’s role and reduces the potential for subjective or biased decisions. By relying on what a reasonable person would understand from the language of the contract, courts create a stable framework for interpreting agreements, especially in commercial contexts.

In contrast, the subjective view focuses on uncovering the actual intentions of the parties. This approach considers all available evidence, including context, conduct, and negotiations, to determine what the parties truly meant. While this method can produce fairer outcomes in some cases, it also introduces uncertainty, as courts must evaluate conflicting evidence and determine whose understanding to prioritize.

For example, imagine a buyer and a seller sign a contract for the sale of 100 widgets. The buyer later claims that during their private negotiations, the seller explicitly told them that “widgets” referred to a specific, rare type of high-quality product. However, the written agreement simply states “widgets” without any further description. Under a full-blown subjective approach, the court might admit not only evidence of the verbal agreement but also the buyer’s personal testimony about their private understanding of what “widgets” meant, even if that understanding was never expressed to the seller. The court might prioritize the buyer’s asserted intentions, viewing the “meeting of the minds” as requiring alignment with the buyer’s subjective interpretation of the term.

Such an approach, while potentially fair to the buyer in this scenario, creates significant uncertainty and undermines the stability of contract law. It forces courts to engage in speculative inquiries about individual parties’ unexpressed thoughts, which makes it harder for other parties to rely on contracts as binding agreements.

No significant American jurisdiction today adopts this extreme form of subjectivity. Courts recognize that contracts depend on mutual understanding, but they generally require that this understanding be evidenced through outward expressions—words, conduct, or context. While the subjective view does influence modern contract interpretation in specific circumstances (such as informal agreements or cases involving unique contexts), courts typically balance subjective evidence with objective standards to maintain fairness and predictability.

These approaches are best illustrated by two influential figures in contract law: Samuel Williston, who championed the objective view, and Arthur Corbin, who advocated for a more subjective approach. Their contrasting philosophies reveal the strengths and limitations of each method, and their influence continues to shape how courts interpret contracts today.

Samuel Williston (1861–1963) was a prominent legal scholar and a professor at Harvard Law School. He is best known for advancing the objective theory of contracts, which focuses on external expressions of intent. Williston argued that courts should rely on what the parties said and wrote, not on their unspoken thoughts. This approach promotes clarity and predictability in contract interpretation.

Williston's treatise, *The Law of Contracts* (1920), was foundational to the objective view. He emphasized that the meaning of a contract should be determined by how a reasonable person would interpret the parties' words and actions. This minimizes the role of subjective evidence, such as private intentions or unverifiable testimony. Williston believed this approach makes contracts more reliable and easier to enforce.

As the reporter for the first Restatement, Williston codified his objective principles. The first Restatement directed courts to interpret contracts based on their plain language and to avoid extrinsic evidence unless ambiguity existed. This reinforced the idea that contracts should be judged by their expressed terms.

Williston also distinguished between written and oral contracts. He argued that oral contracts, like those in writing, should be strictly interpreted according to their language. Oral agreements, however, might require some flexibility to account for context. Despite this distinction, Williston consistently prioritized objective evidence over subjective intent.

Williston's work has had a lasting influence on contract law. His objective approach remains central to how courts interpret contracts, particularly in commercial settings. By focusing on expressed intent, Williston helped create a legal framework that values stability, efficiency, and fairness.

Arthur Linton Corbin (1874–1967) was a leading legal scholar and professor at Yale Law School. He is best known for his treatise *Corbin on Contracts*, first published in 1950. Corbin's work shaped modern contract law and heavily influenced the R2d.

Corbin advocated a flexible approach to contract interpretation. He believed that courts should consider the context of an agreement and the parties' actual intentions.



Figure 1.8. Professor Samuel Williston emphasized clarity and predictability in contract law, championing the objective approach that relies on external expressions of intent. Public domain work.

While he recognized the value of external evidence, he argued that relying solely on it could lead to unfair outcomes.

In *Corbin on Contracts*, he emphasized that the meaning of a contract cannot always be determined by its plain language. Instead, courts should examine the circumstances surrounding the agreement. Corbin urged courts to uncover what the parties truly intended, even if their intentions were not perfectly expressed in writing.

Corbin's views shifted contract law toward a more realistic and relational perspective. His influence is clear in the R2d, which reflects his belief that contracts must be interpreted in light of their context. Unlike Williston, Corbin did not insist on strict adherence to formal language. Instead, he sought to balance fairness and predictability.

Corbin's legacy is his emphasis on achieving equitable outcomes. His approach remains a key part of modern contract law, whose aim is to ensure that agreements reflect the actual understanding of the parties when evidence supports it.

Today, courts generally adopt a balanced approach to contract interpretation one that blends elements of both the objective and subjective views. This modern



Figure 1.9. Arthur Corbin, a proponent of the subjective approach, believed courts should uncover the parties' true intentions to reflect the relational nature of contracts. Copyright © Yale Law Journal. Reprinted with permission.

approach seeks to balance the predictability and stability provided by the objective view with the fairness and flexibility offered by the subjective view.

Courts typically start with the objective approach. They first examine the plain language of the contract, focusing on the words and actions that a reasonable person would interpret as expressing the parties' intent. This provides a clear, stable framework for enforcing agreements, especially in commercial transactions where certainty is crucial.

However, when contracts are ambiguous or when external circumstances suggest that the written language does not reflect the parties' actual understanding, courts may look beyond the words on the page. In these cases, they admit subjective evidence—such as negotiations, conduct, and the broader context of the agreement—to discern the parties' true intent. This ensures that contracts are not enforced in ways that lead to unjust or absurd results.

For example, a court interpreting a contract for “delivery by December 1” might initially assume that the phrase refers to the calendar date. But if evidence shows that

both parties understood it to mean “the first shipment date in December,” the court may adopt that interpretation to reflect the parties’ shared intent. This mix of objective and subjective analysis helps courts align contract enforcement with practical realities.

The R2d reflects this modern approach. While it begins with the presumption that contracts should be interpreted based on their plain language, it acknowledges that courts may need to consider external evidence in certain situations. The R2d encourages judges to interpret contracts in ways that uphold both the reasonable expectations of the parties and the practical needs of the transaction.

The modern approach also reflects the influence of economic, relational, and fairness theories. It recognizes that contracts do not exist in isolation but are shaped by the surrounding circumstances and the relationships between the parties. Courts often tailor their interpretation to ensure that agreements are enforced in ways that promote trust and cooperation.

While this approach seeks to strike a balance, it is not without criticism. Some argue that allowing subjective evidence undermines predictability, particularly in commercial contexts. Others contend that relying solely on objective evidence risks ignoring the realities of human relationships. The modern approach attempts to navigate these tensions by combining the strengths of both perspectives.

By blending objective principles with subjective flexibility, the modern approach ensures that contracts are interpreted fairly and predictably. It reflects contract law’s evolution into a system that balances individual rights, economic efficiency, and relational fairness.

G. Reflections on Contract Law

Contract law has developed over thousands of years to meet humanity’s need for trust and cooperation in trade. For millennia, courts have enforced private agreements, thereby encouraging commerce and fostering trust, even among strangers. This essential function remains unchanged, though the doctrines and details continue to evolve. Rooted in Roman law and carried through the Norman Conquest to England, contract law merged with local customs to address the needs of growing societies. The American colonies inherited this legal tradition but adapted it over time, developing distinct approaches as the distance from England and the demands of a new nation shaped its evolution.

Despite these historical shifts, the core purpose of contract law has endured. It remains a system of voluntary liability that supports individual autonomy and economic cooperation. Central to its philosophy are two enduring principles: freedom to contract—the right to make binding agreements—and freedom from contract—the right not to be bound without consent. These principles reflect the balance that contract law strikes between promoting personal choice and ensuring accountability.

While the purpose of contract law has stayed constant, its nuances and doctrines continue to change. As society and technology evolve, so too do the challenges that courts must address. Additionally, because contract law is primarily state-based, its development across the United States has created a patchwork of variations. These differences enrich the field but can also make it harder to identify universal principles.

This course aims to simplify that complexity. By focusing on the common threads of American contract law, it emphasizes the foundational principles that transcend state lines. The goal is to equip students with a clear understanding of what contract law is while leaving space to explore how it continues to adapt to new circumstances.

The enduring legacy of contract law lies in its ability to balance competing values: individual autonomy and fairness, predictability and flexibility, personal rights and collective trust. As you study these principles, you are engaging with more than just legal rules—you are exploring the framework that shapes human cooperation, trade, and the economic relationships that sustain society.

Chapter 2

What Is a Contract?

The most fundamental question in contract law is, what is a contract? Contrary to popular belief, a contract need not be a written document (although some types of contracts must be properly evidenced by a signed memorandum). Rather, the most basic definition of a contract is a promise or set of promises that courts will enforce. This definition, in turn, requires us to define what a promise is. By unpacking the foundational definition in this way, we not only learn the deeper meaning of contract law but also learn how to do the work of contract practice.

Contract practice is primarily about avoiding litigation through careful drafting. By thoughtfully unpacking and describing terms in a manner that clarifies and memorializes two parties' mutual understanding, the contract lawyer adds great value to transactions that thus become more certain and less subject to dispute. You will begin to develop those skills in this first module, where you will be called upon to parse and explain the technical rules found in the R2d and UCC. These skills are applicable to the interpretation of other treatises and statutes, such that the work you do here translates into a higher capacity for doing legal work in other domains.

But things do not always go as planned. Even careful drafting cannot eliminate every risk. Moreover, not all agreements are carefully drafted, and some are not written down at all. There are many reasons for contractual disputes to arise; and then, once again, the contract lawyer adds value by predicting how a court would evaluate the disputed agreement and advising clients on whether and how to negotiate, sue, or settle. (A settlement is a very common type of agreement in which parties agree to give up—settle—their legal claims in exchange for compensation). This book will specifically teach you how to do that work, i.e., recognize whether courts will enforce specific promises, predict how courts might interpret those promises, and identify what remedies courts might award for broken promises. That learning begins with unpacking and understanding the set of rules defining what a contract is and who can form a contract.

Contract law invokes its own use of language. Certain terms that are used in everyday parlance take on a special meaning in contract law. For example, in *Webster's Dictionary*, the word “bargain” is defined as “something acquired by or as if by negotiation.” But, under contract law, bargaining is not synonymous with or even necessarily related to negotiating. Therefore, it is critical to look up the legal and contractual meaning of key terms, and not to rely on intuition or common knowledge.

Rules

A. Contract

The first definition we encounter in this course is, fittingly, R2d § 1, which defines “contract.”

A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.

A contract is simply a legally binding promise or set of promises. Although lay persons may use the term contract to mean a writing that sets forth an agreement, note that a writing is not required by this definition. Contracts can be written or oral. Only a few specific types of contracts need to be evidenced by a writing, as you will learn when studying the so-called “statute of frauds” in Module III, Defenses.

There are several words in the definition of contract which have a precise legal meaning: contract, promise, breach, remedy, performance, and duty are all specific legal words whose meaning may be different from the lay meaning. To understand the meaning of the term “contract,” we thus have to learn the meaning of the other terms used to define it.

Let us look to the R2d for more clarity on what these terms mean in a legal sense.

B. Promise

A contract is a promise or set of promises. A bilateral contract is an exchange of two promises. Each promise is given in exchange for the other. A unilateral contract is a single promise given in exchange for the completion of a requested performance. As you will learn, most promises are enforceable as contracts only if something is given in exchange for the promise. This is called the “consideration.” But some promises can potentially be enforced even if no consideration is given in exchange for the promise. For now, understand that, in all cases, **a contract requires a promise.**

What, then, is a promise? “Promise” is defined in R2d § 2(1):

A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made.

Once again, there are special legal words here that require additional unpacking. In particular, the term “manifestation of intention” is probably not a term you use in everyday speech, and it certainly has a special meaning here. How can we learn the special legal meaning of such words and phrases? Let us turn to *Black’s Law Dictionary* to look up the legal meaning of words like “manifestation.”

Manifestation. A clear sign or indication that a particular situation or feeling exists; that which exhibits, displays, or reveals.

What can we learn from this definition? A manifestation is an external expression—as distinguished from a secret thought or an undisclosed intention. Therefore, contract law must be concerned with outward acts and clear signs, and not with hidden secrets.

Another vital source necessary to understand the meaning of special legal terms is found in the R2d itself. After each rule, you will find a series of comments that help to explain the rule. It is often necessary to read these comments so that you do not make a mistake by attributing a common or lay meaning to a special legal term or concept.

Manifestation of intention. Many contract disputes arise because different people attach different meanings to the same words and conduct. The phrase “manifestation of intention” adopts an external or objective standard for interpreting conduct; it means the external expression of intention as distinguished from undisclosed intention. R2d § 2 cmt. b.

A promise is a manifestation of commitment to do or not to do something. The concept of manifestation, meaning an outward sign or expression, not a privately held thought or belief, is central to contract law. Although a person may harbor some secret intention, contract law will judge that person’s obligations only by what clear signs or indications that person exhibits, displays, or reveals.

Not all promises result in contractual obligations. As you will soon learn, parties can make gratuitous or illusory promises that are not binding as a matter of law. Promises may be morally binding, such that breaking that promise is viewed as a sin or causes feelings of guilt or blame, but contract courts are not arbiters of morality. Promises may be socially binding in that failing to keep them harms one’s reputation or standing in a community, but contract disputes do not pose such matters to courts. Courts enforce only legally binding promises—and the first half of this course is dedicated to answering the question of whether a particular promise is legally binding.

For example, Grandpa promises to give Grandson \$100 on Grandson’s next birthday, and Grandson promises to accept the gift. This is an agreement, but it is not a contract. As you will soon learn, absent specific facts (such as Grandson’s detrimental reliance on Grandpa’s promise), this agreement lacks consideration, so it will be unenforceable as a matter of law. Consideration, again, is what is given in exchange for a promise. Consideration makes that promise enforceable as a matter of law. You will gradually become more comfortable with this concept as you learn to recognize those situations where a promise might be enforceable despite the lack of a consideration.

The R2d gives further information about the actors involved in promising. The suffix “-or” is added to a verb to create a noun that refers to the person who does an action. The suffix “-ee” is added to a verb to create a noun that refers to the person who is affected by the action. The verb “promise,” therefore, is made into the nouns “promisor” and “promisee,” to refer to the parties relevant to this transaction.

Promisor. The person manifesting the intention is the promisor. R2d § 2(2).

A promisor is the subject of the promise, i.e., a promisor is the person who makes the promise. If that promise is legally binding, it is an obligation, and the person who made that promise may thus be termed an “obligor.”

Promisee. The person to whom the manifestation is addressed is the promisee. R2d § 2(3).

A promisee is the object of the promise, i.e., a promisee is the person to whom a promise is made. A person to whom a legally binding promise, or obligation, is made is called an “obligee.”

Beneficiary. Where performance will benefit a person other than the promisee, that person is a beneficiary. R2d § 2(4).

A beneficiary is a person who benefits from a promise but is not a promisor or promisee. Such a person may also be referred to as a “third-party beneficiary.” As you will learn in Chapter 28, such third-party beneficiaries may have certain rights to sue the promisor or even, in certain cases, the promisee.

What have we learned from these terms? We have learned that contracts are only formed when parties make external, outward, objectively understandable statements or take clear and unequivocal actions that demonstrate a commitment to do or not to do something. In other words, contracts are formed by promises. The person who makes a promise is called the “promisor.” The person who receives the promise is called the “promisee.” And a third party who benefits from the promise but is not the promisee is called a “beneficiary.”

C. Agreements and Bargains

The common meaning of the term “agreement” simply means a harmony of opinion. In other words, the common usage of the term does not require any objective manifestation. Under the common usage, you might “agree” with a person who lives in Australia that the sky is blue despite your never having met that person. But this is not what is meant by agreement under contract law. Under contract law, an agreement is a manifestation of mutual assent—an outward expression of mutual understanding between two or more persons. An agreement is active, not passive. The parties’ words and actions must objectively demonstrate their accord.

The R2d § 3 states:

An agreement is a manifestation of mutual assent on the part of two or more persons. A bargain is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances.

Look at the structure of this provision. Do you notice that “agreement” and “bargain” are defined differently? That means that an agreement is distinguished from a

bargain; in other words, the terms “agreement” and “bargain” must mean two different things. In particular, the definition of agreement does not mention the word “promise” at all. Instead, the focus is on whether the parties have achieved mutual assent. In contrast, the definition of a bargain is an agreement to exchange promises, or to exchange a promise for a performance. This is a distinction that makes a difference.

The existence of an agreement does not necessarily create a legally binding obligation. For example, if you call your friend in Australia and discuss your shared belief that the sky is blue or that today is Tuesday, this is an agreement. But this is not a contract. It is not even a bargain. Indeed, it is not even a promise!

A bargain, in contrast, is a subset of agreements, in which both parties agree to do, or refrain from doing, something as part of an exchange. Not all bargains are contracts. Not all bargains are enforceable as a matter of law. Even if the parties agree to exchange something of value, this does not necessarily turn their agreement into a contract. For example, if a hit man agrees to assassinate a targeted person for \$100,000, this is clearly a bargained-for exchange, but courts will not enforce obligations to commit crimes, so the bargain is not a valid contract. Yet this is still a bargain because it is an agreement that takes the form of an exchange of promises.

Note that the legal definition of bargain makes no mention of negotiating or haggling. The term “bargain” sometimes confuses students who associate bargaining with haggling or some other process of negotiation, but this is not what the legal term requires. Parties to a contract do not necessarily haggle or negotiate. Perhaps the symmetrical concept of mutuality of obligation conveys the concept of bargained-for exchange more naturally.

For example, if you go to the Apple store to purchase a new MacBook, you may choose to pay \$200 for the AppleCare extended warranty, but you will not find any opportunity to bargain with Apple regarding the price or terms of that transaction. It is a take-it-or-leave-it offer. Nevertheless, you have in the technical legal sense made a bargained-for exchange, namely, your \$200 in exchange for Apple’s extended warranty coverage. You will learn about warranties later, in Chapter 18.

D. Bargain Contracts and Non-Bargain Contracts

As you have just learned, a contract is a legally binding promise or set of promises. Most contracts are a special type of bargain that consists of an agreement to exchange promises or to exchange a promise for a performance. For example, Grandpa promises Granddaughter that he will give Granddaughter \$100 if Granddaughter will clean Grandpa’s mansion. Granddaughter agrees, promising to clean Grandpa’s mansion. This is a classic bargain contract—an agreement to make an exchange of promises, each of which is supported by mutual assent and consideration. From Grandpa’s perspective, his promise is to pay \$100, and his consideration is getting his mansion

cleaned. From Granddaughter's perspective, her promise is to clean the mansion, and her consideration is getting \$100. To use the technical phrase, both promises are "supported" by consideration.

The classic bargain contract described above is a bilateral contract, which is defined as the exchange of a promise for a promise. Bilateral (going two ways) refers to the symmetrical nature of this classic bargain contract. Each party gives a promise and gets a promise in return. Bilateral also refers to the two ways in which this classical contract can be formed: typically, a party can accept the offer either by promising to perform or by completing the performance. Upon acceptance, each party gains the legal right to sue the other for failure of the promise—subject to the various limitations you will learn about in this book.

Parties can also enter into a unilateral contract, which is defined as the exchange of a promise for performance. For example, Uncle promises to give Nephew \$10,000 if Nephew quits drinking, smoking, and gambling for the next five years. If Nephew successfully completes this requested performance, then Uncle is legally obligated to make good on his promise of the \$10,000. There is still a bargain here. From Uncle's perspective, his promise is to pay \$10,000, and his consideration is his Nephew's specified behavior. From Nephew's perspective, his performance is the behavior, and his consideration is \$10,000. The element of bargain remains the same.

What makes the Uncle-Nephew example different from the Grandpa-Granddaughter one is that Uncle did not seek Nephew's promise. Nephew could not say "Sure thing, Uncle," then take a swig of vodka and sue Uncle for \$10,000. Nor could Uncle sue Nephew for playing cards the following year. Regarding unilateral contracts, one party can accept only by fully performing, while the other party is bound by promising. Unilateral (going one way) refers to the asymmetrical nature of this scenario and to the fact that the offeree can only accept such an offer by completely performing. Unlike bilateral contracts, a return promise does not create a unilateral contract. Instead, unilateral contracts typically take the form of an offer of a reward or a prize for performing in some way, as the Uncle-Nephew example shows.

However, the term "contract" is sometimes used to include legally enforceable promises that are *not* based on a bargain and that entail no bargained-for consideration. For example, Granduncle promises Grandniece that he will give Grandniece \$10,000 at Grandniece's upcoming high school graduation so that Grandniece can pay to go to college. Grandniece agrees and takes out a large loan to attend a university she could not otherwise afford. If Granduncle backs out, a court might enforce Granduncle's promise even though Grandniece gave nothing in exchange for that promise, due to Grandniece's detrimental reliance on Granduncle's promise. Granduncle's promise is not a bargain contract. But a court might nevertheless enforce Granduncle's promise, so it might nonetheless be a contract under the definition put forth in R2d § 1 ("[a] contract is a promise . . . for the breach of which the law gives a remedy . . .").

We can thus distinguish between bargain contracts and non-bargain contracts. A bargain contract is an agreement between two or more parties to a bargain (an exchange)

which creates legally binding, enforceable obligations between them. A bargain contract consists of an exchange of promises (a bilateral contract) or a promise to reward the other party's performance (a unilateral contract). In either case, bargain contracts must be supported by consideration (the other party's promise or performance).

A non-bargain contract is a legally enforceable promise that is *not* based on a bargain but which a court will nonetheless enforce to avoid injustice. A non-bargain contract still requires a promise. Non-bargain contracts may lack the element of bargained-for exchange (consideration), yet they are still enforceable for reasons of fairness and justice. Although non-bargain contracts do not need to be supported by consideration, as bargain contracts do, they must at least include a promise which it would be unjust for the law not to enforce.

In either case, contracts always require at least one promise. Also remember that contract law is voluntary. Unlike death or taxes, which are mandatory regardless of one's intentions or actions, a person must outwardly manifest some intention to be legally bound. The parties must agree—they must mutually assent—to the terms of their agreement; otherwise, they cannot have incurred a voluntary contractual obligation. This means that *contracts are promises that courts enforce*.

E. Distinguishing Common Law Contracts from UCC Contracts

Thankfully, the American Law Institute has made the work of understanding contracts much easier by codifying it. The R2d, while not a perfect representation of the myriad approaches among all the states, is a reasonable approximation of the common law that is well organized and relatively easy to read. Meanwhile, the UCC has been adopted in virtually all U.S. jurisdictions, thus harmonizing the law of sales throughout the country.

This course will teach you the common law of contracts as found in the R2d while pointing out where the UCC differs meaningfully from the common law. Your first task in applying this knowledge will be to determine whether the UCC applies so that you will apply the appropriate body of law.

How do you discern whether the UCC or the common law governs a contract? Most cases are easy to classify. As explained in the introduction, the UCC applies only to contracts for the sale of goods. Goods are defined as things that are movable and identifiable at the time of sale, such as bananas, electronics, or the notorious “widget.” The UCC does not govern contracts for services, such as someone's promise to clean your apartment or a construction company's promise to build you a new roof. The UCC also does not govern contracts involving real property or intellectual property, which are not movable, physical goods.

In close cases, where it is unclear whether something is a contract for the sale of goods or the sale of services, most courts use the predominant purpose test, which

asks whether the predominant purpose of the contract is to sell goods or to sell a service.

For example, Patricia, a homeowner, and Don's Construction Company, a contractor, agree that Don will construct a new addition to Patricia's home and that Don will supply all the materials for this project. Does the UCC or the common law apply? The predominant purpose is the construction services, not the materials, so this is a contract for services, and the common law applies. Evidence supporting this conclusion includes the contractor's primary role (providing construction services) and the proportion of the contract price attributable to services versus goods. For instance, if Patricia agreed to pay Don \$150,000, and if the materials cost \$30,000, then it is clear that services predominate.

In contrast, if Greg's Electrical Supply agreed to supply Patricia with a new television and also agreed to install the television in Patricia's living room, this would be a contract for the sale of goods. Even though Greg's is also supplying the service of installation, the predominant purpose of the contract is to sell Patricia a television. Evidence for this conclusion includes the fact that electrical suppliers typically deal in sales of electrical goods (not installation services, which is an electrician's role) and that the value of the television is the majority of the contract price.

Some jurisdictions recently adopted a new concept of "hybrid transaction." Hybrid transactions are contracts involving the sale of both goods and non-goods components, such as services or leases. In hybrid-transaction jurisdictions, the test that courts apply to determine the governing law remains the same—the predominant purpose test—but the results may differ. If the sale-of-goods aspect predominates, the UCC applies to the entire transaction. However, if the sale-of-goods aspect does not predominate, the UCC applies only to the goods aspect of the transaction, while the non-goods aspects are governed by other laws.

For example, in a hybrid-transaction jurisdiction, Patricia contracts with Kathy's Custom Carpentry to install a new set of cabinets in her kitchen. The UCC would apply to the cabinets themselves (so Patricia would be protected by UCC-mandated warranties, such as the implied warranty of merchantability, if the cabinets failed to stay closed). However, the UCC would not apply to the installation aspect of the transaction (e.g., if Kathy's failed to install the cabinets to level), which would instead be governed by the common law.

The same concepts apply to mixed sales and leases. In a hybrid-transaction jurisdiction, UCC Article 2 applies to the sales aspects, while UCC Article 2A applies to the lease aspects.

For example, Sarah leases a car from a dealership for \$300 per month for 36 months with an option to buy the car at the end of the lease term for \$12,000. The UCC Article 2A provisions regarding leases will apply to issues like the lessor's duty to maintain the vehicle or the lessee's payment obligations. If Sarah exercises her purchase option, the UCC Article 2 provisions on sales, such as implied warranties and delivery terms, govern the final transfer of ownership.

Finally, the question of what law applies only matters where there is a contract. Again, contracts require promises. If there is no promise, there can be no contract liability under either the common law or the UCC.

Cases

Reading Steinberg v. Chicago Medical School. The *Steinberg* case discusses the legal meaning of the term “contract.” The background of the case may be familiar to many students: a prospective student was rejected from a prestigious medical school. Having paid an application fee, the student-plaintiff argued that the medical school had formed a contract with him and others in a similar position. Under the terms of this contract, the prospective student argued, the medical school had promised to evaluate his application fairly and without bias. The prospective student then argued that the school broke its promise by evaluating his application based on his and his family’s ability to make large donations to the school. The issue before the court is whether the application constituted a contract. The answer depends on whether the school’s writings and conduct fell under the definition of a “contract” in a legal sense.

Although contracts are usually formed through a more obvious sequence of offer followed by acceptance of an offer, the definition of “contract” is flexible enough to contemplate many other situations. Even though there was no written document that said “CONTRACT” in all capital letters at the top, it is still possible that a legally binding agreement was formed through this application process. Read *Steinberg* to see how courts will evaluate such claims and how they will define a contract and its key elements in the process.

Steinberg v. Chicago Medical School

69 Ill. 2d 320 (1977)

DOOLEY, Justice.

Robert Steinberg received a catalog, applied for admission to defendant, Chicago Medical School, for the academic year 1974–75, and paid a \$15 fee. He was rejected. Steinberg filed a class action against the school claiming it had failed to evaluate his application and those of other applicants according to the academic criteria in the school’s bulletin. According to the complaint [which is the initial document or “pleading” that starts a civil action in a court of law], defendant used nonacademic criteria, primarily the ability of the applicant or his family to pledge or make payment of large sums of money to the school.

The 1974–75 bulletin distributed to prospective students contained this statement of standards by which applicants were to be evaluated:

Students are selected on the basis of scholarship, character, and motivation without regard to race, creed, or sex. The student's potential for the study and practice of medicine will be evaluated on the basis of academic achievement, Medical College Admission Test results, personal appraisals by a pre-professional advisory committee or individual instructors, and the personal interview, if requested by the Committee on Admissions.

Count I of the complaint alleged breach of contract; count II was predicated on the Consumer Fraud and Deceptive Business Practices Act and the Uniform Deceptive Trade Practices Act; count III charged fraud; and count IV alleged unjust enrichment.

This was sought to be brought as a class action. [A class action is a lawsuit where a single person or small group of people represents the interests of a larger group who are similarly situated.] Accordingly, there were the customary allegations common to such an action.

The trial court dismissed the complaint for failure to state a cause of action. [Dismissing the complaint entirely means that the plaintiff will not be able to prove the merits of any of its claims or "counts."]

The appellate court reversed as to count I, the contract action, and permitted it to be maintained as a limited class action. It affirmed the circuit court's dismissal of the remaining counts II, III, and IV. [Accordingly, the trial court will need to decide the contract claim on its merits.]

The real questions on this appeal are: Can the facts support a charge of breach of contract? Is an action predicated on fraud maintainable? Is this a proper class-action situation? [This edited version of the case will only include portions that are relevant to the breach of contract claim.]

On motion to dismiss we accept as true all well-pleaded facts. [This is a civil procedure concept that essentially means the court will take the facts that the plaintiff alleges in the complaint as true and will then evaluate whether those facts add up to a claim that, if true, would merit legal relief, a "remedy."]

Count I alleges Steinberg and members of the class to which he belongs applied to defendant and paid the \$15 fee, and that defendant, through its brochure, described the criteria to be employed in evaluating applications, but failed to appraise the applications on the stated criteria. On the contrary, defendant evaluated such applications according to monetary contributions made on behalf of those seeking admission.

A contract, by ancient definition, is an agreement between competent parties, upon a consideration sufficient in law, to do or not to do a particular thing.

An offer, an acceptance and consideration are basic ingredients of a contract.

Steinberg alleges that he and others similarly situated received a brochure describing the criteria that defendant would employ in evaluating applications. He urges that

such constituted an invitation for an offer to apply, that the filing of the applications constituted an offer to have their credentials appraised under the terms described by defendant, and that defendant's voluntary reception of the application and fee constituted an acceptance, the final act necessary for the creation of a binding contract.

This situation is similar to that wherein a merchant advertises goods for sale at a fixed price. While the advertisement itself is not an offer to contract, it constitutes an invitation to deal on the terms described in the advertisement. Although in some cases the advertisement itself may be an offer (*see Lefkowitz v. Great Minneapolis Surplus Store, Inc.*), usually it constitutes only an invitation to deal on the advertised terms. Only when the merchant takes the money is there an acceptance of the offer to purchase.

Here the description in the brochure containing the terms under which an application will be appraised constituted an invitation for an offer. The tender of the application, as well as the payment of the fee pursuant to the terms of the brochure, was an offer to apply. Acceptance of the application and fee constituted acceptance of an offer to apply under the criteria defendant had established.

Consideration is a basic element for the existence of a contract. Any act or promise which is of benefit to one party or disadvantage to the other is a sufficient consideration to support a contract. [This is an older definition of consideration that still appears in some court decisions. More modern courts will define consideration as a bargained-for exchange or mutuality of obligation. *See* R2d § 71.]

The application fee was sufficient consideration to support the agreement between the applicant and the school.

Defendant contends that a further requisite for contract formation is a meeting of the minds. But a subjective understanding is not requisite. It suffices that the conduct of the contracting parties indicates an agreement to the terms of the alleged contract.

Williston, in his work on contracts, states: "In the formation of contracts it was long ago settled that secret intent was immaterial, only overt acts being considered in the determination of such mutual assent as that branch of the law requires. During the first half of the nineteenth century there were many expressions which seemed to indicate the contrary. Chief of these was the familiar cliché, still reechoing in judicial dicta, that a contract requires the 'meeting of the minds' of the parties."

Here it would appear from the complaint that the conduct of the parties amounted to an agreement that the application would be evaluated according to the criteria described by defendant in its literature.

Defendant urges [the case of] *People ex rel. Tinkoff v. Northwestern University* controls. There the plaintiff alleged that since he met the stated requirement for admission, it was the obligation of the university to accept him. Plaintiff was first rejected because he was 14 years of age. He then filed a mandamus action [which requests a court to compel performance of a particular act; here, apparently the plaintiff was hoping the court would compel Northwestern University to admit him], and subsequently the university denied his admission, apparently because of the court action.

That decision turned on the fact that Northwestern University, a private educational institution, had reserved in its charter the right to reject any applicant for any reason it saw fit.

Here, of course, defendant had no such provision in its charter or in the brochure in question. But, more important, Steinberg does not seek to compel the school to admit him. The substance of his action is that under the circumstances it was defendant's duty to appraise his application and those of the others on the terms defendant represented.

A medical school is an institution so important to life in society that its conduct cannot be justified by merely stating that one who does not wish to deal with it on its own terms may simply refrain from dealing with it at all.

As the appellate court noted in a recent case in which this defendant was a party:

A contract between a private institution and a student confers duties upon both parties which cannot be arbitrarily disregarded and may be judicially enforced.

Here our scope of review is exceedingly narrow. Does the complaint set forth facts which could mean that defendant contracted, under the circumstances, to appraise applicants and their applications according to the criteria it described? This is the sole inquiry on this motion to dismiss. We believe the allegations suffice and affirm the appellate court in holding count I stated a cause of action.

[Discussions regarding the tort claim of fraud and the class action issues omitted.]

The appellate court was correct in affirming the dismissal of counts II [consumer fraud and deceptive practices] and IV [unjust enrichment] of plaintiff's complaint and in reversing the dismissal of count I [breach of contract] of the complaint. It erred in affirming the dismissal of count III [fraud] and abbreviating the class represented by plaintiff.

The judgment of the appellate court is affirmed in part and reversed in part, and the judgment of the circuit court of Cook County is affirmed in part and reversed in part. The cause is remanded to the circuit court with directions to proceed in a manner not inconsistent with this opinion.

Appellate court affirmed in part and reversed in part; circuit court affirmed in part and reversed in part; cause remanded.

Reflection

The *Steinberg* case discusses what a contract is and how it can be created. It also previews concepts that will be discussed more thoroughly throughout this course. *Steinberg* defines a contract as "an agreement between competent parties, upon a consideration sufficient in law, to do or not to do a particular thing." With this definition, the court points to a contract's most important parts, or basic ingredients: offer, acceptance, and consideration.

According to R2d § 3, an agreement is “a manifestation of mutual assent on the part of two or more persons.” The *Steinberg* defendant incorrectly defined this manifestation of mutual assent as a “meeting of the minds.” But as the *Steinberg* court points out, there does *not* need to be a true meeting of the minds because the agreement is not based on a person’s secret inward intent but on their outward actions.

As you will learn in our first several modules on contract formation, a student or lawyer who wishes to comprehensively analyze whether parties formed a valid contract should make the following inquiries: (1) what promise(s) did the parties make to each other; (2) was the promise which one party seeks to enforce against the other framed as a definite offer to enter a contract; (3) was that offer accepted by the other side before it was terminated; and (4) was that promise supported by a sufficient consideration?

If a contract was formed, the next question is, what exactly did the parties undertake to do or not to do? A court will decide that issue by engaging in contract interpretation and will then inquire into whether the parties actually did those things. In other words, has the contract been breached, and, if so, what remedies should be provided to the aggrieved party?

In *Steinberg*, the court found that even though the medical school did not wish to be bound to a contract, its words and actions may nonetheless have formed one. The elements of offer, acceptance, and consideration were present. However, the *Steinberg* court left for the jury the questions of what promise(s) the school actually made to Steinberg and whether the school breached those promises. In other words, just because Steinberg and the school had a contract, this does not mean that the contract was breached.

Discussion

1. What is a meeting of the minds? When does a meeting of the minds occur?
 2. Why might it be easy or difficult for a court of law to determine whether a subjective meeting of the minds occurred?
 3. Why did the *Steinberg* court determine that this specific application constituted a contract? What does this demonstrate about the legal definition of what a contract is, generally?
 4. Did Chicago Medical School make any promises to its applicants? Did the applicants make any promises to Chicago Medical School in exchange? When answering this question, make sure to cite the R2d’s definition of “promise,” and use that definition to perform analysis of whether any prospective manifestations constituted a promise.
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Reading Pappas v. Bever. As you might already be able to see, whether a contract was formed depends on whether any *promises* were made. This requires a deeper understanding of the promise itself. Understanding what a promise is and being able to recognize both valid and invalid contractual promises is an essential skill for all lawyers who encounter contracts. Contracts usually take the form of a mutual set of promises to do or not to do a particular thing. But what does the law recognize as promises? The next case, *Pappas*, addresses the issue of what constitutes a promise, which is a question at the heart of contract law.

Pappas v. Bever

219 N.W.2d 720 (Iowa 1974)

McCORMICK, Justice.

Plaintiff William Pappas, receiver for Charles City College, appeals trial court's judgment denying enforcement of a fundraising pledge against defendant Sondra Bever, executor of the estate of Philip Bissonnette, Jr. No evidence was offered bearing on the meaning of the pledge instrument. The court held the instrument alone was insufficient to show the pledge was obligatory. We affirm.

In relevant part the executed form read as follows:

I/we intend to subscribe to the College Founder's Fund the sum of Five Thousand—no/100 Dollars.

I intend to pay () Monthly () Quarterly () Semi-Annually (X) Annually over 60/36 months beginning 1967.

Name Philip Bissonnette

Address 301—2nd Ave.

The form was printed except for the blanks designating the amount of the pledge, terms of payment, signature and address of the pledgor. Bissonnette paid \$1,000 on the pledge in 1967 and \$1,000 in 1968. The college closed in May 1968, and he made no further payments prior to his death May 15, 1969.

The same fund-raising project and pledge form were involved in *Pappas v. Hauser*, 197 N.W.2d 607 (Iowa 1972). There the court held extrinsic evidence could be considered in determining whether the parties intended the pledge to be obligatory or not. Such evidence showed the background of the fund-raising drive, preparation of the form and circumstances surrounding its execution, including statements attributed to the college's fund-raiser to the effect the pledge was only a statement of intention and not binding. Based upon this record the court held the pledge to be nonobligatory. Three members of the court concurred, specially on the ground they would

hold the pledge form as illuminated by evidence of background and surrounding circumstances were nonobligatory without resort to the fundraiser's statements. There was no disagreement with the principle that extrinsic evidence is admissible, which throws light on the situation of the parties, antecedent negotiations, the attending circumstances and the objects they were striving to attain.

In the present case the pledge form stands alone, there being no evidence other than the instrument which purports to cast light on its meaning. Thus, we reach the problem not decided in the *Hauser* case, whether the pledge form standing alone is obligatory or not.

Without extrinsic evidence [extrinsic evidence is evidence that comes from facts and circumstances surrounding the contract and not from the written contract itself] bearing upon the intention of the participants, we must attempt to ascertain the meaning and legal effect of the pledge form by giving the language used in the instrument its common and ordinary meaning. No useful purpose would be served by repetition of the authorities treating the meaning of the word "intend" in various contexts. They are collected in *Pappas v. Hauser*. These authorities demonstrate that when words expressing an intention to do something in the future stand alone, they are not a promise and hence do not create an obligation. A mere expression of intention is not a promise.

The distinction between a statement of intention and a promise is explained in 1 Corbin on Contracts § 15 at 35 (1963):

A statement of intention is the mere expression of a state of mind, put in such a form as neither to invite nor to justify action in reliance by another person. A promise is also the expression of a state of mind but put in such a form as to invite reliance by another person.

The language of the pledge form in this case, standing alone, shows nothing more than a statement of intention. There is no evidence the pledge was intended to be obligatory.

Even if the language were viewed as uncertain, the conclusion is the same. In this case, we are dealing with language printed on the pledge form by the fundraiser, and doubtful language in a written instrument is construed against the party who selected it.

Plaintiff contends the fact two payments were made proves the pledge was obligatory. This is a bootstrap argument. The mere fact a person carries out in part what he said he intended to do does not convert his statement of intention into a promise.

It was plaintiff's burden to prove the pledge was intended to be obligatory. We agree with trial court he failed to do so.

Affirmed.

Reflection

By studying *Pappas*, we learn that a statement of intention, such as a pledge form, is a “mere expression of a state of mind” and therefore nonobligatory. When words expressing an intention to do something in the future stand alone, they are not a promise.

A promise is “a manifestation of commitment to do or not to do something.” Promises require manifestations, which are outward signs or expressions that are not privately held thoughts or beliefs. A mere expression of an intention is not a promise.

Without the admission of extrinsic evidence in this case, it is impossible to determine the parties’ intentions. Barring any outside evidence, by filling out the pledge form, Philip Bissonnette, Jr., only made a mere expression of intention to donate to Charles City College. The court determined that his two prior donations did not sufficiently indicate his intent to make more, especially after the college closed. Therefore, the pledge was nonobligatory.

Discussion

1. What is the difference between a “promise” and a “mere statement of intention”? How should courts distinguish between the two?
 2. What legal consequences result from defining a manifestation as a mere statement of intention and not a promise?
 3. Why did the *Pappas* court determine the specific manifestation in this case was not a promise but rather a mere statement of intention? What does this teach about the general legal meaning of the term promise? Cite and use the R2d’s definition of “promise” in conducting this analysis.
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Problems

Problem 2.1. Contract, Agreement, or Bargain?

For each of the following hypothetical situations, identify whether the parties have made a promise, a contract, an agreement, a bargain, or a mere statement of opinion, and explain your reasoning.

1. Sarah Seller orally offers to sell Greenacre to Carlton for \$100,000, and Carlton orally accepts the offer.
2. Bob the Builder is constructing a home for Harry Homemaker. Bob says to Harry, “I warrant that this house will never burn down.”
3. Harry Homemaker is bragging about his new house to his neighbor, Nancy. Harry says to Nancy, “This house will never burn down.”

4. Ernst Employer says to Wanda Worker, “I will employ you for a year at a salary of \$5,000 if I go into business.”
5. Stephen Stargazer remarks to his friend Tom, “That constellation over there is called the ‘Big Dipper.’” Tom replies, “Yes, that’s right.”

Problem 2.2. The Monster and the Beast

The Beastie Boys, a hip-hop group, asked Zach Scaccia, a DJ known as “Z-Trip,” to create a remix of their songs (the “Megamix”) for fans to download for free to promote the Beastie Boys’ then-upcoming album. Z-Trip was later contracted to work as a DJ for energy-drink manufacturer Monster Energy Co.’s (“Monster”) after-party for Monster’s annual snowboarding competition called “Ruckus in the Rockies.” Nelson Phillips, a Monster employee responsible for planning Ruckus in the Rockies, called Z-Trip, spoke to him for about 30 seconds, and asked if there was any music Monster could use for a web-edit of the event. Z-Trip replied that there was, and Monster could download it for free on his website. Later, over breakfast, the two discussed the video, and Phillips said Monster would not publish the video without Z-Trip’s approval. Phillips believed Monster had permission to use the Megamix for Monster’s promotional video because it was “available for free download on [Z-Trip’s] website . . . it’s there for use. For free.”

A few days later, Phillips e-mailed Z-Trip with a link to the video. Phillips explained that, once Z-Trip approved the video, Phillips would post it on Monster’s YouTube channel. Z-Trip replied with “Dope!” and asked Monster to also post a link where people could download it for free. Phillips emailed Z-Trip again, telling him the video was posted, and Z-Trip again replied with “Dope!” The Beastie Boys sued Monster for copyright infringement for using the remix of the band’s songs in Monster’s promotional video.

Monster brought a third-party complaint (a civil procedure concept where a nonparty is brought into the case and can be held liable for plaintiff’s claims) for breach of contract and fraud against Z-Trip. Monster argued that Z-Trip misrepresented himself to Monster as having the authority to license (permit the use of) the copyrighted material in the Megamix. Monster further argued that Z-Trip breached (failed to perform) his obligations to Monster because Z-Trip promised to convey the right to use the Megamix to Monster, but Z-Trip did not have the authority to do so.

Did Z-Trip promise Monster that Monster could use the Megamix for free in their promotional video?

See Beastie Boys v. Monster Energy Co., 983 F. Supp. 2d 338 (S.D.N.Y. 2013).

Problem 2.3. Lifelong Employment

William Greene began working for Grant Building, Inc., in 1959. Greene allegedly agreed to work at a pay rate below union scale in exchange for a promise that Grant would employ him “for life.”

In 1975, Oliver Realty, Inc., took over management of Grant Building. The president of Oliver Realty assured all former Grant employees that their existing employment contracts would be honored.

Greene explained the terms of his agreement to his new supervisor. The supervisor told Greene that he would look into the matter but never got back to Greene.

In 1983, Greene was fired from Oliver Realty. Greene brought an action for breach of contract against Oliver Realty.

Was a valid bargain formed between William Greene and Grant Building, Inc.?

Was a valid bargain formed between William Greene and Oliver Realty, Inc.?

See Greene v. Oliver Realty, Inc., 363 Pa. Super. 534 (1987), *app. denied*.

MODULE I

Mutual Assent

Contractual liability is voluntary. Parties are obligated to perform contractual duties only when they outwardly manifest an intention to be bound by contractual terms. This outward expression of intent is known as **mutual assent**.

“Assent” signifies the act of expressing agreement or willingness to be bound by specific terms. This outward expression can be through words, actions, or other conduct that clearly indicates acceptance of a bargain. Assent is judged by objective criteria, emphasizing what a reasonable person would interpret from the parties’ external behavior.

“Mutual” signifies that both parties must express their willingness to be bound to a bargain for either to incur legal obligations. To grasp this concept fully, it is helpful to preview its relationship with the concept of “consideration,” which is detailed in the next module.

Consideration ensures that enforceable contracts are based on **bargains**. In legal terms, a bargain does not refer to negotiation or haggling; rather, a bargain is an exchange in which each party receives something of value. For example, Abe promises to wash Bob’s car, and Bob promises to pay Abe \$20. For Abe, the consideration is Bob’s promise of payment, while for Bob, the consideration is Abe’s promise to wash the car. This mutual exchange forms a bargain. In contrast, if Abe promises to wash Bob’s car merely because it annoys him personally when the car is dirty, and Bob makes no reciprocal promise, this would not constitute a bargain—though it might still be enforceable under specific circumstances discussed later.

Mutual assent requires both parties to express agreement to the same bargain. In the example, Abe must express his intent to wash Bob's car in exchange for \$20, and Bob must express his intent to pay the \$20 for the car wash. Importantly, this agreement is judged by their external words and actions, not by their internal, unspoken thoughts. This emphasis on *outward* expressions ensures the predictability and fairness of contract law.

Contrary to popular belief, contract law does *not* require a "meeting of the minds." Courts assess contracts **objectively**, based on what the parties say and do rather than their subjective intentions. For example, if Abe clearly states, "I will wash your car for \$20," and Bob responds, "Deal," their mutual assent is legally sufficient, regardless of any hidden doubts or unspoken thoughts.

Contracts consist of two essential elements: **mutual assent** and **consideration**. This fundamental equation can be expressed as:

$$\text{Contract} = \text{Mutual Assent} + \text{Consideration}$$

Mutual assent itself is often analyzed through three key components: offer, termination, and acceptance. This leads to a more detailed formula:

$$\text{Contract} = \text{Offer} - \text{Termination} + \text{Acceptance} + \text{Consideration}$$

An **offer** is a clear proposal by one party (the offeror) to another (the offeree) that manifests an intention to enter into a contract. To be an offer, it must contain the terms of the bargain. If material terms are missing, then it is not an offer but rather an invitation for offers or some other sort of preliminary negotiations.

Termination refers to conditions under which an offer can be revoked or otherwise cease to exist. While contracts are durable, offers are ephemeral. To form a contract, the offeree must accept the terms of the bargain before the offer is terminated.

Acceptance means the offeree's clear and unequivocal agreement to the offer's terms. There are special rules that address what happens when a purported acceptance does not strictly match all the terms of the offer.

Before proceeding, consider why contract law focuses on observable actions and generally ignores states of mind or intent. This is notably different from tort law, which requires intentionality for some torts, and from criminal law, which requires *mens rea* (guilty mind) for certain crimes. Contract law, however, asks how a reasonable person would interpret objective manifestations. How does this different approach in the structure of contract law evidence some difference in its theoretical foundations? Is contract law accomplishing different goals from tort law and criminal law?

Chapter 3

Bargains

Contract formation generally requires parties to agree to a bargain. A bargain involves either (1) an exchange of promises, referred to as a “bilateral contract,” or (2) a promise to reward the completion of a performance, known as a “unilateral contract.” Each type of bargain reflects different ways in which parties can establish mutual commitments, whether through promises or performance.

A typical bilateral contract involves two parties who promise to provide something to one another, perform an act for one another, or refrain from actions that the other party does not want. Crucially, each promise is given in return for the other party’s promise, creating a mutual exchange.

For example, John offers to sell his Honda Civic to Henry for \$10,000, to be exchanged on Friday, and Henry agrees to purchase the car. Here, the parties have exchanged promises: John promises to deliver the car to Henry, and Henry promises to deliver the cash to John. This constitutes a bargain. It takes the form of a bilateral contract because it is formed by an exchange of promises.

The vast majority of contracts are bilateral bargains, where each party makes a promise as part of a mutually agreed exchange. Bilateral contracts dominate in real-world transactions because they provide mutual assurances, allowing parties to plan their obligations with confidence. These contracts are formed when parties manifest assent to the bargain via mutual promises.

In contrast, a unilateral contract is formed when one party promises to reward another party for completing a specific performance. The contract becomes binding only upon the completion of the requested performance.

For example, John promises his son a Honda Civic if his son refrains from drinking alcohol or using tobacco until he turns 25. Here, John’s promise to reward his son with the car is contingent upon his son’s successful performance of abstaining from these activities. This constitutes a unilateral contract because it is formed through the completion of the performance rather than an exchange of promises. It is still a bargain because both parties get something they value from the exchange.

Unilateral contracts are found in situations involving rewards or incentives, such as contests or prizes. Special rules pertaining to unilateral contracts, where one party promises to reward the other for completing a performance, will be discussed further in the next chapter on offers.

Rules

A. Bargain Contracts

Recall the definition of bargain: “A bargain is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances.” R2d § 3. The typical contract requires both a bargain and consideration:

Except as stated in Subsection (2), the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration. R2d § 17(1).

We will learn the details of the consideration doctrine later. For now, simply understand that consideration generally refers to situations in which both parties agreed to the bargain because of what each expected to get from the exchange. The term “contract,” which you read in R2d § 1, and which you should review now, generally refers to R2d § 17(1) bargain contracts, which entail both a bargain and a consideration. This means that both parties must give and get something as part of the deal.

Typically, what parties give each other in a bargain contract are promises to perform in the future. This is also called a “bilateral contract.” In a bilateral contract, both parties are making promises to each other. The consideration doctrine requires that each party’s promise be given in exchange for the other party’s promise. The promises are part of a mutual exchange in which each party, ostensibly, believed they would be made better off.

For example, building on the hypothetical above, John’s promise to sell his Honda Civic to Henry is the consideration supporting Henry’s promise to give John \$10,000; and Henry’s promise to give John \$10,000 is the consideration supporting John’s promise to sell Henry the car. We assume that each party is hoping to be made better off from this exchange because each wants what he is promised to get more than what he promises to give.

Another type of bargain contract is the unilateral contract. This is where the offeree cannot accept by merely promising to perform in the future. Instead, the offeror makes acceptance conditional on full performance. For example, John could say to Henry, “If you want my car, show up at my house with the cash at noon on Friday.” A reasonable interpretation of this statement is that John is not interested in Henry’s promise to pay; rather, he is only willing to obligate himself to sell the car to Henry if and when Henry performs his end of the bargain.

B. Non-Bargain Contracts

This book is principally about bargain contracts, and so, for the most part, we will focus our study on bargain contracts. There are, however, exceptions to this rule. Some special cases do not require bargains. We will briefly discuss two types of non-bargain contracts before returning to the typical bargain contract case.

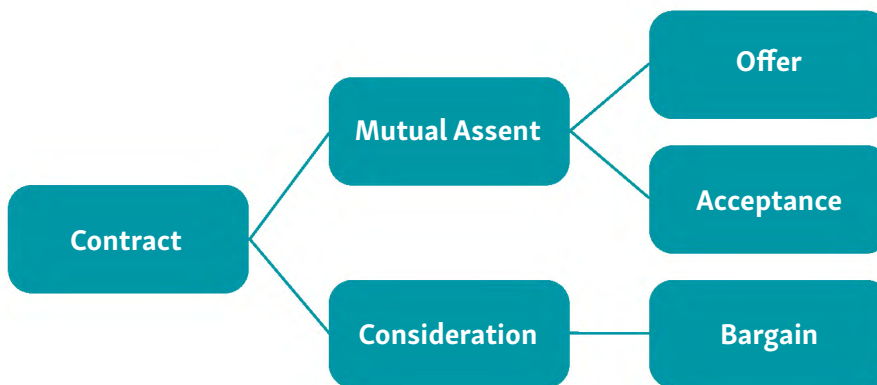


Figure 3.1. Components of a bargain contract.

Recall that Subsection 1 of R2d § 17 said that the formation of a contract requires a bargain *except* as stated in Subsection 2. Now let's look at Subsection 2.

Whether or not there is a bargain a contract may be formed under special rules applicable to formal contracts or under the rules stated in §§ 82–94 [regarding contracts without consideration]. R2d § 17(2).

Thus, there are two exceptions to the rule that contracts require a bargain. We discuss each in turn below. But remember, the exceptions still require there to be at least one promise, and the element of mutual assent still generally must be present. Contractual liability is voluntary. It arises only from promising. Thus, while not all promises result in contractual liability, one cannot incur contractual liability without voluntarily undertaking a contractual duty by making a promise. This is true even for non-bargain contracts.

1. Formal Contracts

The first exception to the rule that all contracts involve bargains is “formal contracts.” Formal contracts are promises that are enforceable, even if they do not entail a bargained-for consideration, because some *formality* is present. The five types of formal contracts recognized in the R2d § 6 are:

- (a) *contracts under seal, a historical artifact involving the imprint of a signet ring into wax affixed to the document, which is not recognized in most modern jurisdictions;*
- (b) *recognizances, such as bail bonds;*
- (c) *negotiable instruments, such as certificates of deposit, promissory notes, bearer bonds, certificates of shares of stock, and other investment securities;*
- (d) *negotiable documents, such as warehouse receipts, bills of lading, and other documents of title; and*
- (e) *letters of credit, which is a promise to honor demands for payment.*

See generally R2d § 6.

Formal contracts, such as promises made under seal, are made enforceable through special processes involving special rules. We will not be studying the special rules for enforcing formal contracts because those rules are beyond the scope of a first-year contract course. They are covered in subject-matter-specific courses dealing with those particular kinds of agreements. Instead, we will be learning the rules that apply to the vast majority of contracts. You should simply be aware that there are such things as formal contracts, such as letters of credit, which may not require consideration due to peculiarities in the historic common law of merchants or state statutes.

2. *Contracts without Consideration*

The second exception is promises that are not supported by bargained-for consideration but are made enforceable in order to prevent injustice, according to the rules stated in R2d §§ 82–94. What are these rules?

R2d §§ 82–94 comprise the section of the R2d titled “Contracts without Consideration.” We have not yet learned the consideration doctrine, which is the subject of its own entire module. But the short version is that consideration is the price paid for a promise. R2d § 71. For example, if you buy a cup of coffee for \$3, the consideration you give to the coffee vendor is the price you pay for the coffee (\$3). Your payment of this price, or even simply your *promise* to pay this price, is the consideration supporting the vendor’s promise to give you the coffee.

R2d §§ 82–94, in contrast, refer to contracts that do not entail this type of bargained-for exchange. As you will learn, the main reason a court would enforce a promise in the absence of a bargain is that justice requires the court to do so. In these cases, courts use their “equitable” powers based on principles of fairness. There are some promises which, while not binding as bargain contracts, should be kept. For example, in the famous case of *Kirksey v. Kirksey*, 8 Ala. 131 (1845), a brother invited his widowed sister-in-law to move onto his land. She moved without giving him anything in exchange for his generous gift. This was not a bargain because there was no exchange and the widow gave nothing in consideration for her brother-in-law’s promise. The brother-in-law then attempted to evict the widow, who would thus become homeless and destitute, along with her children. In that case, the court enforced the brother-in-law’s promise as a matter of equity, or fairness, even though the legal elements of a bargain contract were not met.

We will deal with the enforcement of promises that do not include bargains when we learn the consideration doctrine. That module discusses two alternatives to consideration: promissory restitution, also known as “a promise made for a benefit previously received,” and promissory estoppel, which is sometimes called a “promise reasonably including action or forbearance.” With these exceptions set aside, we shall now proceed with our study of the typical formation of contracts through bargains.

C. Manifestation of Mutual Assent

Contracts require parties to mutually assent to a bargain. It is neither necessary nor sufficient for two parties to privately intend to be bound by a set of promises. Both parties must publicly manifest their intention to form a contract. In other words, mutual assent, in contract law, requires an *outward* manifestation of assent from all parties. A manifestation is a clear sign or indication that a particular situation or feeling exists, or the act of appearing or becoming clear. To express mutual assent, a party must make a promise or engage in conduct that clearly indicates their assent to enter a bargain.

Manifestation of mutual assent to an exchange requires that each party either make a promise or begin or render a performance. R2d § 18.

Contract law recognizes that actions can speak louder than words. Mutual assent can be achieved even if the parties do not exchange a single word. For instance, think of the classic handshake as a way to seal the deal.

The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act. R2d § 19(1).

What happens when someone falsely manifests assent to a contract? For example, what if a seller falsely states their willingness to sell you an expensive watch, and then, after you agree, the seller takes the offer back? What if a partner at a law firm makes you an offer for a summer job, and then, after you agree and eagerly tell your friends, the partner reveals it was only a joke? To put this another way, what happens when a party's objective manifestations do not match their subjective feelings and intentions?

The general rule is that courts apply an objective theory of contract interpretation. "Objective" refers to externally verifiable phenomena, whereas "subjective" refers to an individual's secret thoughts or hidden feelings. The objective theory of contract interpretation means that mutual assent is evaluated from the perspective of a "reasonable person," i.e., it is based on what a reasonable person would understand the parties' words or conduct to mean.

Thus, even though contracts are sometimes referred to as a "meeting of the minds," modern courts generally do not actually require parties to subjectively agree in their minds. Courts only require that the parties manifest assent, giving the outward semblance of agreement. The term "meeting of the minds," because it implies a subjective agreement as well as an objective one, is not an accurate way to describe the requirement of mutual assent.

A fake smile has the same impact as a real one, so long as the observer cannot reasonably tell the difference. Likewise, a fake offer to enter a contract has the same impact as a real one, so long as the person to whom the offer is made cannot reasonably tell the difference. The R2d makes this rule clear in Section 18, comment c, addressing contracts made in sham, or jest:

Where all the parties to what would otherwise be a bargain manifest an intention that the transaction is not to be taken seriously, there is no . . . manifestation of assent to the exchange . . . [However,] [i]f one party is deceived and has no reason to know of the joke the law takes the joker at his word. R2d § 18 cmt. c.

Contracts are a serious matter, and one should not enter contracts lightly. In the case of *Lucy v. Zehmer*, 196 Va. 493 (1954), one party claimed that the contract he wrote and the negotiations leading up to its formation were just a joke. But joking is no defense. If one of the parties takes the joke seriously or if one party is deceived and has no reason to know of the joke, the law takes the joker at his word. A joking contract is still a contract unless both parties are in on the joke or should at least understand that a joke is afoot.

In sum, while a meeting of the minds can be a useful way to think of mutual assent, technically speaking, this is neither necessary nor sufficient for contract formation. It is not enough that two parties subjectively intend to be bound by a set of promises. Both parties must outwardly manifest their intentions. Privately held beliefs do not impact contract formation if they remain unknown to the other party.

D. Misunderstanding: Failure of Mutual Assent

The objective approach to mutual assent tends to make it easier to prove contract liability than a subjective approach because there is no need to prove intent to contract. Again, contracting does not require a meeting of minds. Contracts do not require parties to mean the same thing (subjectively) but to say the same thing (objectively). However, sometimes mutual assent is objectively absent.

A major example of a failure of mutual assent is where the parties have a fundamental misunderstanding about the subject matter, or the terms, of the contract. A misunderstanding occurs where each party has a true belief about what the contract entails, but that belief is not shared by the other party, and neither party has any reason to suspect the other party's meaning. Thus, there is no objective way for a court to determine what they both meant.

The most famous example of a misunderstanding in contract law is *Raffles v. Wichelhaus* (Peerless case), EWHC Exch J19 (1864), in which two parties agreed to ship cotton on a ship named *Peerless*, but, ironically, it turned out that there were two such ships, one departing in October and one in December. The buyer thought the contract referred to the *Peerless* departing in October, but the seller thought the contract referred to the *Peerless* departing in December. The court had no reasonable means of determining which of the two ships the contract referred to and neither party had any reason to know the other's meaning, and so there was no mutual assent, and thus no contract.

Do not confuse a misunderstanding with a mistake. As you will learn in later chapters on defenses to contract formation, a mistake is a belief that is not in accord with

the facts, meaning it is an erroneous perception by one or both parties about some fact or state of the world relating to the contract. A mistake, whether mutual or unilateral, may serve as a defense, and allow the aggrieved party to avoid or rescind the contract, unwinding it as if it never occurred.

But a mistake is different from a failure of mutual assent due to misunderstanding. For example, a mutual mistake would exist in the *Raffles* case if the buyer and seller of cotton agreed that the seller would deliver cotton on a single ship named *Peerless*, but both erroneously believed this ship was departing in October, when in fact it was departing in December. In this counter-factual case, both parties would have made a (mutual) mistake.

Or, if the buyer believed that the sea voyage would take no more than two months when it would in fact require at least three, and if the seller neither knew nor cared how long it would take, then this would be a unilateral mistake. Again, in this counter-factual, the buyer had a belief (the voyage takes two months or less) that is not in accord with the facts (the voyage requires at least three months). This is not a misunderstanding because there is a singular objectively verifiable truth in this instance, and one party was simply wrong.

A misunderstanding, in contrast, occurs where the parties have different but correct beliefs about a material fact relating to the contract. What actually occurred in the *Raffles* case was a misunderstanding, not a mistake. Neither party was mistaken about the state of the world. Both parties correctly understood that cotton would be shipped on a ship named *Peerless*, and they correctly understood when each *Peerless* departed. They simply disagreed over which ship named *Peerless* the contract referred to. They were, so to speak, like ships in the night.

The R2d clarifies that there is no mutual assent, and therefore no contract, where the parties have a total misunderstanding *unless* one of the parties knows or has reason to know of the other party's belief.

There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and . . . neither party knows or has reason to know the meaning attached by the other[.]
R2d § 20(1)(a).

In other words, there *is* mutual assent, despite an actual misunderstanding, if one party knows or has reason to know the meaning attached by the other. Once again, we see the objective view of contracts driving a reasonable interpretation of parties' understanding. The contract is formed based on the meaning of the innocent party. For instance, if the buyer in *Raffles* knew that the seller meant the *Peerless* departing in December, and the seller had no reason to know that the buyer meant the *Peerless* departing in October, then the parties would have had a contract based on the later-departing *Peerless*.

When does a party have reason to know the other party's meaning? According to R2d § 19 cmt. b, "A person has reason to know a fact . . . if he has information from

which a person of ordinary intelligence would infer that the fact in question does or will exist.” It can be difficult or impossible for a judge to determine that a party has this type of inside knowledge. Thus, courts are far more likely to attempt to use contract interpretation tools to find an objectively correct meaning or a subjectively shared meaning, rather than announce a total failure of mutual assent. We will learn how to conduct contract interpretation and resolve ambiguities in contract language in Chapter 14.

E. Reflections on Bargains

The unifying principle of contract law is voluntary agreement. Parties choose whether or not to make promises. Then, contract law may require them to keep those promises. Contract law will not bind parties to promises they did not make. At the same time, contract law *will* bind parties to promises they *appeared* to make, based on an objective assessment of their words or conduct.

Before you jump to the conclusion that this is unfair, recognize that other areas of common law—such as property, torts, and restitution—and many forms of statutory law will hold people responsible for non-promissory actions. For example, a landowner who recklessly disregards a known hazard on his property may be liable for injuries to visitors under the law of property. A celebrity who profits by promoting a baseless investment opportunity may be liable under the securities law. Contract law does not operate in a vacuum, although law school may initially give students that impression.

Thus, contract law focuses on parties’ willingness to enter into a transaction. In general, contract law requires both parties to express this willingness under specific conditions. The remainder of this module covers those conditions, which are analytically separated into three phases: offer, termination of the offer, and acceptance of the offer.

Cases

Reading Lucy v. Zehmer. The *Lucy* case has become a law school favorite due to its colorful characters and vivid details, which also make it easy to remember. But while the facts are fun, it’s equally important to extract the holdings and reasoning, which tell us how contract law will be interpreted more generally.

The central lesson in this case comes from the fact that one party claims to have been “just bluffing” when he bargained and agreed to sell his farm. In technical terms, the seller had a subjective and privately held belief that the bargaining was just a joke. Unfortunately for the seller, however, the joke was

not obvious to the buyer or to a third-party observer. Thus, the seller was held to his bluff.

As you read this case, think about why contract law focuses on objective and outward manifestations that signify assent to be bound by contracts instead of focusing on or including what parties privately thought or secretly believed at the time of contract formation. What might be the reasoning for the requirement of an objective manifestation of intent to be bound by contractual terms? How might commerce and the economy function differently if the law enforced private opinions and secret beliefs instead of focusing on what parties objectively say and do?

Lucy v. Zehmer

196 Va. 493 (1954)

BUCHANAN, J., delivered the opinion of the court.

This suit was instituted by W.O. Lucy and J.C. Lucy, complainants, against A.H. Zehmer and Ida S. Zehmer, his wife, defendants, to have specific performance of a contract by which it was alleged the Zehmers had sold to W.O. Lucy a tract of land owned by A.H. Zehmer in Dinwiddie County containing 471.6 acres, more or less, known as the Ferguson farm, for \$50,000. J.C. Lucy, the other complainant, is a brother of W.O. Lucy, to whom W.O. Lucy transferred a half interest in his alleged purchase.

The instrument sought to be enforced was written by A.H. Zehmer on December 20, 1952, in these words: "We hereby agree to sell to W.O. Lucy the Ferguson Farm complete for \$50,000.00, title satisfactory to buyer," and signed by the defendants, A.H. Zehmer and Ida S. Zehmer.

The answer of A.H. Zehmer admitted that at the time mentioned W.O. Lucy offered him \$50,000 cash for the farm, but that he, Zehmer, considered that the offer was made in jest; that so thinking, and both he and Lucy having had several drinks, he wrote out "the memorandum" quoted above and induced his wife to sign it; that he did not deliver the memorandum to Lucy, but that Lucy picked it up, read it, put it in his pocket, attempted to offer Zehmer \$5 to bind the bargain, which Zehmer refused to accept, and realizing for the first time that Lucy was serious, Zehmer assured him that he had no intention of selling the farm and that the whole matter was a joke. Lucy left the premises insisting that he had purchased the farm.

Depositions were taken and the decree appealed from was entered holding that the complainants had failed to establish their right to specific performance and dismissing their bill. The assignment of error is to this action of the court.

W.O. Lucy, a lumberman and farmer, thus testified in substance: He had known Zehmer for fifteen or twenty years and had been familiar with the Ferguson farm for

ten years. Seven or eight years ago he had offered Zehmer \$20,000 for the farm which Zehmer had accepted, but the agreement was verbal and Zehmer backed out.

On the night of December 20, 1952, around eight o'clock, he took an employee to McKenney, where Zehmer lived and operated a restaurant, filling station and motor court. While there he decided to see Zehmer and again try to buy the Ferguson farm. He entered the restaurant and talked to Mrs. Zehmer until Zehmer came in. He asked Zehmer if he had sold the Ferguson farm. Zehmer replied that he had not. Lucy said, "I bet you wouldn't take \$50,000.00 for that place." Zehmer replied, "Yes, I would too; you wouldn't give fifty." Lucy said he would and told Zehmer to write up an agreement to that effect.

Zehmer took a restaurant check and wrote on the back of it, "I do hereby agree to sell to W.O. Lucy the Ferguson Farm for \$50,000 complete." Lucy told him he had better change it to "We" because Mrs. Zehmer would have to sign it too. Zehmer then tore up what he had written, wrote the agreement quoted above and asked Mrs. Zehmer, who was at the other end of the counter ten or twelve feet away, to sign it. Mrs. Zehmer said she would for \$50,000 and signed it. Zehmer brought it back and gave it to Lucy, who offered him \$5 which Zehmer refused, saying, "You don't need to give me any money, you got the agreement there signed by both of us."

The discussion leading to the signing of the agreement, said Lucy, lasted thirty or forty minutes, during which Zehmer seemed to doubt that Lucy could raise \$50,000. Lucy suggested the provision for having the title examined and Zehmer made the suggestion that he would sell it "complete, everything there," and stated that all he had on the farm was three heifers.

Lucy took a partly filled bottle of whiskey into the restaurant for the purpose of giving Zehmer a drink if he wanted it. Zehmer did, and he and Lucy had one or two drinks together. Lucy said that while he felt the drinks he took, he was not intoxicated, and from the way Zehmer handled the transaction he did not think he was either.

The next day Lucy telephoned to J.C. Lucy and arranged with the latter to take a half interest in the purchase and pay half of the price. On Monday he engaged an attorney to examine the title. The attorney reported favorably, and Lucy wrote Zehmer stating that the title was satisfactory, that he was ready to pay the purchase price in cash and asked when Zehmer would be ready to close the deal. Zehmer replied by mailed letter, asserting that he had never agreed or intended to sell.

Mr. and Mrs. Zehmer were called by the complainants as adverse witnesses. Zehmer testified in substance as follows: He bought this farm more than ten years ago for \$11,000. He had had twenty-five offers, to buy it, including several from Lucy, who had never offered any specific sum of money. He had given them all the same answer, that he was not interested in selling it. On the night before Christmas, everybody and his brother came by to have a drink. He took a good many drinks during the afternoon and had a pint of his own. When he entered the restaurant around eight-thirty Lucy was there and he could see that he was "pretty high." He said to Lucy, "Boy, you got some good liquor, drinking, ain't you?" Lucy then offered him a drink. "I was already

high as a Georgia pine and didn't have any better sense than to pour another great big slug out and gulp it down, and he took one too."

After they had talked a while Lucy asked whether he still had the Ferguson farm. He replied that he had not sold it and Lucy said, "I bet you wouldn't take \$50,000.00 for it." Zehmer asked him if he would give \$50,000 and Lucy said yes. Zehmer replied, "You haven't got \$50,000 in cash." Lucy said he did and Zehmer replied that he did not believe it. They argued "pro and con for a long time," mainly about "whether he had \$50,000 in cash that he could put up right then and buy that farm."

Finally, said Zehmer, Lucy told him if he didn't believe he had \$50,000, "you sign that piece of paper here and say you will take \$50,000.00 for the farm." He, Zehmer, "just grabbed the back off of a guest check there" and wrote on the back of it. At that point in his testimony Zehmer asked to see what he had written to "see if I recognize my own handwriting." He examined the paper and exclaimed, "Great balls of fire, I got 'Firgerson' for Ferguson. I have got satisfactory spelled wrong. I don't recognize that writing if I would see it, wouldn't know it was mine."

After Zehmer had, as he described it, "scribbled this thing off," Lucy said, "Get your wife to sign it." Zehmer walked over to where she was and she at first refused to sign but did so after he told her that he "was just needling him [Lucy], and didn't mean a thing in the world, that I was not selling the farm." Zehmer then "took it back over there . . . and I was still looking at the dern thing. I had the drink right there by my hand, and I reached over to get a drink, and he said, 'Let me see it.' He reached and picked it up, and when I looked back again, he had it in his pocket and he dropped a five-dollar bill over there, and he said, 'Here is five dollars payment on it.' I said, 'Hell no, that is beer and liquor talking. I am not going to sell you the farm. I have told you that too many times before.'"

Mrs. Zehmer testified that when Lucy came into the restaurant he looked as if he had had a drink. When Zehmer came in he took a drink out of a bottle that Lucy handed him. She went back to help the waitress who was getting things ready for next day. Lucy and Zehmer were talking but she did not pay too much attention to what they were saying. She heard Lucy ask Zehmer if he had sold the Ferguson farm, and Zehmer replied that he had not and did not want to sell it. Lucy said, "I bet you wouldn't take \$50,000 cash for that farm," and Zehmer replied, "You haven't got \$50,000 cash." Lucy said, "I can get it." Zehmer said he might form a company and get it, "but you haven't got \$50,000.00 cash to pay me tonight." Lucy asked him if he would put it in writing that he would sell him this farm. Zehmer then wrote on the back of a pad, "I agree to sell the Ferguson Place to W.O. Lucy for \$50,000.00 cash." Lucy said, "All right, get your wife to sign it." Zehmer came back to where she was standing and said, "You want to put your name to this?" She said "No," but he said in an undertone, "It is nothing but a joke," and she signed it.

She said that only one paper was written, and it said: "I hereby agree to sell," but the "I" had been changed to "We." However, she said she read what she signed and was then asked, "When you read 'We hereby agree to sell to W.O. Lucy,' what did you

interpret that to mean, that particular phrase?” She said she thought that was a cash sale that night; but she also said that when she read that part about “title satisfactory to buyer” she understood that if the title was good Lucy would pay \$50,000 but if the title was bad, he would have a right to reject it, and that that was her understanding at the time she signed her name.

On examination by her own counsel, she said that her husband laid this piece of paper down after it was signed; that Lucy said to let him see it, took it, folded it and put it in his wallet, then said to Zehmer, “Let me give you \$5.00,” but Zehmer said, “No, this is liquor talking. I don’t want to sell the farm, I have told you that I want my son to have it. This is all a joke.” Lucy then said at least twice, “Zehmer, you have sold your farm,” wheeled around and started for the door. He paused at the door and said, “I will bring you \$50,000.00 tomorrow. No, tomorrow is Sunday. I will bring it to you Monday.” She said you could tell that he was drinking, and she said to her husband, “You should have taken him home,” but he said, “Well, I am just about as bad off as he is.”

The waitress referred to by Mrs. Zehmer testified that when Lucy first came in “he was mouthy.” When Zehmer came in they were laughing and joking, and she thought they took a drink or two. She was sweeping and cleaning up for next day. She said she heard Lucy tell Zehmer, “I will give you so much for the farm,” and Zehmer said, “You haven’t got that much.” Lucy answered, “Oh, yes, I will give you that much.” Then “they jotted down something on paper . . . and Mr. Lucy reached over and took it, said let me see it.” He looked at it, put it in his pocket and in about a minute he left. She was asked whether she saw Lucy offer Zehmer any money and replied, “He had five dollars laying up there, they didn’t take it.” She said Zehmer told Lucy he didn’t want his money “because he didn’t have enough money to pay for his property and wasn’t going to sell his farm.” Both appeared to be drinking right much, she said.

She [the waitress] repeated on cross-examination that she was busy and paying no attention to what was going on. She was some distance away and did not see either of them sign the paper. She was asked whether she saw Zehmer put the agreement down on the table in front of Lucy, and her answer was this: “Time he got through writing whatever it was on the paper, Mr. Lucy reached over and said, ‘Let’s see it.’ He took it and put it in his pocket,” before showing it to Mrs. Zehmer. Her version was that Lucy kept raising his offer until it got to \$50,000.

The defendants insist that the evidence was ample to support their contention that the writing sought to be enforced was prepared as a bluff or dare to force Lucy to admit that he did not have \$50,000; that the whole matter was a joke; that the writing was not delivered to Lucy and no binding contract was ever made between the parties.

It is an unusual, if not bizarre, defense. When made to the writing admittedly prepared by one of the defendants and signed by both, clear evidence is required to sustain it.

In his testimony Zehmer claimed that he “was high as a Georgia pine,” and that the transaction “was just a bunch of two doggoned drunks bluffing to see who could talk the biggest and say the most.” That claim is inconsistent with his attempt to testify in

detail as to what was said and what was done. It is contradicted by other evidence as to the condition of both parties and rendered of no weight by the testimony of his wife that when Lucy left the restaurant, she suggested that Zehmer drive him home. The record is convincing that Zehmer was not intoxicated to the extent of being unable to comprehend the nature and consequences of the instrument he executed, and hence that instrument is not to be invalidated on that ground. It was in fact conceded by defendants' counsel in oral argument that under the evidence Zehmer was not too drunk to make a valid contract.

The evidence is convincing also that Zehmer wrote two agreements, the first one beginning "I hereby agree to sell." Zehmer first said he could not remember about that, then that "I don't think I wrote but one out." Mrs. Zehmer said that what he wrote was "I hereby agree," but that the "I" was changed to "We" after that night. The agreement that was written and signed is in the record and indicates no such change. Neither are the mistakes in spelling that Zehmer sought to point out readily apparent.

The appearance of the contract, the fact that it was under discussion for forty minutes or more before it was signed; Lucy's objection to the first draft because it was written in the singular, and he wanted Mrs. Zehmer to sign it also; the rewriting to meet that objection and the signing by Mrs. Zehmer; the discussion of what was to be included in the sale, the provision for the examination of the title, the completeness of the instrument that was executed, the taking possession of it by Lucy with no request or suggestion by either of the defendants that he give it back, are facts which furnish persuasive evidence that the execution of the contract was a serious business transaction rather than a casual, jesting matter as defendants now contend.

On Sunday, the day after the instrument was signed on Saturday night, there was a social gathering in a home in the town of McKenney at which there were general comments that the sale had been made. Mrs. Zehmer testified that on that occasion as she passed by a group of people, including Lucy, who were talking about the transaction, \$50,000 was mentioned, whereupon she stepped up and said, "Well, with the high-price whiskey you were drinking last night you should have paid more. That was cheap." Lucy testified that at that time Zehmer told him that he did not want to "stick" him or hold him to the agreement because he, Lucy, was too tight and didn't know what he was doing, to which Lucy replied that he was not too tight; that he had been stuck before and was going through with it. Zehmer's version was that he said to Lucy: "I am not trying to claim it wasn't a deal on account of the fact the price was too low. If I had wanted to sell \$50,000.00 would be a good price, in fact I think you would get stuck at \$50,000.00." A disinterested witness testified that what Zehmer said to Lucy was that "he was going to let him up off the deal, because he thought he was too tight, didn't know what he was doing. Lucy said something to the effect that 'I have been stuck before and I will go through with it.'"

If it be assumed, contrary to what we think the evidence shows, that Zehmer was jesting about selling his farm to Lucy and that the transaction was intended by him to be a joke, nevertheless the evidence shows that Lucy did not so understand it but

considered it to be a serious business transaction and the contract to be binding on the Zehmers as well as on himself. The very next day he arranged with his brother to put up half the money and take a half interest in the land. The day after that he employed an attorney to examine the title. The next night, Tuesday, he was back at Zehmer's place and there Zehmer told him for the first time, Lucy said, that he wasn't going to sell, and he told Zehmer, "You know you sold that place fair and square." After receiving the report from his attorney that the title was good, he wrote to Zehmer that he was ready to close the deal.

Not only did Lucy actually believe, but the evidence shows he was warranted in believing, that the contract represented a serious business transaction and a good faith sale and purchase of the farm.

In the field of contracts, as generally elsewhere,

We must look to the outward expression of a person as manifesting his intention rather than to his secret and unexpressed intention. The law imputes to a person an intention corresponding to the reasonable meaning of his words and acts.

At no time prior to the execution of the contract had Zehmer indicated to Lucy by word or act that he was not in earnest about selling the farm. They had argued about it and discussed its terms, as Zehmer admitted, for a long time. Lucy testified that if there was any jesting it was about paying \$50,000 that night. The contract and the evidence show that he was not expected to pay the money that night. Zehmer said that after the writing was signed, he laid it down on the counter in front of Lucy. Lucy said Zehmer handed it to him. In any event there had been what appeared to be a good faith offer and a good faith acceptance, followed by the execution and apparent delivery of a written contract. Both said that Lucy put the writing in his pocket and then offered Zehmer \$5 to seal the bargain. Not until then, even under the defendants' evidence, was anything said or done to indicate that the matter was a joke. Both of the Zehmers testified that when Zehmer asked his wife to sign he whispered that it was a joke so Lucy wouldn't hear and that it was not intended that he should hear.

The mental assent of the parties is not requisite for the formation of a contract. If the words or other acts of one of the parties have but one reasonable meaning, his undisclosed intention is immaterial except when an unreasonable meaning which he attaches to his manifestations is known to the other party.

The law, therefore, judges of an agreement between two persons exclusively from those expressions of their intentions which are communicated between them.

An agreement or mutual assent is of course essential to a valid contract but the law imputes to a person an intention corresponding to the reasonable meaning of his words and acts. If his words and acts, judged by a reasonable standard, manifest an intention to agree, it is immaterial what may be the real but unexpressed state of his mind.

So, a person cannot set up that he was merely jesting when his conduct and words would warrant a reasonable person in believing that he intended a real agreement.

Whether the writing signed by the defendants and now sought to be enforced by the complainants was the result of a serious offer by Lucy and a serious acceptance by the defendants or was a serious offer by Lucy and an acceptance in secret jest by the defendants, in either event it constituted a binding contract of sale between the parties.

Defendants contend further, however, that even though a contract was made, equity should decline to enforce it under the circumstances. These circumstances have been set forth in detail above. They disclose some drinking by the two parties but not to an extent that they were unable to understand fully what they were doing. There was no fraud, no misrepresentation, no sharp practice and no dealing between unequal parties. The farm had been bought for \$11,000 and was assessed for taxation at \$6,300. The purchase price was \$50,000. Zehmer admitted that it was a good price. There is in fact present in this case none of the grounds usually urged against specific performance.

Specific performance, it is true, is not a matter of absolute or arbitrary right, but is addressed to the reasonable and sound discretion of the court. But it is likewise true that the discretion which may be exercised is not an arbitrary or capricious one, but one which is controlled by the established doctrines and settled principles of equity; and, generally, where a contract is in its nature and circumstances unobjectionable, it is as much a matter of course for courts of equity to decree a specific performance of it as it is for a court of law to give damages for a breach of it.

The complainants are entitled to have specific performance of the contracts sued on. The decree appealed from is therefore reversed and the cause is remanded for the entry of a proper decree requiring the defendants to perform the contract in accordance with the prayer of the bill.

Reversed and remanded.

Reflection

Lucy v. Zehmer demonstrates that courts determine the existence of an agreement between parties by looking at their outward manifestations. For a contract to exist, there needs to be an agreement between the parties. The law judges that agreement based on the reasonable meaning of parties' outward conduct (objective manifestations), and not their secret inward intent (subjective beliefs).

Thus, the court will not look at whether Zehmer was secretly joking but rather at his outward manifestations and whether they warranted a reasonable person in believing that Zehmer intended a real agreement. If you were standing behind Lucy at the restaurant, as an impartial third party, would you think that Zehmer's conduct and words justified Lucy's thinking that there was an agreement to sell the farm?

The moral of *Lucy* is that contracts are not joking matters, and courts will bind parties at their word. It would be far too easy to avoid deals if a party could simply

claim it was merely joking. How would a court ever prove otherwise? And if contracts can be so easily avoided, how would people be able to rely on them such that commerce could proceed between strangers? The rule must be that contractual intent is measured objectively, as it was in *Lucy*, if contracts are to have much effect at all.

Discussion

1. In *Lucy*, does the court inquire whether the parties subjectively and secretly intended to contract? Why or why not?
 2. Think of any situation where a joke should not be construed as a contract. Can you distinguish that situation from the facts of *Lucy*?
 3. Contracts are often referred to as a meeting of the minds. Did the parties have a meeting of the minds in this case? If not, what does that signify about the trope that contracts are a meeting of the minds?
-
-

Reading Raffles v. Wichelhaus. A misunderstanding is where parties have different, though correct, beliefs about some material fact related to the contract and thus fail to reach mutual assent to the terms of the deal.

The next case is both very famous and notoriously cryptic. The *Peerless* case is about a misunderstanding so fundamental that it causes a failure of mutual assent.

The essence of the facts are as follows. The buyer, Wichelhaus, agreed to purchase 125 bales of Surat cotton from Raffles, a merchant in Bombay, India. Raffles agreed to deliver the cotton to Liverpool, England via a ship named *Peerless*.

Contracts in those days often referred to a specific ship in order to set the agreed-upon time for delivery. It was commonly understood that a specific ship would sail at a specific time.

The time of delivery can matter a great deal in certain business arrangements. But, in this case, the parties had a misunderstanding that went to the heart of the contract.

Unbeknownst to the parties, there was not just one ship named *Peerless*. Rather, there were two ships with that same name. One of the ships *Peerless* was to set sail in October and the other *Peerless* was to sail in December. The seller (Raffles) apparently knew only of the December *Peerless*, while the buyer (Wichelhaus) had the October *Peerless* in mind.

This is a classic example of a total misunderstanding, where both parties were each correct about their own version of the facts, but they did not share a common understanding.

The famous *Peerless* case is appended below so that students can puzzle over it for themselves. But do not be dismayed if you find it impenetrable, as commentators no less prestigious than Oliver Wendall Holmes, Samuel Williston, Arthur Corbin, and Grant Gilmore cannot seem to agree on its meaning.

Raffles v. Wichelhaus

2 EWHC Exch J19 (1864) (*Peerless* Case)

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, guaranteed 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 17-d. 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, at 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.

[Procedural posture:] Demurrer, and joinder therein.

[Opinion by Judge] MILWARD, in support of the demurrer.

The contract was 1864 for the sale of a number of bales of cotton of a particular RAFFLES 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), in support of the plea.—There is nothing on the face of the contract to shew 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 shewing that the defendant meant one “Peerless” and the plaintiff another. That being so, there was no consensus ad idem, and therefore no binding contract.

(He was then stopped by the Court.)

PER CURIAM. There must be judgment for the defendants.

Reflection

The *Peerless* case illustrates how a fundamental misunderstanding about a material term can prevent the formation of a contract because mutual assent is lacking. Imagine you’re adopting a dog from a shelter and drafting a pet adoption contract based on a description provided over the phone: a black-and-white dog weighing about 50 pounds. You reasonably envision the Border Collie you had seen on the shelter’s website, while the shelter employee, also reasonably, believes you’re adopting a Dalmatian matching the same description that had arrived recently and wasn’t yet listed online. Because neither party specifies the dog’s breed or other unique identifiers, you both sign the contract believing you’ve agreed on the same animal, when, in reality, you each have different dogs in mind. This kind of misunderstanding about a material term—where both interpretations are reasonable but irreconcilable—prevents the formation of a valid contract. Similarly, in *Raffles v. Wichelhaus*, each party reasonably but mistakenly believed the term “*Peerless*” referred to a different ship, leading to a failure of mutual assent and an unenforceable agreement.

Discussion

1. In *Lucy*, the court determined there was a contract, but in *Peerless*, the court determined there was no contract. Can you distinguish factually between the cases and explain why these different facts should lead to a different legal result?
2. Identify the specific misunderstanding in the *Peerless* case. Can you use this situation to generalize about how the court will treat misunderstandings?

Problems

Problem 3.1. Can Machines Form Mutual Assent?



Figure 3.2. Travel insurance vending machine in a Japanese airport.

Source: Benzoyl (Flickr), CC BY-SA 2.0.

Sadie Bernstein, a resident of New York City, decided to travel to Miami, Florida, to get away for the winter. On December 16, 1951, she went to Newark Airport (just outside of New York City, in the State of New Jersey) to purchase an airplane ticket. Just before reaching the ticket counter, Bernstein observed a prominent machine with

a well-illuminated display of airplanes flying round and round. The machine was installed by the Fidelity & Casualty Company of New York, an insurance provider. A printed placard on the machine read the following in very large block letters:

*DOMESTIC AIRLINE TRIP INSURANCE 25¢ FOR EACH \$5,000
MAXIMUM \$25,000.*

[This is equivalent to about \$2.50 per \$50,000 of insurance up to a maximum of \$250,000 in today's money.]

Bernstein inserted five quarters (\$1.25) into the machine. The machine opened, and from inside its slot, Bernstein removed an insurance policy application form. She used a pen that was affixed to the machine to fill out the form, which included the departure and destination cities and the name of the airline. Bernstein replaced the completed application in the slot and pressed a button labeled "SUBMIT." The machine closed its slot and then printed out a policy that was twenty-two pages long. The first page of the policy contained a clause titled "Coverage." This provision limited coverage to "civilian scheduled airlines," although Bernstein did not read the policy.

Bernstein then went to the Miami Airlines counter and purchased a ticket for travel from Newark to Miami. Three to four feet from the counter was a large sign that listed which non-scheduled airlines were permitted to conduct business in the terminal. Miami Airlines was listed as a non-scheduled airline, although Bernstein did not notice that sign.

Bernstein boarded her flight on Miami Airlines, which, unfortunately, crashed en route. She subsequently died in the plane crash. Her beneficiary, Marion Lachs, sued to recover the amount of the policy.

In a lawsuit by Lachs against Fidelity to recover the amount of the policy, should a court find that there was mutual assent between Bernstein and Fidelity, despite the use of the vending machine?

See Lachs v. Fid. & Cas. Co. of New York, 118 N.E.2d 555 (N.Y. 1954).

Problem 3.2. Misunderstanding the Triangle

Ernest and Evelyn Chilson owned approximately twenty acres of land. The land, although contiguous, could be easily divided into three distinct units (see figure). The property was divided by Butler Avenue. The largest parcel of land was 17.3 acres and referred to as "Butler North." "Butler South" was approximately 4.3 acres, and finally, a small parcel of land above Butler North was called "The Triangle" and was approximately 2.4 acres. The Chilsons originally acquired the property in two separate transactions, then later directed a title agency to prepare one deed for the whole property.

In December 1984, the Chilsons listed Unit 1 and Unit 2 with a broker, seeking a tenant for a long-term lease. Daniel Hill and Craig Shafer saw a sign and inquired

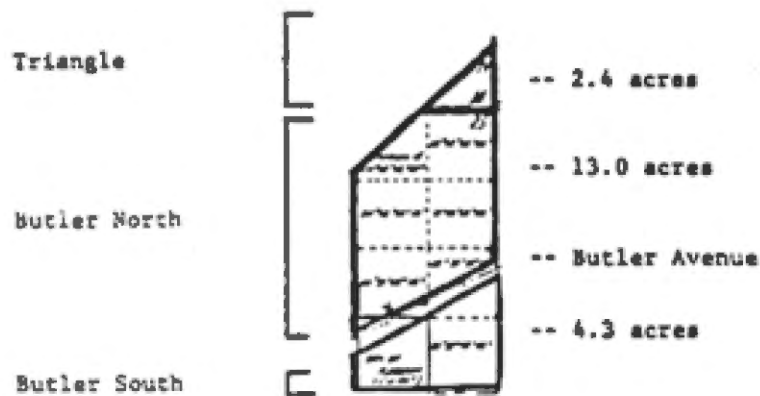


Figure 3.3. Parcel known as “the triangle.”

about the land with the broker. Hill and Shafer obtained a copy of the appraisal which listed the property as “15 acres of vacant land on the north side of Butler Avenue.”

Hill and Shafer inspected the land and submitted a letter of intent proposing to purchase the listed property. The letter of intent described the Triangle and Butler North. Hill and Shafer proposed that the price of the land be subject to an adjustment, depending on the actual acreage to be determined by a survey.

The Chilsons rejected the proposal and insisted that the listing price was a “take it or leave it” offer. The Chilsons also refused throughout the negotiations to include a map of the land or provide any information about the land beyond a simple description.

However, the description did not describe Butler North and the Triangle. The provided description instead described Butler North and Butler South.

Hill and Shafer agreed to purchase the land for the listed price and entered into a written contract with the Chilsons. On July 5, 1985, the escrow instructions were signed. When the Chilsons reviewed the escrow instructions, they discovered the error in the description. The Chilsons argued that they always intended to sell Butler North and the Triangle and that the description describing Butler North and Butler South was due to an error.

After discovering the error, the Chilsons prepared an amendment to correct the provided description, but Hill and Shafer refused the amendment. The Chilsons canceled the escrow, and Hill and Shafer sued for specific performance.

Was there a valid manifestation of mutual assent between the Chilsons and Hill and Shafer?

See Hill-Shafer Partnership v. Chilson Family Trust, 165 Ariz. 469 (1990).

Chapter 4

Offers

The manifestation of the offer by the offeror creates the “power of acceptance” in the offeree. What, then, is an offer? Consider its definition:

An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it. R2d § 24.

In simpler terms, an offer is a proposal to enter a voluntary bargain or exchange. This proposal is manifested by the offeror (the person who makes the offer) in such a way that the offeree (the person who receives the offer) reasonably believes that accepting the offer will create a binding contract.

For example, if a random stranger walks up to you on the street and says, “I will buy your house for a million dollars,” this is a manifestation of willingness to enter into a bargain. But is it an offer? In other words, are you justified in expecting that by responding, “I accept your offer,” the random stranger will pay you a million dollars for your house? No, that would not be a reasonable conclusion under these circumstances.

On the other hand, what if you had a series of business meetings with a lumber company that wanted to buy your farm and use it to cut down trees for lumber? Imagine the company would negotiate and haggle about the price, terms, closing date, title warranties, and all the many details involved in selling acreage for many months, until your business associate finally presented you with a written, signed statement including a definitive price. Would that be an offer? Probably yes, because the circumstances, including the negotiations and the clarity of the written proposal, make it reasonable to conclude that your assent would finalize the bargain.

In contrasting these examples, remember that preliminary negotiations are not required for a manifestation to qualify as an offer. However, the absence of negotiations or any prior relationship between the parties often indicates that a manifestation is not an offer. Conversely, extensive negotiations that culminate in a clear and definitive manifestation of willingness to enter a bargain tend to justify the conclusion that the manifestation invites assent to a binding agreement.

Understanding the nuances of what constitutes an offer is crucial to analyzing whether a binding contract has been formed. This chapter explores these nuances,

focusing on how courts evaluate the context and content of a purported offer to determine whether it creates the power of acceptance in the offeree.

Rules

A. Preliminary Negotiations

The manifestation of an offer usually does not spring out of nowhere. Parties often negotiate and bargain before agreeing to a contract in order to clarify their deal and extract the most value from it.

The typical process of contract formation begins with “preliminary negotiations.” As the name implies, these preliminary negotiations or discussions occur before a contract is formed. Under the common law of contracts, there is usually no contractual liability until contract formation. During preliminary negotiations, the parties remain free to walk away from the deal if they cannot come to terms. (Some scholars have argued contractual liability should not be binary—on or off—in this way and that there should be “pre-contractual liability” in some situations. But these suggestions have not been particularly influential on courts, which continue to view the moment of contract formation as the time when contractual liability attaches.)

Preliminary negotiations end when one party proposes a set of final terms. The proposing party then becomes the “offeror,” and the receiving party becomes the “offeree.” Under common law, the offeree has two paths forward. The offeree can either accept the terms, thus forming a contract, or reject them. (Under the UCC, the offeree has a little more flexibility to accept on slightly different terms, as you will learn in the section on “battle of the forms” in Chapter 6.) The period of time when the offeree has this power to accept or reject the offer is called “the duration of the power of acceptance.” An offeree’s acceptance is valid only if it is made while the offeree has the power of acceptance. You will learn more about the process of acceptance in a later chapter.

Preliminary negotiations are colloquially referred to as “bargaining,” but as you have now learned, the term “bargain” has a technical meaning in contract law. “Bargain” does not mean “haggling” or “negotiating.” In fact, many contracts are formed without any haggling or negotiating at all. A major example is the so-called “contract of adhesion.” A contract of adhesion is a non-negotiated, “take it or leave it” contract, which is drafted entirely by one side, without input from the other party. Contracts of adhesion are common in sales of goods contracts and in “software as a service” (SaaS) agreements, such as terms of service on a web page or app.

For example, when you sign up to use a new app, like Uber, you will agree to a contract called a “Terms of Use” or a “Terms of Service.” When you agree to these terms by clicking a box marked “I Agree,” this act demonstrates your assent and binds you

to the terms in that agreement. You cannot haggle or negotiate with Uber to change those terms. You can either agree to Uber's terms—or not use the app.

This is called a “contract of adhesion” because your only option if you wish to use Uber's app is to “adhere” to Uber's terms. Neither negotiation nor haggling are required, or possible, to form this contract. All the law needs is for both parties to manifest assent to terms that contemplate some sort of bargained-for exchange. Here, the bargained-for exchange is that you get to use the Uber app in exchange for abiding by Uber's terms of service. Even though you did not bargain with Uber in the colloquial sense, this is a bargain in the legal sense because both parties agreed to the deal and both parties are getting something from the exchange—you are getting an app, and hopefully a ride, and Uber is getting your agreement to its terms, and hopefully getting paid.

Preliminary negotiations are not necessary to form contracts. But the presence of negotiations can be evidence that parties are taking the deal seriously. Prolonged bargaining is an expected precursor to some kinds of deals. For example, if you want to buy a house, you will probably engage in some bargaining before making an offer. You might ask the seller to include the window treatments, to lower the price, or to close by a certain date. But in other situations, such as taking a cab ride or buying a cup of coffee, the act of bargaining or haggling is not an expected or necessary precursor to creating a bargained-for exchange.

Evidence regarding the extent of negotiations, or the lack thereof, may be relevant to determining whether a manifestation is in fact an offer. If the circumstances show that a party did *not* intend a communication to be an offer, then this is treated as a continuation of negotiations, or what is sometimes called “an invitation to deal.”

As usual, the perspective the law uses to evaluate these communications is that of the “reasonable person.”

A manifestation of willingness to enter into a bargain is not an offer if the person to whom it is addressed knows or has reason to know that the person making it does not intend to conclude a bargain until he has made a further manifestation of assent. R2d § 26.

In other words, a manifestation is not an offer if the person to whom the communication is addressed knows or has reason to know that it was intended only as part of negotiations. For example, if, during negotiations, a lumber man says to a farm owner, “Would you sell your land for \$50,000?” that is probably not an offer. The farm owner could not say, “Yes, we have a deal,” and thereby create a contract because the reasonable interpretation of the lumber man's words—in particular, his use of the word “would”—is that the lumber man was merely inquiring about the owner's willingness to sell for \$50,000. He was not making an offer to purchase at that price.

In sum, distinguishing an offer from preliminary negotiations requires nuanced analysis and great attention to detail, language, and context.

B. Certainty

Even when a person fully intends to make an offer, they may fail to present an acceptable offer because of a lack of certainty.

Even though a manifestation of intention is intended to be understood as an offer, it cannot be accepted so as to form a contract unless the terms of the contract are reasonably certain. R2d § 33(1).

Certainty is the opposite of ambiguity. When an offer is too ambiguous, it cannot be enforced by courts because courts would not know exactly what the parties intended to be enforced. In fact, the ability of courts to enforce a promise is the test for whether a promise is “reasonably certain” under the law.

The terms of a contract are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy. R2d § 33(2).

How much detail is required to make an offer certain depends on the circumstances of the transaction. The minimum standard of certainty under common law requires an offer to include the:

- (1) parties,
- (2) subject matter,
- (3) quantity, and
- (4) price.

For example, if Maestro offers to give Novice three hours of piano lessons for \$100, that offer probably meets the common law standard for reasonable certainty.

The Maestro example is an offer even though Maestro did not specify the time for performance. When the contract does not call for a specific time, courts will imply that the time for performance is at a reasonable time, given the circumstances.

Under the UCC, offers for sales of goods may be valid even when lacking a price term. Courts may imply a reasonable price where goods have a clear market value. *See* UCC § 2-305.

C. Advertisements as Offers

Advertisements to the general public, also known as general solicitations, present a special problem in the analysis of whether a manifestation is an offer. Most advertisements are not offers. The vast majority of advertisements do not manifest an intention to be bound; and they do not propose reasonably certain terms.

Most advertisements are, at best, invitations to make offers, or a mere quotation of the price at which a good or service might potentially be available for purchase—called

a “price quote.” The general rule is that ads and price quotes are not offers, simply because they are not intended or understood as such.

Advertisements of goods by display, sign, handbill, newspaper, radio or television are not ordinarily intended or understood as offers to sell. The same is true of catalogues, price lists and circulars, even though the terms of suggested bargains may be stated in some detail. R2d § 26 cmt. b.

Advertisements, as well as price quotes, also tend to lack reasonably certain terms, such as the quantity of goods available.

Incompleteness of terms is one of the principal reasons why advertisements and price quotations are ordinarily not interpreted as offers. R2d § 26 cmt. c.

In addition, advertisements do not typically identify a counterparty. They are not usually directed at anyone in particular. Instead, they are theoretically directed at *everyone*. This presents a policy problem because it is typically not possible for every person who hears an advertisement to accept it as an offer.

For example, if an advertisement says “Jim’s Cupcakes—\$2 each,” it is not clear how many cupcakes “Jim” is offering to sell. Anyone who views this advertisement might come calling. Once Jim has sold all the cupcakes, is Jim liable to every person who walks through the door thereafter? A store cannot reasonably be expected to stock an infinite supply of (physical) goods. This is the so-called “problem of over-subscription,” and it is a major reason why courts do not typically construe advertisements as offers.

In sum, the general rule is that advertisements are not offers. However, there are exceptions to this general rule. Some advertisements can rise to the level of offers. In the famous case of *Lefkowitz v. Great Minneapolis Supply Store*, 251 Minn. 188 (1957), a store published the following advertisements in a newspaper:



Figure 4.2. Pastel mink scarfs and stole advertisement in *Lefkowitz*.

Credit: Seth C. Oranburg.

In the *Lefkowitz* case, below, the court held that the ad for the black lapin stole was an offer because the ad specified the item, its value, its price, and the terms for purchase (“first come, first served”). The court also implied that the ad for the fur coat was an offer, too.

The *Lefkowitz* case also previews some remedies concepts. The court found that expectation damages were not available for the coat because its value (“worth to \$100”) was uncertain. Unlike with the coats, the court found sufficient evidence to establish the stole’s value (“worth \$139.50”), allowing it to calculate expectation damages.

This case is the exception that proves the rule. Advertisements are usually not offers. This advertisement was an offer only for very special reasons. First, it included all essential terms—subject matter, price, and quantity. Second, it provided detailed instructions for how someone could accept the offer—by showing up first on Saturday morning with \$1. Third, it provided a mechanism for limiting the number of potential offerees—the language, “first come, first served.” This language turned what otherwise would have been an invitation to deal into an offer, which the plaintiff, Lefkowitz, accepted by showing up first on Saturday morning with a dollar in hand. (This advertisement was also special because it took the form of a so-called “unilateral contract,” which you will read about below.)

D. Catalogs as Offers

Since quantity is an essential term in an offer, catalogs—including mail-order print catalogs and websites advertising clothing or other goods for sale—are generally not offers. A typical catalog will contain a blank order form where a prospective buyer can fill in details like the item number, quantity, size, and price. Only when that information is filled in does the order form become an offer by the prospective buyer. A blank order form lacks reasonable certainty and does not manifest an intent to be bound. But a filled-in order form is often an offer by the buyer to purchase the identified goods.

However, the party distributing the catalog is not bound unless they choose to be. Remember: catalogs themselves are not generally offers. Instead, it is the buyer who makes the offer when they fill in and submit the order form. When the company receives the filled-in order form from the prospective buyer, the company has the option to accept or reject that offer. This is important because of the oversubscription problem we discussed above. The company may have run out of supplies, changed their product lineup, or revised their prices since the catalog was distributed. If catalogs were offers, then the company would risk breaching its promises whenever a customer made an order they could not fulfill.

E. Bids as Offers

The bidding process is a common fact pattern in contract law. This can seem confusing to law students who have not themselves worked in construction and contracting. But the process is actually quite intuitive.

When a person, whom we will call the “owner,” decides to do some major construction project, that person will often try to get the highest quality work done for the lowest possible price by putting out a “request for proposal” or a “request for bid.” This request acts like an advertisement. It informs the world that the owner is looking for construction services. Construction service providers, known as “general contractors,” will then submit “bids” to do the project at a certain price.

But how does the general contractor (GC) know what to bid? The GC's goal is to organize and oversee the work, and to make a profit for this service. So, the GC, in turn, will typically contract with project specialists known as "subcontractors," who will themselves bid on aspects of the job by submitting their own proposals to do specific aspects of the work at a certain price.

For example, imagine Eric wants to build a swimming pool in his back yard. Eric, the owner, calls up four local contractors (GCs) that do swimming pool construction and asks them to submit bids. Each of the four GCs comes to Eric's house and takes measurements. Then the GCs begin seeking subcontractors to do parts of the work: excavators to remove and haul away the dirt, cement layers to build the foundation, plumbers to install the pipework, and masons to create a mosaic border. The subcontractors give their bids to the GC, who adds up the bids and tacks on some additional profit for the GC (perhaps around 15%). The GC then submits their best bid to the owner, Eric. Eric selects one of the GCs to do the work based on the proposed price and his perception of the GC's quality and ability to get the job done on time.

This bidding process is important to understand because, as you might imagine, many contract disputes involve construction contracts. Lawyers often must figure out at what point in the bidding process an "offer" was made, and at what point a contract was formed. For example, imagine the plumbing subcontractor quotes \$10,000 for her work to the GC, and the GC relies on her bid when submitting the GC's total bid to the owner. What would happen if the GC ends up winning the contract and, thus, decides to accept the subcontractor's bid, but the subcontractor refuses to do the work for the quoted \$10,000 price? If these were all binding promises, then the owner, Eric, could sue the GC, and the GC, in turn, could sue the subcontractor. But if either the subcontractor or the GC did not make a legally cognizable offer, the situation changes. No liability can attach to a communication that is not, in fact, an offer.

Courts have generally held that a request for bids in the construction context is not an offer but that the bid itself *is* often an offer. The result is that a request for bids acts similarly to an advertisement. It is a mere invitation to deal. But a bid, once accepted, usually creates a binding contract. A separate question, which you will address in the next chapter, is whether a bid, assuming it is an offer, can be retracted, and thus terminated, prior to acceptance.

F. Offers for Rewards (Unilateral Contracts)

Some offers do not invite a promissory response. They do not allow acceptance by promising. Rather, these offers only permit acceptance by completing the requested performance. These are called "offers for unilateral contracts." Recall that a unilateral contract is a type of bargain contract made up of a single promise to reward the completion of some performance. A unilateral contract cannot, by definition, be accepted by promising to perform. The only way to accept an offer for a unilateral contract is to do the requested performance.

This may sound abstract, but an example should make it clear and concrete. In 1893, the Carbolic Smoke Ball Company offered a cash reward to any person who inhaled for one month the company's "carbolic smoke ball" product—which was advertised to prevent the flu—but who nonetheless contracted the flu. The company put out this offer in a newspaper advertisement as a "prove me wrong" test, pronouncing to readers that "many thousand Carbolic Smoke Balls were sold on these advertisements, but only three persons claimed the reward of £100, thus proving conclusively that this invaluable remedy will prevent and cure the above-mentioned diseases."

Setting aside the fact that the Carbolic Smoke Ball was carcinogenic and in no way prevented or cured any disease, this advertisement is a classic example of an offer for a reward. Even when made in advertisements, as the carbolic smoke ball proposition was, offers for rewards are often considered legally cognizable "offers" to enter unilateral contracts. Even though the offeree never promises to do anything, once she successfully performs as requested, this act accepts the offer and places the offeror under a binding promise to give her the reward.

Offers for rewards overcome the usual rule that advertisements are not offers, because they provide clear instructions on how to accept the offer (by completing the requested performance) and because they generate significant reliance on the part of anyone who sees the offer and seeks to earn the reward by starting to perform.

In the Carbolic Smoke Ball case, the only way to accept the offer, and thus earn the reward, was by (1) inhaling the Carbolic Smoke Ball for a month and (2) contracting one of the diseases that the product was supposed to prevent. Once an unfortunate individual knowingly takes up this challenge and then "succeeds" by contracting the disease, they have earned the reward. The company's promise is enforceable as a unilateral contract.

Offers that can be accepted only by completely performing are called "offers for unilateral contracts" because they contain only *one* promise—thus, the prefix "uni." In contrast, bilateral contracts, which we have mostly been studying, are created through an exchange of promises. There are at least *two* promises—thus, the prefix "bi." Offers for unilateral contracts are subject to special rules of irrevocability, which you will learn in the next chapter on termination of the offer. You will continue to learn about these two forms of bargain contracts as we continue our discussion of contract formation.

G. Reflections on Offers

An offer is a manifestation of willingness to enter into a bargain. An offer can take the form of a proposal to exchange promises or a proposal to exchange a promise for a performance. An offer must demonstrate that the offeror is presently willing to enter a bargain, and it must be distinguished from a mere invitation to deal or preliminary negotiations. An offer must contain "reasonably certain" terms indicating what the parties are agreeing to do for each other; otherwise, a court will not be able to enforce any resulting promises.

THE ILLUSTRATED LONDON NEWS

£100 REWARD

WAS RECENTLY OFFERED BY THE

CARBOLIC SMOKE BALL CO.

To any person who removed Influenza, Coughs, Colds, Croup, Asthma, Bronchitis, Whooping Cough, Hoarseness, Loss of Voice, Throat Inflammation, Croup, Whooping Cough, or any disease caused by taking Cold, after having used the Carbolic Smoke Ball according to the printed directions.

Many thousands Carbolic Smoke Balls were sold on these advertisements, but only three persons claimed the reward of £100, thus proving conclusively that this Carbolic Smoke Ball will prevent and cure the above-mentioned diseases.

THE CARBOLIC SMOKE BALL CO., Ltd.,

£200 REWARD

to the person who purchases a Carbolic Smoke Ball and afterwards contracts any of the following diseases, viz.:

INFLUENZA	CATARH	THROAT DEAFNESS	DIPHTHERIA
COUGHS	ASTHMA	LOSS OF VOICE	CROUP
COLD IN THE HEAD	BRONCHITIS	LARYNGITIS	WHOOPING COUGH
COLD ON THE CHEST	SORE THROAT	SNORING	NEURALGIA
	HOARSENESS	SORE EYES	HEADACHE

no any disease caused by taking cold while using the Carbolic Smoke Ball. This offer is made to those who have purchased a Carbolic Smoke Ball since Jan. 1, 1900, and is subject to conditions to be obtained on application, a duplicate of which must be signed and deposited with the Company in London by the applicant before commencing the treatment specified in the conditions. This offer will remain open until 31st March 31, 1902.

As all the diseases mentioned above arise from one cause, they can be avoided by using the Carbolic Smoke Ball at the first onset, and thus.

THE CARBOLIC SMOKE BALL will last a fairly long time, making it the cheapest remedy in the world.

THE CARBOLIC SMOKE BALL will be useful and convenient, put into the nose, day, or night, or in the hand, ready for use.

CARBOLIC SMOKE BALL CO., LTD.,
27, PRINCES STREET, MANOVER SQUARE, LONDON, W.

PARIS DEPOT—16, Rue de la Paix. AMERICAN DEPOT—106, Broadway, New York. CANADIAN DEPOT—77 & 79, Broad Street, Toronto, Ontario.

Figure 4.3. Carbolic Smoke Ball advertisement. Public domain work.

It is important to recognize that this legal definition of “offer” is narrower than the ordinary usage of the term. For example, if Alain says to Berta, “I will drive you to work tomorrow,” without more, this is not an offer, even though it seems to be an offer in the lay sense. Remember that legal terms have special meanings that do not always accord with their ordinary meanings.

The term “promise” also has a special meaning in contract law. A promise is an expression of commitment to do or not do a certain thing, which the offeree would be justified in relying on. R2d § 2. This is different from the colloquial meaning of “promise.” For example, saying, “I promise that everything is going to be okay,” is not a promise under contract law because it does not include an intention to do anything specific and because no one would be justified in relying on this vague assurance. The maker of this statement would incur no contractual liability if everything is not, in fact, “okay.”

By now, you should start to see the relationship between a promise and an offer. A promise generates a contractual obligation to follow through on the promise. An offer necessarily embeds a promise or set of promises but is not itself a legally binding promise *until* the offer is accepted and a contract is formed. Offers generally take the form of “I promise to do X if you promise to do Y.” The promises to do X and Y, so long as they are defined with sufficient certainty, will become legal obligations if, and only if, this offer is accepted. Once an offer is made, this creates a “power of

acceptance” for the duration of the offer. Assuming the offer is accepted in the correct timeframe and in the correct manner, then the offer transforms into a legally enforceable contract.

Cases

Reading *Lefkowitz v. Great Minneapolis Surplus Store, Inc.* Advertisements are generally not offers; rather, advertisements are invitations to make an offer. For example, if Target places an ad in a local magazine that says “10% off on Xbox games” and Greg Gamer reads the advertisement, Greg should not feel secure that the specific game he has in mind will be in stock at a Target store and available for 10 % off. The ad is not precise enough for Greg to reasonably believe an offer has been made. No specific game or number of games is identified. The price is not clear—10% off what? This advertisement is not an offer. Greg does not have the power of acceptance.

What if the advertisement did specify a game, such as the newest version of *Halo*? And what if it also stated a price, say \$60? This is a more specific ad, to be sure, but it will not be enough to overcome the general rule that advertisements are not offers. For one thing, the quantity term is still not specified. Also, there is no identified offeree, or universe of potential offerees, who might accept. If other shoppers arrive before Greg, Target may not even have a game to sell him. There is an oversubscription problem. The lack of a quantity term, and the lack of a mechanism for limiting the number of potential acceptances, means the advertisement is still not an offer.

But what about those “doorbuster” sales, where there is a guaranteed number of units for sale? What if Target advertised that the first five, ten, or twenty buyers of the newest version of *Halo* would get the game and perhaps also a limited-edition action figure? Can this constitute an offer? The answer to these questions is found in the next case. In *Lefkowitz*, an advertisement clearly indicated the price, quantity, subject matter, and manner of acceptance. It also contained the language “first come, first served,” which put the analysis over the top by providing a clear means of limiting the number of potential offerees and solving the oversubscription problem. This ad, therefore, constituted an offer that gave the plaintiff the power of acceptance.

Lefkowitz also has a few other lessons. For example, if an advertisement to the general public is deemed an offer, that offer can be changed or retracted only through a similar ad. The case also explores the legal implications of a unilateral contract, which specifies the actions a person must take to accept an offer and which can only be accepted by completing those actions.

Lefkowitz v. Great Minneapolis Surplus Store, Inc.

251 Minn. 188 (1957)

MURPHY, Justice.

This is an appeal from an order of the Municipal Court of Minneapolis denying the motion of the defendant for amended findings of fact, or, in the alternative, for a new trial. The order for judgment awarded the plaintiff the sum of \$138.50 as damages for breach of contract.

This case grows out of the alleged refusal of the defendant to sell to the plaintiff a certain fur piece which it had offered for sale in a newspaper advertisement. It appears from the record that on April 6, 1956, the defendant published the following advertisement in a Minneapolis newspaper:

Saturday 9 A.M. Sharp
3 Brand New Fur Coats Worth to \$100.00
First Come First Served \$1 Each

On April 13, the defendant again published an advertisement in the same newspaper as follows:

Saturday 9 A.M.
2 Brand New Pastel Mink 3-Skin Scarfs
Selling for \$89.50
Out they go Saturday. Each . . . \$1.00
1 Black Lapin Stole Beautiful, worth \$139.50 . . . \$1.00
First Come First Served

The record supports the findings of the court that on each of the Saturdays following the publication of the above-described ads the plaintiff was the first to present himself at the appropriate counter in the defendant's store and on each occasion demanded the coat and the stole so advertised and indicated his readiness to pay the sale price of \$1.

On both occasions, the defendant refused to sell the merchandise to the plaintiff, stating on the first occasion that by a "house rule" the offer was intended for women only and sales would not be made to men, and on the second visit that plaintiff knew defendant's house rules.

The trial court properly disallowed plaintiff's claim for the value of the fur coats since the value of these articles was speculative and uncertain. The only evidence of value was the advertisement itself to the effect that the coats were "Worth to \$100.00," how much less being speculative especially in view of the price for which they were offered for sale.

With reference to the offer of the defendant on April 13, 1956, to sell the "1 Black Lapin Stole . . . worth \$139.50" the trial court held that the value of this article was

established and granted judgment in favor of the plaintiff for that amount less the \$1 quoted purchase price.

1.

The defendant contends that a newspaper advertisement offering items of merchandise for sale at a named price is a “unilateral offer” which may be withdrawn without notice. Defendant relies upon authorities which hold that, where an advertiser publishes in a newspaper that he has a certain quantity or quality of goods which he wants to dispose of at certain prices and on certain terms, such advertisements are not offers which become contracts as soon as any person to whose notice they may come signifies his acceptance by notifying the other that he will take a certain quantity of them. Such advertisements have been construed as an invitation for an offer of sale on the terms stated, which offer, when received, may be accepted or rejected and which therefore does not become a contract of sale until accepted by the seller; and until a contract has been so made, the seller may modify or revoke such prices or terms.

The defendant relies principally on *Craft v. Elder & Johnston Co.* In that case, the court discussed the legal effect of an advertisement offering for sale, as a one-day special, an electric sewing machine at a named price. The view was expressed that the advertisement was “not an offer made to any specific person but was made to the public generally. Thereby it would be properly designated as a unilateral offer and not being supported by any consideration could be withdrawn at will and without notice.” It is true that such an offer may be withdrawn before acceptance. Since all offers are by their nature unilateral because they are necessarily made by one party or on one side in the negotiation of a contract, the distinction made in that decision between a unilateral offer and a unilateral contract is not clear. On the facts before us we are concerned with whether the advertisement constituted an offer, and, if so, whether the plaintiff’s conduct constituted an acceptance.

There are numerous authorities which hold that a particular advertisement in a newspaper or circular letter relating to a sale of articles may be construed by the court as constituting an offer, acceptance of which would complete a contract.

The test of whether a binding obligation may originate in advertisements addressed to the general public is “whether the facts show that some performance was promised in positive terms in return for something requested.”

The authorities above cited emphasize that, where the offer is clear, definite, and explicit, and leaves nothing open for negotiation, it constitutes an offer, acceptance of which will complete the contract. The most recent case on the subject is *Johnson v. Capital City Ford Co.*, in which the court pointed out that a newspaper advertisement relating to the purchase and sale of automobiles may constitute an offer, acceptance of which will consummate a contract and create an obligation in the offeror to perform according to the terms of the published offer.

Whether in any individual instance a newspaper advertisement is an offer rather than an invitation to make an offer depends on the legal intention of the parties and the surrounding circumstances.

We are of the view on the facts before us that the offer by the defendant of the sale of the Lapin fur was clear, definite, explicit and left nothing open for negotiation. The plaintiff having successfully managed to be the first one to appear at the seller's place of business to be served, as requested by the advertisement, and having offered the stated purchase price of the article, he was entitled to performance on the part of the defendant. We think the trial court was correct in holding that there was in the conduct of the parties a sufficient mutuality of obligation to constitute a contract of sale.

2.

The defendant contends that the offer was modified by a “house rule” to the effect that only women were qualified to receive the bargains advertised. The advertisement contained no such restriction. This objection may be disposed of briefly by stating that, while an advertiser has the right at any time before acceptance to modify his offer, he does not have the right, after acceptance, to impose new or arbitrary conditions not contained in the published offer.

Affirmed.

Reflection

Advertisements are generally not offers—they are invitations to make offers. For an advertisement to be an offer, the advertisement must be so clear and definite that there is nothing left to negotiate, and it must provide a mechanism for solving the oversubscription problem.

For example, think of advertisements for “Black Friday” sales. Stores like Walmart and Target advertise televisions and other electronics for significant discounts, and people begin lining up hours in advance. Imagine Walmart runs a commercial advertising a huge television for 80% off its regular price. People may camp out all night to try to buy this television, but obviously there is no guarantee that everyone, or anyone, will leave with the tv. Walmart might have only one in stock, or possibly none in stock. It does not matter. The advertisement was not an offer. So Walmart will not be liable.

On the other hand, imagine the advertisement said “The first three people to appear at the customer service desk at the Walmart in Epping, New Hampshire, on Black Friday with \$100 cash in hand can purchase a NH603 model of flat screen television (worth \$1,000) for \$100.” Like the ad in *Lefkowitz*, this might be sufficiently definite and specific that anyone who reads the advertisement would understand it to mean that the first person to show up at the Walmart with \$100 in cash can leave with the aforementioned TV.

What if Walmart tries to modify or retract their offer at any point before acceptance? As you will learn in the next chapter, an offer can generally be retracted, and thus terminated, at any time prior to acceptance. However, in *Lefkowitz*, the court clarified that offers made in advertisements cannot be retracted or modified except through another advertisement to the public. You will see this rule again in the next chapter.

Discussion

1. The rule of thumb is that advertisements are, generally, not offers. What made the ads in *Lefkowitz* different such that the court found them to be offers?
 2. Identify several advertisements that you believe are not offers. What about each makes them not an offer? What specific element(s) of an offer is missing?
 3. Try to locate an advertisement that is an offer. What makes this ad different such that it rises to the level of an offer?
 4. Great Minneapolis Supply Store told Lefkowitz there was a “house rule” that its ad was only an offer to women. Why did the court find that Lefkowitz, a man, was allowed to accept this offer?
-

Reading *Leonard v. Pepsico, Inc.* The following case is, on one level, a silly story about an advertisement that went too far. Our hapless plaintiff was a college student turned entrepreneur who attempted to raise enough money to purchase enough Pepsi points to procure an AV-8B Harrier II jump jet.



Figure 4.4. US AV-8B Harrier II jump jet hovering. Source: D. Miller CC-A-2.0.

The interesting questions in this case are not about whether the plaintiff got the military fighter plane—he did not—but why he felt so entitled to receive one, and what the legal basis was for the denial of his request to get one. The

answer is not merely a simple matter of public policy—although one can imagine good reasons why restricted munitions and military aircraft should not be provided to the public—but rather involves some knowledge of how catalogs and advertisements work in our system of offer and acceptance. As you read on, think about what a catalog is. Is a catalog an advertisement? If so, is it an advertisement that rises to the level of an offer? If not, when does an offer first arise from a catalog ordering process? Before reading this case, you can watch the advertisement via this link: <https://bit.ly/PepsiHarrierAd>.

Leonard v. Pepsico, Inc.

88 F. Supp. 2d 116 (S.D.N.Y. 1999)

KIMBA M. WOOD, District Judge.

Plaintiff brought this action seeking, among other things, specific performance of an alleged offer of a Harrier Jet, featured in a television advertisement for defendant's "Pepsi Stuff" promotion. Defendant has moved for summary judgment pursuant to Federal Rule of Civil Procedure 56. For the reasons stated below, defendant's motion is granted.

I. Background

This case arises out of a promotional campaign conducted by defendant, the producer and distributor of the soft drinks Pepsi and Diet Pepsi. The promotion, entitled "Pepsi Stuff," encouraged consumers to collect "Pepsi Points" from specially marked packages of Pepsi or Diet Pepsi and redeem these points for merchandise featuring the Pepsi logo. Before introducing the promotion nationally, defendant conducted a test of the promotion in the Pacific Northwest from October 1995 to March 1996. A Pepsi Stuff catalog was distributed to consumers in the test market, including Washington State. Plaintiff is a resident of Seattle, Washington. While living in Seattle, plaintiff saw the Pepsi Stuff commercial that he contends constituted an offer of a Harrier Jet.

A. The Alleged Offer

Because whether the television commercial constituted an offer is the central question in this case, the Court will describe the commercial in detail. The commercial opens upon an idyllic, suburban morning, where the chirping of birds in sun-dappled trees welcomes a paperboy on his morning route. As the newspaper hits the stoop of a conventional two-story house, the tattoo of a military drum introduces the subtitle, "MONDAY 7:58 AM." The stirring strains of a martial air mark the appearance of a well-coiffed teenager preparing to leave for school, dressed in a shirt emblazoned with the Pepsi logo, a red-white-and-blue ball. While the teenager confidently preens, the military drumroll again sounds as the subtitle "T-SHIRT 75 PEPSI POINTS" scrolls across the screen. Bursting from his room, the teenager strides down the hallway wearing a leather jacket. The drumroll sounds again, as the subtitle "LEATHER JACKET

1450 PEPSI POINTS” appears. The teenager opens the door of his house and, unfazed by the glare of the early morning sunshine, puts on a pair of sunglasses. The drum-roll then accompanies the subtitle “SHADES 175 PEPSI POINTS.” A voiceover then intones, “Introducing the new Pepsi Stuff catalog,” as the camera focuses on the cover of the catalog.

The scene then shifts to three young boys sitting in front of a high school building. The boy in the middle is intent on his Pepsi Stuff Catalog, while the boys on either side are each drinking Pepsi. The three boys gaze in awe at an object rushing overhead, as the military march builds to a crescendo. The Harrier Jet is not yet visible, but the observer senses the presence of a mighty plane as the extreme winds generated by its flight create a paper maelstrom in a classroom devoted to an otherwise dull physics lesson. Finally, the Harrier Jet swings into view and lands by the side of the school building, next to a bicycle rack. Several students run for cover, and the velocity of the wind strips one hapless faculty member down to his underwear. While the faculty member is being deprived of his dignity, the voiceover announces: “Now the more Pepsi you drink, the more great stuff you’re gonna get.”

The teenager opens the cockpit of the fighter and can be seen, helmetless, holding a Pepsi. “[L]ooking very pleased with himself,” the teenager exclaims, “Sure beats the bus,” and chortles. The military drumroll sounds a final time, as the following words appear: “HARRIER FIGHTER 7,000,000 PEPSI POINTS.” A few seconds later, the following appears in more stylized script: “Drink Pepsi—Get Stuff.” With that message, the music and the commercial end with a triumphant flourish.

Inspired by this commercial, plaintiff set out to obtain a Harrier Jet. Plaintiff explains that he is “typical of the ‘Pepsi Generation’ . . . he is young, has an adventurous spirit, and the notion of obtaining a Harrier Jet appealed to him enormously.” Plaintiff consulted the Pepsi Stuff Catalog. The Catalog features youths dressed in Pepsi Stuff regalia or enjoying Pepsi Stuff accessories, such as “Blue Shades” (“As if you need another reason to look forward to sunny days.”), “Pepsi Tees” (“Live in ‘em. Laugh in ‘em. Get in ‘em.”), “Bag of Balls” (“Three balls. One bag. No rules.”), and “Pepsi Phone Card” (“Call your mom!”). The Catalog specifies the number of Pepsi Points required to obtain promotional merchandise. The Catalog includes an Order Form which lists, on one side, fifty-three items of Pepsi Stuff merchandise redeemable for Pepsi Points. Conspicuously absent from the Order Form is any entry or description of a Harrier Jet. The amount of Pepsi Points required to obtain the listed merchandise ranges from 15 (for a “Jacket Tattoo” (“Sew ‘em on your jacket, not your arm.”)) to 3300 (for a “Fila Mountain Bike” (“Rugged. All-terrain. Exclusively for Pepsi.”)). It should be noted that plaintiff objects to the implication that because an item was not shown in the Catalog, it was unavailable.

The rear foldout pages of the Catalog contain directions for redeeming Pepsi Points for merchandise. These directions note that merchandise may be ordered “only” with the original Order Form. The Catalog notes that in the event that a consumer lacks enough Pepsi Points to obtain a desired item, additional Pepsi Points may be

purchased for ten cents each; however, at least fifteen original Pepsi Points must accompany each order.

Although plaintiff initially set out to collect 7,000,000 Pepsi Points by consuming Pepsi products, it soon became clear to him that he “would not be able to buy (let alone drink) enough Pepsi to collect the necessary Pepsi Points fast enough.” Reevaluating his strategy, plaintiff “focused for the first time on the packaging materials in the Pepsi Stuff promotion,” and realized that buying Pepsi Points would be a more promising option. Through acquaintances, plaintiff ultimately raised about \$700,000.

B. Plaintiff’s Efforts to Redeem the Alleged Offer

On or about March 27, 1996, plaintiff submitted an Order Form, fifteen original Pepsi Points, and a check for \$700,008.50. Plaintiff appears to have been represented by counsel at the time he mailed his check; the check is drawn on an account of plaintiff’s first set of attorneys. At the bottom of the Order Form, plaintiff wrote in “1 Harrier Jet” in the “Item” column and “7,000,000” in the “Total Points” column. In a letter accompanying his submission, plaintiff stated that the check was to purchase additional Pepsi Points “expressly for obtaining a new Harrier jet as advertised in your Pepsi Stuff commercial.”

On or about May 7, 1996, defendant’s fulfillment house rejected plaintiff’s submission and returned the check, explaining that:

The item that you have requested is not part of the Pepsi Stuff collection. It is not included in the catalogue or on the order form, and only catalogue merchandise can be redeemed under this program.

The Harrier jet in the Pepsi commercial is fanciful and is simply included to create a humorous and entertaining ad. We apologize for any misunderstanding or confusion that you may have experienced and are enclosing some free product coupons for your use.

Plaintiff’s previous counsel responded on or about May 14, 1996, as follows:

Your letter of May 7, 1996 is totally unacceptable. We have reviewed the video tape of the Pepsi Stuff commercial . . . and it clearly offers the new Harrier jet for 7,000,000 Pepsi Points. Our client followed your rules explicitly. . . .

This is a formal demand that you honor your commitment and make immediate arrangements to transfer the new Harrier jet to our client. If we do not receive transfer instructions within ten (10) business days of the date of this letter you will leave us no choice but to file an appropriate action against Pepsi . . .

This letter was apparently sent onward to the advertising company responsible for the actual commercial, BBDO New York (“BBDO”). In a letter dated May 30, 1996, BBDO Vice President Raymond E. McGovern, Jr., explained to plaintiff that:

I find it hard to believe that you are of the opinion that the Pepsi Stuff commercial (“Commercial”) really offers a new Harrier Jet. The use of the Jet was

clearly a joke that was meant to make the Commercial more humorous and entertaining. In my opinion, no reasonable person would agree with your analysis of the Commercial.

[Approximately three years of procedural history omitted.]

II. Discussion

[Standard for summary judgment omitted.]

[Choice of law analysis omitted.]

B. Defendant's Advertisement Was Not an Offer

1. Advertisements as Offers

The general rule is that an advertisement does not constitute an offer. The Restatement (Second) of Contracts explains that:

Advertisements of goods by display, sign, handbill, newspaper, radio or television are not ordinarily intended or understood as offers to sell. The same is true of catalogues, price lists and circulars, even though the terms of suggested bargains may be stated in some detail. It is of course possible to make an offer by an advertisement directed to the general public (see § 29), but there must ordinarily be some language of commitment or some invitation to take action without further communication.

Similarly, a leading treatise notes that:

It is quite possible to make a definite and operative offer to buy or sell goods by advertisement, in a newspaper, by a handbill, a catalog or circular or on a placard in a store window. It is not customary to do this, however; and the presumption is the other way. . . . Such advertisements are understood to be mere requests to consider and examine and negotiate; and no one can reasonably regard them as otherwise unless the circumstances are exceptional and the words used are very plain and clear.

An advertisement is not transformed into an enforceable offer merely by a potential offeree's expression of willingness to accept the offer through, among other means, completion of an order form.

In *Mesaros v. United States*, for example, the plaintiffs sued the United States Mint for failure to deliver a number of Statue of Liberty commemorative coins that they had ordered. When demand for the coins proved unexpectedly robust, a number of individuals who had sent in their orders in a timely fashion were left empty-handed. The court began by noting the "well-established" rule that advertisements and order forms are "mere notices and solicitations for offers which create no power of acceptance in the recipient." The spurned coin collectors could not maintain a breach of contract action because no contract would be formed until the advertiser accepted the order form and processed payment. Under these principles, plaintiff's letter of March 27,

1996, with the Order Form and the appropriate number of Pepsi Points, constituted the offer. There would be no enforceable contract until defendant accepted the Order Form and cashed the check.

The exception to the rule that advertisements do not create any power of acceptance in potential offerees is where the advertisement is “clear, definite, and explicit, and leaves nothing open for negotiation,” in that circumstance, “it constitutes an offer, acceptance of which will complete the contract.” In *Lefkowitz*, defendant had published a newspaper announcement stating: “Saturday 9 AM Sharp, 3 Brand New Fur Coats, Worth to \$100.00, First Come First Served \$1 Each.” Mr. Morris Lefkowitz arrived at the store, dollar in hand, but was informed that under defendant’s “house rules,” the offer was open to ladies, but not gentlemen. The court ruled that because plaintiff had fulfilled all of the terms of the advertisement and the advertisement was specific and left nothing open for negotiation, a contract had been formed.

The present case is distinguishable from *Lefkowitz*. First, the commercial cannot be regarded in itself as sufficiently definite, because it specifically reserved the details of the offer to a separate writing, the Catalog. The commercial itself made no mention of the steps a potential offeree would be required to take to accept the alleged offer of a Harrier Jet. The advertisement in *Lefkowitz*, in contrast, “identified the person who could accept.” Second, even if the Catalog had included a Harrier Jet among the items that could be obtained by redemption of Pepsi Points, the advertisement of a Harrier Jet by both television commercial and catalog would still not constitute an offer. As the *Mesaros* court explained, the absence of any words of limitation such as “first come, first served,” renders the alleged offer sufficiently indefinite that no contract could be formed. “A customer would not usually have reason to believe that the shopkeeper intended exposure to the risk of a multitude of acceptances resulting in a number of contracts exceeding the shopkeeper’s inventory.” There was no such danger in *Lefkowitz*, owing to the limitation “first come, first served.”

The Court finds, in sum, that the Harrier Jet commercial was merely an advertisement. The Court now turns to the line of cases upon which plaintiff rests much of his argument.

2. Rewards as Offers

In opposing the present motion, plaintiff largely relies on a different species of unilateral offer, involving public offers of a reward for performance of a specified act. Because these cases generally involve public declarations regarding the efficacy or trustworthiness of specific products, one court has aptly characterized these authorities as “prove me wrong” cases.

The most venerable of these precedents is the case of *Carlill v. Carbolic Smoke Ball Co.*, a quote from which heads plaintiff’s memorandum of law: “[I]f a person chooses to make extravagant promises . . . he probably does so because it pays him to make them, and, if he has made them, the extravagance of the promises is no reason in law why he should not be bound by them.”

Long a staple of law school curricula, *Carbolic Smoke Ball* owes its fame not merely to “the comic and slightly mysterious object involved,” but also to its role in developing the law of unilateral offers. The case arose during the London influenza epidemic of the 1890s. Among other advertisements of the time, for Clarke’s World Famous Blood Mixture, Towle’s Pennyroyal and Steel Pills for Females, Sequah’s Prairie Flower, and Epp’s Glycerin Jube-Jubes, appeared solicitations for the Carbolic Smoke Ball. The specific advertisement that Mrs. Carlill saw, and relied upon, read as follows:

100 £ reward will be paid by the Carbolic Smoke Ball Company to any person who contracts the increasing epidemic influenza, colds, or any diseases caused by taking cold, after having used the ball three times daily for two weeks according to the printed directions supplied with each ball. 1000 £ is deposited with the Alliance Bank, Regent Street, shewing our sincerity in the matter.

During the last epidemic of influenza many thousand carbolic smoke balls were sold as preventives against this disease, and in no ascertained case was the disease contracted by those using the carbolic smoke ball.

“On the faith of this advertisement,” Mrs. Carlill purchased the smoke ball and used it as directed, but contracted influenza nevertheless. The lower court held that she was entitled to recover the promised reward.

Affirming the lower court’s decision, Lord Justice Lindley began by noting that the advertisement was an express promise to pay £ 100 in the event that a consumer of the Carbolic Smoke Ball was stricken with influenza. The advertisement was construed as offering a reward because it sought to induce performance, unlike an invitation to negotiate, which seeks a reciprocal promise. As Lord Justice Lindley explained, “advertisements offering rewards . . . are offers to anybody who performs the conditions named in the advertisement, and anybody who does perform the condition accepts the offer.” Because Mrs. Carlill had complied with the terms of the offer, yet contracted influenza, she was entitled to £ 100.

Like *Carbolic Smoke Ball*, the decisions relied upon by plaintiff involve offers of reward.

Other “reward” cases underscore the distinction between typical advertisements, in which the alleged offer is merely an invitation to negotiate for purchase of commercial goods, and promises of reward, in which the alleged offer is intended to induce a potential offeree to perform a specific action, often for noncommercial reasons.

James v. Turilli arose from a boast by defendant that the “notorious Missouri desperado” Jesse James had not been killed in 1882, as portrayed in song and legend, but had lived under the alias “J. Frank Dalton” at the “Jesse James Museum” operated by none other than defendant. Defendant offered \$10,000 “to anyone who could prove me wrong.” The widow of the outlaw’s son demonstrated, at trial, that the outlaw had in fact been killed in 1882. On appeal, the court held that defendant should be liable to pay the amount offered.

In the present case, the Harrier Jet commercial did not direct that anyone who appeared at Pepsi headquarters with 7,000,000 Pepsi Points on the Fourth of July would receive a Harrier Jet. Instead, the commercial urged consumers to accumulate Pepsi Points and to refer to the Catalog to determine how they could redeem their Pepsi Points. The commercial sought a reciprocal promise, expressed through acceptance of, and compliance with, the terms of the Order Form. As noted previously, the Catalog contains no mention of the Harrier Jet. Plaintiff states that he “noted that the Harrier Jet was not among the items described in the catalog, but this did not affect [his] understanding of the offer.” It should have.

Carbolic Smoke Ball itself draws a distinction between the offer of reward in that case, and typical advertisements, which are merely offers to negotiate. As Lord Justice Bowen explains:

It is an offer to become liable to any one who, before it is retracted, performs the condition. . . . It is not like cases in which you offer to negotiate, or you issue advertisements that you have got a stock of books to sell, or houses to let, in which case there is no offer to be bound by any contract. Such advertisements are offers to negotiate—offers to receive offers—offers to chaffer, as, I think, some learned judge in one of the cases has said.

Because the alleged offer in this case was, at most, an advertisement to receive offers rather than an offer of reward, plaintiff cannot show that there was an offer made in the circumstances of this case.

C. An Objective, Reasonable Person Would Not Have Considered the Commercial an Offer

Plaintiff’s understanding of the commercial as an offer must also be rejected because the Court finds that no objective person could reasonably have concluded that the commercial actually offered consumers a Harrier Jet.

1. Objective Reasonable Person Standard

In evaluating the commercial, the Court must not consider defendant’s subjective intent in making the commercial, or plaintiff’s subjective view of what the commercial offered, but what an objective, reasonable person would have understood the commercial to convey.

If it is clear that an offer was not serious, then no offer has been made:

What kind of act creates a power of acceptance and is therefore an offer? It must be an expression of will or intention. It must be an act that leads the offeree reasonably to conclude that a power to create a contract is conferred. This applies to the content of the power as well as to the fact of its existence. It is on this ground that we must exclude invitations to deal or acts of mere preliminary negotiation, and acts evidently done in jest or without intent to create legal relations.

An obvious joke, of course, would not give rise to a contract. On the other hand, if there is no indication that the offer is “evidently in jest,” and that an objective, reasonable person would find that the offer was serious, then there may be a valid offer.

[Discussion of whether plaintiff may demand a jury trial omitted.]

3. Whether the Commercial Was “Evidently Done In Jest”

Plaintiff’s insistence that the commercial appears to be a serious offer requires the Court to explain why the commercial is funny. Explaining why a joke is funny is a daunting task; as the essayist E.B. White has remarked, “Humor can be dissected, as a frog can, but the thing dies in the process.” The commercial is the embodiment of what defendant appropriately characterizes as “zany humor.”

First, the commercial suggests, as commercials often do, that use of the advertised product will transform what, for most youth, can be a fairly routine and ordinary experience. The military tattoo and stirring martial music, as well as the use of subtitles in a Courier font that scroll terse messages across the screen, such as “MONDAY 7:58 AM,” evoke military and espionage thrillers. The implication of the commercial is that Pepsi Stuff merchandise will inject drama and moment into hitherto unexceptional lives. The commercial in this case thus makes the exaggerated claims similar to those of many television advertisements: that by consuming the featured clothing, car, beer, or potato chips, one will become attractive, stylish, desirable, and admired by all. A reasonable viewer would understand such advertisements as mere puffery, not as statements of fact, and refrain from interpreting the promises of the commercial as being literally true.

Second, the callow youth featured in the commercial is a highly improbable pilot, one who could barely be trusted with the keys to his parents’ car, much less the prize aircraft of the United States Marine Corps. Rather than checking the fuel gauges on his aircraft, the teenager spends his precious preflight minutes preening. The youth’s concern for his coiffure appears to extend to his flying without a helmet. Finally, the teenager’s comment that flying a Harrier Jet to school “sure beats the bus” evinces an improbably insouciant attitude toward the relative difficulty and danger of piloting a fighter plane in a residential area, as opposed to taking public transportation.

Third, the notion of traveling to school in a Harrier Jet is an exaggerated adolescent fantasy. In this commercial, the fantasy is underscored by how the teenager’s schoolmates gape in admiration, ignoring their physics lesson. The force of the wind generated by the Harrier Jet blows off one teacher’s clothes, literally defrocking an authority figure. As if to emphasize the fantastic quality of having a Harrier Jet arrive at school, the Jet lands next to a plebeian bike rack. This fantasy is, of course, extremely unrealistic. No school would provide landing space for a student’s fighter jet, or condone the disruption the jet’s use would cause.

Fourth, the primary mission of a Harrier Jet, according to the United States Marine Corps, is to “attack and destroy surface targets under day and night visual conditions.” Manufactured by McDonnell Douglas, the Harrier Jet played a significant

role in the air offensive of Operation Desert Storm in 1991. The jet is designed to carry a considerable armament load, including Sidewinder and Maverick missiles. As one news report has noted, “Fully loaded, the Harrier can float like a butterfly and sting like a bee—albeit a roaring 14-ton butterfly and a bee with 9,200 pounds of bombs and missiles.” In light of the Harrier Jet’s well-documented function in attacking and destroying surface and air targets, armed reconnaissance and air interdiction, and offensive and defensive anti-aircraft warfare, depiction of such a jet as a way to get to school in the morning is clearly not serious even if, as plaintiff contends, the jet is capable of being acquired “in a form that eliminates [its] potential for military use.”

Fifth, the number of Pepsi Points the commercial mentions as required to “purchase” the jet is 7,000,000. To amass that number of points, one would have to drink 7,000,000 Pepsis (or roughly 190 Pepsis a day for the next hundred years—an unlikely possibility), or one would have to purchase approximately \$700,000 worth of Pepsi Points. The cost of a Harrier Jet is roughly \$23 million dollars, a fact of which plaintiff was aware when he set out to gather the amount he believed necessary to accept the alleged offer. Even if an objective, reasonable person were not aware of this fact, he would conclude that purchasing a fighter plane for \$700,000 is a deal too good to be true.

Plaintiff argues that a reasonable, objective person would have understood the commercial to make a serious offer of a Harrier Jet because there was “absolutely no distinction in the manner” in which the items in the commercial were presented. Plaintiff also relies upon a press release highlighting the promotional campaign, issued by defendant, in which “[n]o mention is made by [defendant] of humor, or anything of the sort.” These arguments suggest merely that the humor of the promotional campaign was tongue in cheek. Humor is not limited to what Justice Cardozo called “[t]he rough and boisterous joke . . . [that] evokes its own guffaws.” In light of the obvious absurdity of the commercial, the Court rejects plaintiff’s argument that the commercial was not clearly in jest.

[Discovery dispute omitted.]

[Discussion of the applicability of the statute of frauds omitted.]

[Discussion of plaintiff’s fraud claim omitted.]

III. Conclusion

In sum, there are three reasons why plaintiff’s demand cannot prevail as a matter of law. First, the commercial was merely an advertisement, not a unilateral offer. Second, the tongue-in-cheek attitude of the commercial would not cause a reasonable person to conclude that a soft drink company would be giving away fighter planes as part of a promotion. Third, there is no writing between the parties sufficient to satisfy the Statute of Frauds.

For the reasons stated above, the Court grants defendant’s motion for summary judgment.

Reflection

Leonard demonstrates how advertisements, especially advertisements for rewards, may or may not be offers. Remember that absent special circumstances, advertisements are generally construed to be an invitation to make an offer. *Lefkowitz* demonstrated when those special circumstances exist. *Leonard*, on the other hand, is a case without special circumstances. Unlike *Lefkowitz*, the commercial was not sufficiently definite and did not include words of limitation like “first come, first served.” Therefore, the advertisement is an invitation to make an offer, not an offer.

Advertisements for rewards can also rise to the status of an offer. These types of offers (offers for a unilateral contract) can only be accepted by completely performing. The plaintiff in *Leonard* tried to argue that the commercial was an advertisement for a reward. The court was unconvinced and determined that the commercial was an invitation to make an offer and that the manner of acceptance was for a reciprocal promise through the order form. If it were for a reward, the advertisement would have had to direct someone to complete performance to receive the reward (e.g., “You turn in the Pepsi points, you get the jet!”).

Lastly, the court used the objective reasonable person standard (introduced in *Lucy* in the last chapter) to determine whether the offer (commercial ad) could be construed seriously. The court determined that an objectively reasonable person would have understood the commercial to be an obvious joke. Obvious jokes, like the one in the commercial, do not give rise to a contract.

Discussion

1. It may seem obvious to some that the Pepsi commercial was meant in jest, but the court still provided a thorough analysis of whether the ad was serious. Why did the court bother with this analysis?
 2. Why did the *Pepsico* court determine that the ad was in jest and not to be taken seriously?
 3. Pepsi provided customers like Leonard an opportunity obtain Pepsi Points they could spend via a catalog. Was the catalog an offer? Why or why not?
 4. If you were the attorney for Pepsico, would you have identified any legal problems with the advertisement? With the benefit of hindsight, what changes, if any, would you recommend Pepsico make to its ad to avoid unwanted legal liability?
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Reading Academy Chicago Publishers v. Cheever. Even when a person intends to make an offer, and not merely to engage in preliminary negotiations, they may fail to present an acceptable offer because of a lack of certainty. Certainty is the opposite of ambiguity. When an offer is too ambiguous, it cannot be enforced by courts because courts would not know exactly what the parties intended to be enforced.

Cheever highlights a situation where an agreement, although detailed, was insufficiently certain for a court to enforce it. Although courts have powers to imply terms and thereby make agreements sufficiently certain in some cases, in others, there is not enough certainty provided by the parties from which a court could create an enforceable obligation.

Academy Chicago Publishers v. Cheever

144 Ill. 2d 24 (1991)

HEIPLE, J.

This is a suit for declaratory judgment. It arose out of an agreement between the widow of the widely published author, John Cheever, and Academy Chicago Publishers. Contact between the parties began in 1987 when the publisher approached Mrs. Cheever about the possibility of publishing a collection of Mr. Cheever's short stories which, though previously published, had never been collected into a single anthology. In August of that year, a publishing agreement was signed which provided, in pertinent part:

Agreement made this 15th day of August 1987, between Academy Chicago Publishers or any affiliated entity or imprint (hereinafter referred to as the Publisher) and Mary W. Cheever and Franklin H. Dennis of the USA (hereinafter referred to as Author).

Whereas the parties are desirous of publishing and having published a certain work or works, tentatively titled The Uncollected Stories of John Cheever (hereinafter referred to as the Work):

2. The Author will deliver to the Publisher on a mutually agreeable date one copy of the manuscript of the Work as finally arranged by the editor and satisfactory to the Publisher in form and content.

5. Within a reasonable time and a mutually agreeable date after delivery of the final revised manuscript, the Publisher will publish the Work at its own expense, in such style and manner and at such price as it deems best, and will keep the Work in print as long as it deems it expedient; but it will not be responsible for delays caused by circumstances beyond its control.

Academy and its editor, Franklin Dennis, assumed the task of locating and procuring the uncollected stories and delivering them to Mrs. Cheever. Mrs. Cheever and Mr. Dennis received partial advances for manuscript preparation. By the end of 1987, Academy had located and delivered more than 60 uncollected stories to Mrs. Cheever. Shortly thereafter, Mrs. Cheever informed Academy in writing that she objected to the publication of the book and attempted to return her advance.

Academy filed suit in the circuit court of Cook County in February 1988, seeking a declaratory judgment: (1) granting Academy the exclusive right to publish the tentatively titled, "The Uncollected Stories of John Cheever"; (2) designating Franklin Dennis as the book's editor; and (3) obligating Mrs. Cheever to deliver the manuscript from which the work was to be published. The trial court entered an order declaring, *inter alia*: (1) that the publishing agreement executed by the parties was valid and enforceable; (2) that Mrs. Cheever was entitled to select the short stories to be included in the manuscript for publication; (3) that Mrs. Cheever would comply with her obligations of good faith and fair dealing if she delivered a manuscript including at least 10 to 15 stories totaling at least 140 pages; (4) Academy controlled the design and format of the work to be published, but control must be exercised in cooperation with Mrs. Cheever.

Academy appealed the trial court's order, challenging particularly the declaration regarding the minimum story and page numbers for Mrs. Cheever's compliance with the publishing agreement, and the declaration that Academy must consult with defendant on all matters of publication of the manuscript.

The appellate court affirmed the decision of the trial court with respect to the validity and enforceability of the publishing agreement and the minimum story and page number requirements for Mrs. Cheever's compliance with same. The appellate court reversed the trial court's declaration regarding control of publication, stating that the trial court erred in considering extrinsic evidence to interpret the agreement regarding control of the publication, given the explicit language of the agreement granting exclusive control to Academy.

The parties raise several issues on appeal; this matter, however, is one of contract and we confine our discussion to the issue of the validity and enforceability of the publishing agreement.

While the trial court and the appellate court agreed that the publishing agreement constitutes a valid and enforceable contract, we cannot concur. The principles of contract state that in order for a valid contract to be formed, an "offer must be so definite as to its material terms or require such definite terms in the acceptance that the promises and performances to be rendered by each party are reasonably certain." Although the parties may have had and manifested the intent to make a contract, if the content of their agreement is unduly uncertain and indefinite no contract is formed.

The pertinent language of this agreement lacks the definite and certain essential terms required for the formation of an enforceable contract. A contract "is sufficiently definite and certain to be enforceable if the court is enabled from the terms and provisions thereof, under proper rules of construction and applicable principles of equity,

to ascertain what the parties have agreed to do.” The provisions of the subject publishing agreement do not provide the court with a means of determining the intent of the parties.

Trial testimony reveals that a major source of controversy between the parties is the length and content of the proposed book. The agreement sheds no light on the minimum or maximum number of stories or pages necessary for publication of the collection, nor is there any implicit language from which we can glean the intentions of the parties with respect to this essential contract term. The publishing agreement is similarly silent with respect to who will decide which stories will be included in the collection. Other omissions, ambiguities, unresolved essential terms and illusory terms are: No date certain for delivery of the manuscript. No definition of the criteria which would render the manuscript satisfactory to the publisher either as to form or content. No date certain as to when publication will occur. No certainty as to style or manner in which the book will be published nor is there any indication as to the price at which such book will be sold, or the length of time publication shall continue, all of which terms are left to the sole discretion of the publisher.

A contract may be enforced even though some contract terms may be missing or left to be agreed upon, but if the essential terms are so uncertain that there is no basis for deciding whether the agreement has been kept or broken, there is no contract. Without setting forth adequate terms for compliance, the publishing agreement provides no basis for determining when breach has occurred, and, therefore, is not a valid and enforceable contract.

An enforceable contract must include a meeting of the minds or mutual assent as to the terms of the contract. It is not compelling that the parties share a subjective understanding as to the terms of the contract; the parties’ conduct may indicate an agreement to the terms of same. *Steinberg v. Chicago Medical School*. In the instant case, however, no mutual assent has been illustrated. The parties did not and do not share a common understanding of the essential terms of the publishing agreement.

In rendering its judgment, the trial court supplied minimum terms for Mrs. Cheever’s compliance, including story and page numbers. It is not uncommon for a court to supply a missing material term, as the reasonable conclusion often is that the parties intended that the term be supplied by implication. However, where the subject matter of the contract has not been decided upon and there is no standard available for reasonable implication, courts ordinarily refuse to supply the missing term. No suitable standard was available for the trial court to apply. It is our opinion that the trial court incorrectly supplied minimum compliance terms to the publishing agreement, as the agreement did not constitute a valid and enforceable contract to begin with. As noted above, the publishing agreement contains major unresolved uncertainties. It is not the role of the court to rewrite the contract and spell out essential elements not included therein.

In light of our decision that there was no valid and enforceable contract between the parties, we need not address other issues raised on appeal. For the foregoing

reasons, the decisions of the trial and appellate courts in this declaratory judgment action are reversed.

Reversed.

Reflection

The *Cheever* case was hotly contested by lower and higher courts. This contest evidences the natural tendency of many courts to try and make agreements enforceable, especially where there has been performance by the parties. Although the court did not state things in this manner, it appears to be that the greater the amount of performance under a purported contract, the greater the desire of courts to find a contract exists. Otherwise, we must do something else with that performance, such as wrap it in a quasi-contract or repay it using restitution. In cases like this, there is a tension between pragmatism and efficiency, on the one hand, and rigor and veracity, on the other.

Discussion

1. The *Cheever* case illustrates a situation where an offer is too indefinite to enforce. What are the minimum requirements for the terms of an offer? What must an offer include for it to be enforceable?
 2. How did the lower court attempt to rectify the inadequacies of the contract in *Cheever*? Why did the higher court reject the lower court's approach?
 3. If you were the attorney for the publishing company, what advice would you give to ensure that future contracts were not unenforceable due to indefiniteness?
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Problems

Problem 4.1. Lexus Advertisement

A used car dealership posted an advertisement in the newspaper, advertising a used Lexus for the price of \$24,000. However, the newspaper made a typographical and proofreading error. The retail price of the used Lexus was actually \$34,000.

Brian Donovan saw the advertisement and attempted to purchase the Lexus for the advertised price. When Donovan appeared at the dealership, the dealership refused to sell him the car for the advertised price, explaining that the newspaper had misprinted the price of the car.

Donovan then sued the dealership for breach of contract.

Was the advertisement an offer? If the advertisement was specific enough to be understood as an offer, would the car dealership be able to modify the offer?

See Donovan v. RRL Corp., 26 Cal. 4th 261, 27 P.3d 702 (2001).

Problem 4.2. Volvo Advertisement

In 1966, Lee Calan Imports, an automobile dealer, advertised a 1964 Volvo Station Wagon for sale in the newspaper. The dealership told the newspaper to advertise the car at \$1,795, but the newspaper accidentally listed it at \$1,095. Christopher O'Brien saw the advertisement in the newspaper and went to Lee Calan Imports to buy it at the advertised price. However, Lee Calan Imports refused to sell the car at the price in the newspaper.

Did the advertisement constitute an offer on the part of Lee Calan Imports?

See O'Keefe v. Lee Calan Imports, Inc., 262 N.E.2d 758 (Ill. App. Ct. 1970).

Problem 4.3. Definite Commission

RRA is a temporary personnel agency that supplies technical employees to national laboratories and other contractors. The agency pays the employee's wages and benefits, and the contractor pays the agency for supplying the employee. In early 1993, Richard Padilla was hired by RRA.

Soon thereafter, two disputes arose regarding Padilla's compensation by RRA. First, he claimed breach of an oral contract negotiated with Stan Rashkin, a vice president of RRA, to pay him a commission of 1% to 10% if he procured additional contracts for RRA. He alleged that he obtained two contracts with a total value of \$655,200 but was paid only a \$750 finder's fee. Second, he contended that he was paid an hourly wage below that provided by his written contract with RRA.

Defendant contends that there is no contract because the alleged terms are too indefinite. Defendant's argument focuses on the absence of a specific commission rate. Padilla's deposition testimony regarding the compensation terms was as follows:

A: *And [Rashkin] asked me what I thought on it, and I said, "Well, to me, I would like to get somewhere between one and ten percent, depending on the size of the contract and how much of a profit margin there was for the company." Because he says, "Oh, yeah, ten percent is pretty high, but it would all have to depend on what—you know, each contract is different." Like I said, depends on the billing rate and how much of a profit that contract allows. Some contracts end up with a lot higher profit rate than other ones do. And I told Stan I understand that if the company don't make much, then I don't make much; but if the company makes a bunch, then I expect to get a lot of it, also. And he agreed to it and—*

Q: *He agreed to what?*

A: *To the fact of giving one to ten percent. And I told him, okay, because I know of a couple of contracts that are coming up, and I think I can get the people to come over to RAA. And he said it sounded very good to him because they were just breaking into a new market at the time, and he could use all the new contracts there that they could muster. Up to that point, they were basically out in Los Alamos. And [Rashkin] told me then that if I brought in a contract that he would get with me afterwards, show me all the paperwork on it, as far as how much it was, getting—actually bringing in, where everything was going to, and then we would negotiate the one to ten percent depending on, you know, how it came out. And I said, “Fine, that way we can look over the figures and I’d know exactly why you’re offering,” like I told him, “two, one, eight, ten, whatever.”*

To paraphrase, Padilla and Rashkin agreed that if Padilla procured a contract, the two would then review the circumstances surrounding the contract and negotiate a commission of between 1% and 10%.

Is this agreement sufficiently definite to be enforceable?

See Padilla v. RRA, Inc., 946 P.2d 1122 (N.M. Ct. App. 1997).

Chapter 5

Termination of the Offer

Contracts are a bit like magic. As a sorcerer conjures a spell by intentionally speaking certain magic words, an ordinary person can invoke a contractual obligation through intentional words as well. Even after studying contract law for more than a decade, I still find it awesome and powerful that the law allows people to create binding obligations with mere words. Contracts still feel like magic to me.

The first magic moment in contract law is the creation of an offer. As discussed in the previous chapter, once an offer is made, the specter of law is invoked. An offer is an obligation waiting to spring into existence. We call this opportunity to create a legal obligation the “power of acceptance.”

An offer gives to the offeree a continuing power to complete the manifestation of mutual assent by acceptance of the offer. R2d § 35(1).

But offers do not wait forever. The offer must be accepted, in which case it transforms into a binding legal obligation; otherwise, the offer is terminated. Once an offer is terminated, the power of acceptance disappears. The offer cannot be accepted unless it is made anew.

A contract cannot be created by acceptance of an offer after the power of acceptance has been terminated in one of the ways listed in R2d § 35(2).

This chapter is about the termination of the offer while it is still just an offer, such that a contract never comes into being. When an offer is made by an offeror, that offer confers the power of acceptance upon the offeree. The ball, so to speak, is now in the offeree’s court. The offeree may choose to accept the offer. Acceptance is discussed in the next chapter. But otherwise, if the offer is not accepted, the offer will eventually be terminated, destroying the power of acceptance.

There are four methods through which an offer may be terminated, which are laid out in R2d § 36.

An offeree’s power of acceptance may be terminated by (a) rejection or counter-offer by the offeree, or (b) lapse of time, or (c) revocation by the offeror, or (d) death or incapacity of the offeror or offeree. R2d § 36(1).

There are two main categories of actions that will terminate an offer before it can mature into a binding contract. The first category is affirmative actions taken by the

offeror or the offeree. The offeror can revoke the offer; the offeree can reject the offer; or the offeree can make a counteroffer, which has the same effect as a rejection. The second category involves intervening events—lapse of time or the death of the offeree. If either of these events occurs, this automatically terminates the offer without any affirmative action or statement by either party.

An offer, once dead, cannot be accepted. However, either party is free to renew the offer or to make a new offer on the same or similar terms as the old one. Crucially, once an offer is accepted, it cannot be terminated. Once an offer is accepted, the offer matures into a contract. A contract is legally binding. It does not die as easily as offers do.

Students would be wise to watch out for fact patterns where, for example, an offeror purports to revoke an offer that was already accepted, or where an offeree accepts an offer, and then purports to change her mind by rejecting the offer. Neither action is an effective termination because the offer has already been accepted. The issue, instead, will be enforcement of a binding contract, which is the topic of the second half of this book. For now, we continue examining how offers are made, terminated, or accepted.

Rules

A. Rejection

An offeree can terminate an offer and lose the power of acceptance by rejecting the offer.

An offeree's power of acceptance is terminated by his rejection of the offer, unless the offeror has manifested a contrary intention. R2d § 38(1).

Offers can be rejected either directly, where the offeree directly communicates to the offeror their intent to reject the offer, or indirectly, where the offeree's conduct clearly demonstrates to the offeror that the offeree intends to reject the offer.

Direct rejection occurs when the offeree makes a clear and unequivocal manifestation (outward sign) of their intent to reject the offer, such as by saying, "No, I am not interested in that offer." Once the offeror receives notice of such a direct rejection, the offer is terminated.

However, a seeming rejection will *not* act as such if the offeror—or the offeree—manifests "a contrary intention." An offeror would manifest a contrary intention by saying something to the effect of "You can say 'no' now, but I'll give you a day to think about it, and you can get back to me tomorrow." An offeree would manifest a contrary intention by stating an intention to reject the offer at present but also indicating that they plan to "take [the offer] under further advisement."

A manifestation of intention not to accept an offer is a rejection unless the offeree manifests an intention to take it under further advisement. R2d § 38(2).

Thus, the offeree can state that she wishes to reject the offer for now but plans to reconsider it at a future time. For instance, the offeree's statement "I am not interested in that offer today, but I will revisit your offer tomorrow" will keep the offer alive. The power of acceptance has not been terminated. So tomorrow, after reconsideration, the offeree could still accept the offer.

Whether an offeree manifests a contrary intention depends on an analysis of specific facts. For example, if Susan offers to sell her laptop to Bill for \$500 and Bill says, "I'm not interested at that price," that is probably a rejection by Bill that terminates the offer. However, if Bill says, "I'm not interested at that price, but let me get back to you after pay day," that might not terminate the offer because Bill has manifested a contrary intention. Bill seems to have manifested an intention to take the offer under further advisement.

An indirect rejection occurs when the offeree's actions reasonably indicate to the offeror that the offeree does not intend to accept the offer. For example, Zeke offers to sell his house to Yolanda. Instead of responding to Zeke, Yolanda, the offeree, goes off and buys a house from a third party, Wendy. When Zeke, the offeror, learns about Yolanda's actions, Zeke may well wonder whether Yolanda's purchase of Wendy's house is an indirect rejection of his offer to sell her his own house. The answer matters to Zeke because he may feel wary about selling his house to someone else while his offer to Yolanda is still open.

To resolve this issue, the law asks whether Zeke should reasonably interpret Yolanda's actions as indicating an intention to reject his offer. Since most people only buy one house at a time, it is likely reasonable for Zeke to see Yolanda's purchase of Wendy's house as an indirect rejection of his offer—through her conduct, if not through her words. As a result, Zeke can confidently move forward with selling his house to someone else. If Yolanda comes back, in the end, to accept Zeke's offer, she should not expect it to still be open. Yolanda's power of acceptance was terminated due to her own actions.

B. Counteroffer

A counteroffer functions as a rejection. What, then, is a "counteroffer"?

A counter-offer is an offer made by an offeree to his offeror relating to the same matter as the original offer and proposing a substituted bargain differing from that proposed by the original offer. R2d § 39(1).

The definition of "counteroffer" has three elements.

First, a counteroffer must be an offer. In other words, the counteroffer itself must meet the definition of an "offer" under R2d § 24. Offers were discussed in the last chapter.

Second, the counteroffer must relate to the same matter as the original offer. If Keisha offers to sell Xavier her car and Xavier responds by offering to mow Keisha's lawn,

Xavier's statement is probably not a counteroffer because it does not relate to the same matter as Keisha's offer. In contrast, if Xavier offers to buy Keisha's car for a lower price, this would be a counteroffer because it relates to the same matter as the original offer.

Third, the counteroffer must propose a substitute for the original bargain. If the purported counteroffer and the original offer could both be accepted at once, that is not really a counteroffer at all.

Deciding whether a response to an offer is a counteroffer can be difficult and requires nuanced analysis. For example, Alpha Investors Corporation puts out an advertisement that states, "We will buy all outstanding shares of Alpha stock for a reasonable price." This is probably not an offer but an invitation for offers because advertisements usually are not offers and the price is indeterminate here. Ivana, an owner of shares in Alpha, emails Alpha with her own offer, writing, "I will sell you half of my shares for \$100 each." Alpha replies to Ivana's offer, "Will you sell your other half for \$110 each?"

Does Alpha's reply, offering to buy the other half of Ivana's shares, terminate Ivana's offer with respect to the first half of her shares? Probably not. Alpha's response does not technically appear to be a counteroffer, because Alpha's proposal (although it relates to the same matter as Ivana's) is not strictly a substitute for Ivana's offer. Rather, Alpha's offer is a new offer that is a *complement* to Ivana's original offer. Thus, regardless of whether Ivana is interested in Alpha's new offer, Alpha could still thereafter accept Ivana's original offer to purchase the first half of Ivana's shares for \$100 each.

Once again, these are default rules. They can be altered by the parties. As with rejections, it is possible for either of the parties to manifest a contrary intention and keep an offer open despite a seeming counteroffer.

An offeree's power of acceptance is terminated by his making of a counter-offer, unless the offeror has manifested a contrary intention or unless the counter-offer manifests a contrary intention of the offeree. R2d §39(2).

For example, if Ivana responds to Alpha's offer above by saying, "I would love to sell you my shares, but that price is too low. Without terminating your offer, I'd like to propose a higher price." This would *not* terminate the offer because Ivana clearly manifested her intention to hold the original offer open.

In sum, the R2d makes clear that a counteroffer generally functions as a rejection. This is actually not the most difficult part of the rule. The most difficult part of the rule is determining whether what appears to be a counteroffer is in fact an *acceptance*. That distinction will be discussed in detail in the next chapter.

C. Revocation

Recall the maxim that the offeror is "the master of the bargain." The offeror sets the terms by making the offer. The general rule is that the offeror can revoke that offer at any time prior to acceptance.

An offeree's power of acceptance is terminated when the offeree receives from the offeror a manifestation of an intention not to enter into the proposed contract. R2d § 42.

Most offers are freely revocable, meaning that the power of acceptance terminates when an offeror revokes an offer. Note that the process of revocation requires the offeree to receive notice of the revocation. Moreover, the revocation is not effective, and the power of acceptance is still available, until the offeree receives actual or constructive notice of revocation.

Actual or express revocation does not require the offeror to use magic words such as “I revoke.”

The word “revoke” is not essential to a revocation. Any clear manifestation of unwillingness to enter into the proposed bargain is sufficient. Thus a statement that property offered for sale has been otherwise disposed of is a revocation. R2d § 42 cmt. d.

For example, Aileen offers to sell her house to Brendan. Before Brendan accepts, Aileen calls Brendan and says to him, “I am feeling really nervous about selling my house, and I might not want to go through with this transaction.” The reasonable interpretation of this conversation is that Aileen has revoked her offer, and so Brendan’s power of acceptance is terminated.

Constructive notice or indirect communication of revocation occurs where an offeror takes an action that is inconsistent with the offer.

An offeree's power of acceptance is terminated when the offeror takes definite action inconsistent with an intention to enter into the proposed contract and the offeree acquires reliable information to that effect. R2d § 43.

For example, if Aileen offers to sell her house to Brendan but then puts a sign on her property that says “sold” before Brendan accepts, then Aileen has indirectly communicated that the offer is revoked. The revocation is effective when Brendan is informed of the action. For example, if Brendan drives by the house and sees the “sold” sign at 2 p.m. on Tuesday, then his power of acceptance is terminated at 2 p.m. on Tuesday. After that time, Brendan cannot accept Aileen’s offer.

D. Revocation of General Offer

Advertisements are usually not offers, as you learned in the last chapter, because they typically do not manifest an intent to be bound and often lack material terms. However, in rare cases where advertisements are deemed offers, such as in *Lefkowitz v. Great Minneapolis Supply Store*, 86 N.W.2d 689 (Minn. 1957), special rules govern their revocation. Offers made to the public through advertisements or other general notifications are known as “general offers.”

When an offer is made by advertisement or another general notification to the public or an indefinite number of persons, the offeree's power of acceptance is terminated when the offeror provides notice of revocation by means equivalent to or better than the original offer's publicity. R2d § 46 requires that revocation of a general offer match or exceed the reach of the original communication. This ensures that all potential offerees have an opportunity to receive notice of revocation. Personal notice to individual offerees, while potentially effective in narrow circumstances, is generally insufficient for revoking a general offer unless it is clearly the most effective means of providing notice.

This principle was at issue in *Lefkowitz*. The store advertised fur coats for \$1 on a first-come, first-served basis. Lefkowitz validly accepted the first offer by arriving at the store with \$1 in hand. After acceptance, the store attempted to impose a "house rule" that the offer applied only to women. The court found that this rule had no effect because Lefkowitz had already accepted the offer, forming a binding contract.

On a subsequent occasion, Lefkowitz returned to accept a similar advertisement offering a mink stole for \$1. This time, the store claimed that Lefkowitz's actual knowledge of the house rule prevented his acceptance. However, the court ruled that the store's attempt to impose the house rule was ineffective because it failed to provide public notice equivalent to the original advertisement. Personal notice to Lefkowitz did not suffice to revoke or alter the general offer, as it failed to inform the broader audience targeted by the original advertisement.

The Restatement reinforces these principles. Comment b to R2d § 46 explains that general offers require revocation through public means reasonably calculated to reach the same audience. Illustration 1 demonstrates that, in rare cases, personal notice may be appropriate if it is the most effective means available. However, this is an exception, not the rule. For most general offers, personal notice does not satisfy the requirement of general notification.

The key takeaway is that revocation of a general offer must provide notice comparable to the original offer's publicity. Attempts to revoke or alter the terms of a general offer must use similar public methods to ensure fairness and prevent selective enforcement. Personal notice alone is insufficient unless clearly demonstrated as the best means of reaching all potential offerees.

E. Lapse of Time

Remember that there are two categories of methods for terminating offers. The first is where the offeror or the offeree takes some affirmative action to terminate the offer. The second is where, without any affirmative action by either party and without notice to either party, some intervening event automatically terminates the offer.

The main way an offer automatically terminates is through lapse of time. Offers do not last forever. Once an offer is made, how long does it last before the offeree can no longer accept it? Offerors are the masters of their bargains, so they can specify when

their offers will expire. If the offeror says, “You have three days to accept the offer,” then a specified time was given, and the offer will terminate after three days.

What happens if no time is specified? If no time is specified, then the offer lapses after a “reasonable time.” What constitutes a reasonable time is often a factual question because it can vary depending on the circumstances in a case.

An offeree’s power of acceptance is terminated at the time specified in the offer, or, if no time is specified, at the end of a reasonable time. R2d § 41(1).

A common fact pattern is where an offer is made in face-to-face conversation. Generally, when offers are made during a face-to-face conversation, the offer terminates at the end of that conversation. This is known as the “conversation rule.”

However, as you will see in *Yaros v. Trustees of University of Pennsylvania*, 742 A.2d 1118 (Pa. Super. Ct. 1999), below, the conversation rule is not always dispositive. If it reasonably appears that the offeror or offeree intends to keep the offer alive beyond the conversation, then the offer is not terminated. In *Yaros*, the critical language was: “You’ve got to get back to me.”

The conversation rule includes both face-to-face negotiations and discussions over the telephone. It probably applies equally to any other live communication, like Face-Time, Zoom, or VR, but these new technologies have not yet been thoroughly tested in courts.

F. Death or Incapacity of the Offeror or Offeree

The second way an offer automatically terminates, without any affirmative action by either party, is through the death or incapacity of the offeror or offeree. The death or incapacity of either terminates an offer even if the other party has no notice of this event.

An offeree’s power of acceptance is terminated when the offeree or offeror dies or is deprived of legal capacity to enter into the proposed contract. R2d § 48.

This rule, although still followed in most jurisdictions, is out of sync with the other rules regarding termination of the power of acceptance, which all turn on reasonable notice of the termination. It appears that this rule is a holdover from a now-outdated notion that contracts require a subjective meeting of the minds. Obviously, a subjective meeting of the minds is impossible if one of those minds is now dead or incapacitated. Modern contract law generally uses an objective standard, asking how a reasonable person would interpret manifestations, but this rule does not fit with that reasoning.

Perhaps the rule remains good law because it seems unfair to hold an estate liable for offers made by a decedent that were not accepted during the decedent’s lifetime. But this rule is on shaky ground. Some state legislatures have overturned it with statutes that allow banks and collection agencies to accept offers after the death of the offeror. And courts have refused to obey this rule on equitable grounds.

Since it seems possible that this rule is eroding, lawyers can make arguments why this rule should or should not be followed. For example, if the application of the death-of-offeree rule means that a widow does not receive a payout from an insurance company, the widow's attorney might present facts that tend to show this result is unfair, and that argument might prevail.

G. Irrevocability

The general rule is that the offeror is the “master of the bargain” and can at any time prior to acceptance revoke the offer at will. However, offers can be made irrevocable, such that they cannot be revoked or terminated by any of the methods listed in R2d § 36.

There are four ways in which an offer can be made irrevocable:

- (1) option contracts supported by “consideration”;
- (2) merchant’s “firm offer” under the UCC;
- (3) the part-performance doctrine, which applies to offers for “unilateral contracts”; and
- (4) option contracts that result from detrimental reliance by the offeree.

You can remember these methods of irrevocability through the simple acronym “OFUR” (option, firm, unilateral, reliance) which might remind you of Lefkowitz’s fur coat.

1. *Traditional Option Contracts with Consideration*

The traditional way to make an offer irrevocable is to form an option contract. An option contract is a separate contract, created using the usual rules of contract formation, in which the offeror promises not to revoke their offer and the offeree provides consideration in exchange for this promise.

According to R2d § 25, an option contract is “a promise which meets the requirements for the formation of a contract and limits the promisor’s power to revoke an offer.” For example, if Aileen offers to sell her house to Brendan, Brendan might bargain for time to consider Aileen’s offer. Brendan could say, “I will pay you \$100 if you will keep your offer open for one week.” If Aileen accepts Brendan’s offer, they create an option contract that limits Aileen’s power to revoke her offer for the agreed period.

Option contracts require an offer, acceptance, and consideration, like any other contract. However, the key distinction lies in their function. The primary purpose of an option contract is to make the underlying offer irrevocable for a specific period, thereby creating a protected window during which the offeree can decide whether to accept the underlying offer.

Another unique aspect of option contracts is their treatment of consideration. While consideration in a typical contract must reflect a genuine exchange of value, option contracts allow for nominal consideration—a legal fiction designed to make the promise enforceable. For example, a promise to hold an offer open for one week in exchange for twenty-five cents is sufficient to create a binding option contract, even though twenty-five cents is trivial in comparison to the value of the underlying property.

Courts who follow R2d acknowledge the sufficiency of nominal consideration in option contracts for practical reasons. Option contracts serve to facilitate negotiations and business dealings by securing the availability of the underlying offer without requiring significant financial commitment at the outset. This contrasts with general bargained-for exchange contracts, where consideration must represent a meaningful reciprocal obligation. As explained in R2d § 87, nominal consideration suffices because the promise to hold the offer open is the focus, not the adequacy of the payment.

For instance, in *Baumer v. United States*, 580 F.2d 863 (5th Cir. 1978), the court upheld an option to buy real estate despite the optionee's failure to deliver the one dollar recited as consideration. The court reasoned that the recital created an implied promise to pay, which satisfied the consideration requirement. Similarly, in *Carter Oil Co. v. Owen*, 27 F. Supp. 74 (N.D. Ill. 1939), the court reaffirmed that any valuable consideration, even if nominal, binds an option agreement. These cases illustrate how the flexibility of nominal consideration ensures that option contracts can function effectively, without overly burdensome formalities.

Option contracts also have special rules governing termination. According to R2d § 37, “the power of acceptance under an option contract is not terminated by rejection or counteroffer, by revocation, or by death or incapacity of the offeror, unless the requirements are met for the discharge of a contractual duty.” This reinforces the robust protection provided to the offeree during the option period.

Option contracts can be written or oral, provided the statute of frauds does not apply to the underlying agreement. Their essential purpose is to ensure stability in negotiations, making them a critical tool in business and legal practice.

2. Merchant's “Firm Offer” under the UCC

In addition to traditional option contracts supported by consideration, the UCC provides another way to make an offer irrevocable—specifically for merchants. Recall that the UCC applies to transactions involving the sale of goods. Goods are defined as movable and identifiable items at the time of sale.

Certain UCC provisions, including the firm offer rule, apply exclusively to merchants. The UCC defines two types of merchants: (1) persons who regularly deal in goods of the kind involved in the transaction (narrow sense), or (2) persons who, by their occupation, hold themselves out as having knowledge or skill peculiar to the

goods or transaction in question, or who hire an agent with such expertise (broad sense). See UCC § 2-104. A person can be a merchant either by dealing in specific goods or by demonstrating professional expertise in the practices of the trade.

The firm-offer rule is a merchant-specific provision.

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror. NH UCC § 2-205.

A firm offer functions similarly to an option contract in that it makes an offer irrevocable for a period of time. However, unlike traditional option contracts, the firm offer does not require consideration from the offeree. If a merchant provides a binding assurance to hold an offer open in a signed writing, they are bound by that promise—even without receiving compensation.

For example, imagine a merchant named ChefCo, which sells restaurant equipment, offers to sell an espresso machine to a café owner for \$3,000. In a signed letter, ChefCo states that the offer will remain open for 30 days to give the café owner time to decide. Under UCC § 2-205, ChefCo's promise to hold the offer open is binding, and it cannot revoke the offer during the 30-day period, even though the café owner has not paid ChefCo any consideration to keep the offer open.

If no specific time period is stated in a firm offer, the UCC provides that the offer remains open for a "reasonable time." However, the irrevocability period cannot exceed three months under any circumstances. After the specified or reasonable time period ends, the offer becomes revocable unless renewed by the offeror.

The firm-offer rule is designed to facilitate commercial transactions by ensuring that merchants can rely on binding assurances without the formalities of consideration while also imposing reasonable limits on the duration of irrevocability.

3. The Part-Performance Doctrine—Unilateral Contracts

Recall the distinction between a unilateral contract and a bilateral contract. Most offers can be accepted either by promising to perform or by actually performing, which typically generates an implied promise to complete the performance. This results in a bilateral contract formed through an exchange of promises on both sides. See R2d § 62.

For example, suppose your neighbor says, "I will give you \$20 to mow my lawn by Friday." You can accept this offer by saying, "Okay, I will do that." Your promise to mow the lawn creates an obligation to complete the task, and your neighbor is likewise obligated to pay you. Alternatively, you could accept the offer by beginning

to mow the lawn, which constitutes an implied promise to finish the job by Friday. In either case, the contract is bilateral, formed through the exchange of promises.

Now consider a different case. Your neighbor says, “I will give you \$20 if you mow my lawn by Friday, and I’ll only pay you after you finish mowing the lawn to my satisfaction.” This is an offer for a unilateral contract. Here, only one side takes on a promissory obligation—your neighbor’s promise to pay upon satisfactory completion. You cannot accept the offer by promising to mow the lawn. Instead, the offer invites acceptance solely through performance.

This creates both an opportunity and a risk for the offeree. On the one hand, you are free to decide whether or not to perform, as you are under no obligation to mow the lawn until you actually begin the task. On the other hand, the offeror remains free to revoke the offer at any time prior to your acceptance, leaving you vulnerable to losing the benefit of the contract even after you’ve started to perform. For instance, if you begin mowing the lawn on Thursday and, just before you finish, your neighbor says, “Never mind, I revoke the offer,” the law historically would have allowed such a revocation because you had not yet completed performance.

The unfairness of this rule led to the development of the part-performance doctrine, now codified in R2d § 45. This section provides:

Where an offer invites an offeree to accept by rendering a performance and does not invite a promissory acceptance, an option contract is created when the offeree tenders or begins the invited performance or tenders a beginning of it.

Under this doctrine, once the offeree begins performance, an option contract is created. This option contract binds the offeror to keep the offer open for a reasonable time, giving the offeree the opportunity to complete the performance and form the unilateral contract.

For example, if Susan posts a notice offering a \$1,000 reward for the return of her lost dog, this is an offer for a unilateral contract. You cannot accept the offer by calling Susan and promising to find the dog; acceptance occurs only by finding and returning the dog. If you find the dog and are walking toward Susan’s house to return it, Susan cannot revoke the offer upon seeing your approach. Your partial performance of the requested task creates an option contract, preventing Susan from revoking the offer and ensuring that you have a reasonable time to complete the task.

Similarly, if you start mowing your neighbor’s lawn, your performance generates an option contract obligating the neighbor to keep the offer open until you have had a reasonable opportunity to complete the job. The specified time period—Friday, in this case—defines what is reasonable. However, the doctrine does not protect mere preparation to perform. If you only walk toward your neighbor’s house with the intent to start mowing, the neighbor may still revoke the offer because you have not yet begun the performance.

The part-performance doctrine balances the interests of both parties by ensuring fairness in unilateral contracts. It protects offerees who invest time and effort in reliance on the offer while preserving the flexibility inherent in the unilateral contract structure. However, it applies only after performance has begun, reinforcing the principle that preparation alone is insufficient to bind the offeror.

4. Option Contracts Based on Detrimental Reliance Rather than Consideration

The final way to make an offer irrevocable is through detrimental reliance, a principle that extends beyond the part-performance doctrine. At its core, this approach is rooted in the concept of reliance.

Under the general rule, courts enforce option contracts only if they are supported by consideration—a bargained-for exchange where the offeror receives something of value in return for their promise to hold the offer open. However, in some cases, courts protect offers from revocation even without consideration. This occurs when the offeree reasonably relies on the offeror's assurances and suffers a detriment as a result.

Reliance refers to a situation where one party reasonably depends on the promise of another and takes action based on that dependence. Detrimental reliance occurs when the action taken in reliance worsens the relying party's position. Courts often enforce promises that lack consideration when detrimental reliance is present, treating reliance as a substitute for consideration.

This principle applies to the formation of option contracts as well. Even though option contracts typically require consideration to be binding, an offer may become irrevocable through detrimental reliance if the offeree takes significant action based on the offer. The *Restatement (Second) of Contracts* articulates this principle in § 87(2):

An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice.

Consider this example: Aileen offers to sell her house to Brendan and says, "I will give you one week to think about it." Aileen's promise to keep the offer open is unsupported by consideration; she receives nothing in return. Ordinarily, she could revoke her offer at any time before Brendan accepts, as her promise is unenforceable for lack of consideration.

Now imagine Brendan takes significant steps in reliance on Aileen's promise. For instance, he mortgages his own house to raise the cash to buy Aileen's property. In doing so, Brendan incurs closing costs, damages his credit score, and expends significant time and effort. If Aileen decides to revoke her offer before the week is up, Brendan is left worse off.

In this situation, Brendan's detrimental reliance could make Aileen's promise enforceable as a reliance-based option contract. The key question would be whether Brendan's actions were reasonable and whether a reasonable person in Brendan's position would have taken such steps based on Aileen's promise to hold the offer open.

It is critical to distinguish reliance-based option contracts from standard option contracts supported by consideration. Courts almost always enforce valid option contracts with consideration, as they represent a bargained-for exchange. By contrast, reliance-based option contracts are enforced only when justice so requires. Brendan's likelihood of success in court is much higher if he paid Aileen for her promise to keep the offer open. Without payment, Brendan must rely on the court's equitable discretion and its assessment of whether his reliance justifies enforcement of the promise.

This distinction highlights the discretionary nature of reliance-based enforcement. While courts recognize reliance as a substitute for consideration, they impose limits to ensure fairness. Only reasonable and substantial reliance will transform an offer into an irrevocable option contract.

H. Reflections on Termination of the Offer

Offers are ephemeral. They quickly mature into contracts or decay into nothing. Offers have a natural half-life; they lapse and dissolve into non-offers after a reasonable time. But offers may also be terminated by action—either by the offeror or the offeree. The offeror, as the master of the bargain, retains the power to revoke the offer unless it has become irrevocable through an option contract, a firm offer, part performance, or detrimental reliance. The offeree, too, can terminate the offer, by providing the offeror with reasonable notice of rejection or counteroffer.

When an offer is terminated by either party, the termination becomes effective upon notice to the other. Notice can be actual, as when the offeror explicitly communicates that the offer is withdrawn, or constructive, as when the offeree learns that the offeror has sold the subject matter to someone else. Timing is critical in these situations. If the offeree accepts the offer before receiving notice of its termination, the acceptance creates a binding contract. This principle is explored further in the “mailbox rule,” discussed in the chapter on acceptance.

An exception to the notice requirement arises when either party dies or becomes incapacitated. Death or incapacity immediately terminates an offer, even without notice to the other party. This rule may seem inconsistent with the modern objective view of contract formation, where the focus is on outward manifestations of intent. Yet, the automatic termination rule persists, reflecting the historical roots of contract law in subjective theories of mutual agreement.

To summarize, an offer creates a power of acceptance in the offeree when it is received. This power is extinguished when the offeree receives a revocation, or when

the offeror receives a rejection or counteroffer. The power of acceptance also terminates automatically upon lapse of the offer or the death or incapacity of either party. Once the power of acceptance is terminated, the offer can no longer be accepted. But as long as the offer remains alive, the offeree may accept it by sending a valid acceptance, as you will learn in the next chapter.

Cases

Reading Smaligo v. Fireman's Fund Insurance Co. Direct rejection may be easy to identify where a party makes a clear and unequivocal manifestation, such as a statement that the party does not intend to accept an offer. The harder case, however, arises where a party's actions may constitute an indirect rejection. The *Smaligo* case illustrates a situation where a party may have indirectly rejected an offer to settle a lawsuit by taking an action that may be considered inconsistent with entertaining a settlement offer. As you read this case, think about what sorts of actions the plaintiffs (the Smaligos) might have taken that would still have kept the settlement offer open and what other actions they could have taken that would manifest their intention to terminate the offer.

Smaligo v. Fireman's Fund Insurance Co.

432 Pa. 133 (1968)

[On March 27, 1967, during a weekend stay with her parents, Elizabeth Smaligo was struck and killed by a hit-and-run driver in North Versailles Township. She was 37 years old. Michael and Mary Smaligo, Elizabeth's parents, made a claim against their insurance company under the terms of the Uninsured Motorist Provisions of an automobile liability policy that had been issued to them by that company wherein the company had agreed to pay "all sums which the insured or his legal representative shall be legally entitled to recover as damages."

The company refused to pay the \$9,750.00 requested by the Smaligos in settlement.

On July 27, 1967, the company notified the Smaligos' counsel by a letter that stated:]

We [Fireman's Insurance Fund] concede that there is a settlement value to the case but that it is not worth \$9,750, as demanded by you. In an effort to avoid further expenses and time to both, I will now make an offer to conclude this claim on an amicable basis and for the sum of \$7,500, which you may convey to your clients. If the offer of \$7,500 is not acceptable, I would then suggest that your arbitration papers be prepared as we have no intention of increasing this offer, feeling that it is fair and just to all parties concerned.

On August 30, 1967, Smaligos' counsel made a demand for arbitration to the American Arbitration Association. A hearing was held on December 18, 1967, which resulted in the arbitrator awarding only \$243.

The Smaligos argued that there was an offer and acceptance of a settlement in the amount of \$7,500. However, we are constrained to agree with the reasoning of the lower court that, when the Smaligos filed for arbitration of the dispute, they rejected the offer of settlement. The letter quoted offering the \$7,500 clearly stated that the company was "now" offering the same and that if it is not acceptable then Smaligos should proceed to arbitration.

By proceeding to arbitration, the Smaligos showed the offer was not acceptable and such conduct clearly showed that the Smaligos did not intend to accept the offer nor take it under further advisement.

Reflection

Smaligo illustrates how an offer is indirectly rejected based on conduct inconsistent with the offer.

R2d § 38 states:

A manifestation of intention not to accept an offer is a rejection unless the offeree manifests an intention to take it under further advisement.

In this case, the insurance company clearly offered the Smaligos \$7,500 and explained that if the Smaligos found this amount unacceptable, they could proceed with arbitration, but the insurance company would not be increasing the offer. The Smaligos chose to proceed with arbitration, therefore rejecting the offer from the insurance company. The Smaligos made it clear that they found the amount unacceptable and showed no intent to take the offer under further advisement.

The important takeaway from this case is that offers can be indirectly rejected. Offers can be rejected by a manifestation of intent not to accept.

Discussion

1. How can offers be rejected? Can you distinguish between an express versus an implied rejection?
 2. Why should rejection terminate the power of acceptance? Consider how a rejection impacts the offeror and what a reasonable offeror might do upon receiving a rejection.
 3. Why did the Smaligos' filing for arbitration implicitly reject the Insurance Fund's offer to settle the case? What else might the Smaligos have done to avoid terminating their power of acceptance?
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Reading Yaros v. Trustees of University of Pennsylvania. The offeror, the master of the bargain, can stipulate for how long an offer is available for acceptance. But what happens if no time was stipulated? If the offeror does not stipulate the duration of the offer, then the offer lapses after a reasonable time. What constitutes a reasonable amount of time is often a factual question because it can vary depending on the circumstances in a case. As you read the *Yaros* case below, pay attention to how the court determined what a reasonable amount of time should have been, given the situation and whether offers always end at the end of conversations. This case also introduces the “conversation rule” while simultaneously providing an exception to it.

Yaros v. Trustees of University of Pennsylvania

742 A.2d 1118 (Pa. Super. Ct. 1999)

ORIE MELVIN, J.:

This is an appeal from an Order entered February 22, 1999, granting appellee Dr. Nancy Yaros’s Motion to Enforce Settlement against appellant, the Trustees of the University of Pennsylvania (“University”). For the reasons that follow, we affirm.

The record reveals Dr. Yaros brought a negligence action against the University after she fell at one of its ice skating rinks. Trial was held before the Honorable Paul Ribner. At trial, attorney Richard P. Haaz represented Dr. Yaros. Counsel for the University was John Orlando. Also present was Erika Gross, who was the liability administrator for the University. Testimony began on January 26, 1998. On that date, the University offered Dr. Yaros a settlement offer of \$750,000.00. Attorney Haaz informed Attorney Orlando that Dr. Yaros would accept \$1.5 million in settlement up until the time she testified, after which she would not settle for any amount. The trial continued, two defense witnesses took the stand, and then Dr. Yaros testified. No settlement was reached at that time.

On January 29, 1998, after the conclusion of testimony, the University offered Dr. Yaros \$750,000.00 in settlement. Attorney Orlando made the offer to Attorney Haaz during a ten minute recess prior to closing arguments. At the close of the conversation Attorney Orlando told Attorney Haaz “you’ve got to get back to me.” When he made this statement, Attorney Orlando looked at the clock and placed his palms sideward. No time limitations regarding the offer were communicated, nor was it indicated that the offer was only open until closing arguments began. Attorney Haaz stated he would talk to his client now. After the offer was made Attorney Haaz left the courtroom to speak to his client. Attorney Orlando also left the courtroom to go to the men’s restroom. Attorney Haaz returned to the courtroom without Dr. Yaros, who was in the restroom. Attorney Haaz asked the trial court for two minutes to speak to his client before closings, to which the court agreed. At that time Attorney Orlando assumed Attorney Haaz had not discussed the offer with Dr. Yaros.

Upon Dr. Yaros's return, Attorney Haaz did not confer with her and closing arguments commenced immediately. Earlier that day, Judge Ribner informed both counsel he expected closing arguments to be finished by 5:00 p.m. so he could charge the jury the next day. During the University's closing, Dr. Yaros authorized Attorney Haaz to accept the offer. After the University ended its closing, Attorney Haaz gave his rebuttal. At a sidebar conference following closings Attorney Haaz stated Dr. Yaros accepted the University's settlement offer. Attorney Orlando replied by stating, "I don't know if it's still there, judge." The next day, prior to jury deliberations Dr. Yaros orally moved to enforce the settlement. Judge Ribner denied the motion pending evidentiary hearings on the matter and the jury's verdict. The jury came back with a defense verdict. Following trial, Dr. Yaros filed a Motion for Post-Trial Relief and a Motion to Enforce Settlement. One evidentiary hearing was held before Judge Ribner. However, upon his retirement the case was reassigned to the Honorable Sandra Mazer Moss, who conducted hearings on January 12 and 15, 1999. On February 22, 1999, Judge Mazer Moss granted Dr. Yaros's Motion to Enforce Settlement. This timely appeal followed.

On appeal, the University raises several allegations of error in connection with the trial court's enforcement of the settlement. It presents the following issues for our review:

1. Whether the Trial Court erred in granting [Dr. Yaros's] Motion to Enforce Settlement, which overturns a unanimous jury verdict for [the University], even though the Trial Court failed to apply the proper legal standard for determining whether there was a valid and enforceable settlement agreement between the parties?
2. Whether the Trial Court erred in granting [Dr. Yaros's] Motion to Enforce Settlement, even though, as a matter of law, [Dr. Yaros's] conduct constituted a rejection of the settlement offer?
3. Whether the Trial Court erred in granting [Dr. Yaros's] Motion to Enforce Settlement, even though, as a matter of law, [Dr. Yaros] did not accept the settlement offer within a reasonable time under the circumstances, and therefore allowed the offer to lapse?
4. Whether the Trial Court's factual finding that [Dr. Yaros] accepted the University's offer within a reasonable period of time was against the weight of the evidence, capricious and erroneous as a matter of law?

We first address the University's contention the trial court failed to apply the proper legal standard in determining whether there was a valid and enforceable settlement. Initially, we note the University's first claim on appeal challenges the trial court's conclusions of law. When reviewing questions of law, our scope of review is plenary. Thus, we are free to draw our own inferences and reach our own conclusions. "If a trial court erred in its application of the law, [we] will correct the error."

The trial court found the University's offer was not withdrawn and Dr. Yaros accepted it within a reasonable amount of time under the circumstances. In analyzing

whether this was a valid and enforceable settlement agreement the trial court relied upon the standards set forth in *Vaskie v. West American Ins. Co.*, wherein this Court stated:

Under such circumstances, i.e. where an offer does not specify an expiration date or otherwise limit the allowable time for acceptance, it is both hornbook law and well-established in Pennsylvania that the offer is deemed to be outstanding for a reasonable period of time.

The University asserts the above legal standard is only a general rule. It maintains the “conversation rule” as stated in Restatement (Second) Contracts § 41, comment d governs. That comment provides as follows:

d. Direct negotiations. Where the parties bargain face to face or over the telephone, the time for acceptance does not ordinarily extend beyond the end of the conversation unless a contrary intention is indicated. A contrary intention may be indicated by express words or by the circumstances. For example, the delivery of a written offer to the offeree, or an expectation that some action will be taken before acceptance, may indicate that a delayed acceptance is invited.

Our Court has adopted the legal standard enunciated in comment d; *Textron, Inc. v. Froelich* (stating “an oral offer ordinarily terminates at the end of the conversation”); and *Boyd v. Merchants’ and Farmers’ Peanut Co.* (stating “[w]hen an offer is made to another orally and he goes away without accepting it, it would seem that ordinarily the offer would be considered as having lapsed”).

In *Textron*, the Court acknowledged that this standard does not preclude the possibility that an oral offer continues past the conversation and noted the general rule that if no time is specified, the offer terminates at the end of a reasonable amount of time. Furthermore, the Court stated while there may be times when a judge could find as a matter of law that an oral offer terminates with the end of the conversation, if there is any doubt as to what is a reasonable interpretation, the decision should be left to the factfinder. The University insists that because of the face-to-face nature of the negotiations, the offer terminated at the end of the conversation between counsel or at the very latest at the beginning of closing arguments.

Because the parties’ counsel conducted face-to-face negotiations it appears comment d initially provides the more on point legal standard; however, this does not affect the trial court’s ultimate decision. The offer by the University clearly extended beyond the end of counsels’ conversation, during the court recess when Attorney Haaz walked out of the courtroom to speak with his client about the settlement offer. A contrary intention was clearly indicated by Attorney Orlando when he ended the conversation with Attorney Haaz by stating “get back to me.” Thus, the time for acceptance by Dr. Yaros extended beyond the end of the conversation between the parties’ attorneys. The question that then arises is how long was the offer open. The University maintains it intended the offer was only open until the beginning of closing

arguments, and such intention was clear. It submits that although Attorney Orlando did not articulate explicitly a definite time limit for Dr. Yaros's acceptance, its intention was manifested by the fact closing arguments were imminent, the established pattern of including an event condition with a settlement offer, and the verbal and non-verbal expressions used.

The enforceability of settlement agreements is determined according to principles of contract law. "[I]n the case of a disputed oral contract, what was said and done by the parties as well as what was intended by what was said and done by them are questions of fact." We find preposterous the University's assertion that its intention regarding the time limitation of the offer was clear. The trial court made a factual determination that no time or event conditions were ever placed on the settlement offer.

Here, the duration of the offer was not even clear to its trial counsel Attorney Orlando or its risk manager, Erika Gross. After Dr. Yaros accepted the offer Attorney Orlando stated, "I don't know if it's still there, judge." Certainly, if Attorney Orlando, the offeror, was unclear of whether the offer was still open after closing arguments were complete, it's incredulous to argue the offeree, Dr. Yaros, was clearly aware that the offer would lapse once closing arguments began. Moreover, we reject the University's claim that verbal and non-verbal conduct made the time limitation of the offer apparent. The University argues Attorney Orlando's statement "you've got to get back to me" can only be interpreted as "you've got to get back to me with an answer as soon as possible—which is, when we both come back into the courtroom: you from your discussion with your client and I from the Men's Room, so we can conclude this negotiation in the next few minutes before closings." We will not reject the trial court's findings in favor of such a strained interpretation of the statement, "you've got to get back to me," or conduct like Attorney Haaz's statement that he needed two minutes to speak with his client and Attorney Orlando's non-verbal act of looking at the clock and "put[ting] [his] palms sideways."

Additionally, the University makes much of the fact that Dr. Yaros had earlier during the trial imposed an event condition on a settlement offer. During trial Attorney Haaz informed Attorney Orlando that Dr. Yaros would accept a settlement in a certain dollar amount only up until the time she testified. The University now maintains this established a pattern of including an event condition with a settlement offer. While the prior course of dealings between the parties is instructive, in this case it cuts against the University's argument. In the parties' prior course of dealings, Dr. Yaros and her counsel explicitly informed the University of the event condition. There was no such explanation when the University made its offer just prior to closing arguments. Moreover, the offer remained open during the course of several witnesses' testimony. Under such circumstances, the prior course of dealing between the parties did not establish closing argument was an event which would terminate the offer.

The University next argues Dr. Yaros's conduct constituted a rejection of the offer. Specifically, it maintains that because Attorney Haaz did not confer with Dr. Yaros

when she returned to the courtroom just prior to closings and because Dr. Yaros participated in closing and rebuttal arguments without accepting the offer, it was justified in inferring she had in fact rejected the offer. The trial court found Dr. Yaros never rejected the offer. The court further rebuffed the University's contention that it could infer its offer had been rejected when closing arguments commenced.

An offer is rejected when the offeror is justified in inferring from the words or conduct of the offeree that the offeree intends not to accept the offer or to take it under further advisement. In *Smaligo*, an insurance company made a settlement offer informing the offeree plaintiffs that proceeding forward with the case would be viewed as a rejection. The plaintiffs proceeded to arbitration. This Court agreed with the trial court that plaintiffs' action clearly showed that they did not intend to accept the offer. Unlike *Smaligo*, this is not a situation where the offeree was placed on notice that certain conduct would constitute a rejection of the offer. While an offeree need not be put on specific notice that certain conduct will be viewed by the offeror as a rejection of the offer, not all conduct can justify an offeror in inferring that the offer has been rejected. In this case we can find no error in the trial court's finding that the University was not justified in inferring that proceeding to closing arguments would constitute a rejection of the settlement offer.

There is no per se rule that commencing with closing arguments constitutes a rejection of a settlement offer. Nor do we wish to create one here. It would produce a situation where an offeror would have the unfair advantage of unilaterally asserting after the offer has been accepted that an unspecified, undefined and uncommunicated event at trial constituted a rejection. Moreover, we agree with Dr. Yaros's observation that since the University believed she had not had an opportunity to consult with her counsel and was unaware of the settlement offer, it would not be justified in inferring that proceeding to closing arguments constituted a rejection of the offer. How the University could interpret the actions of Dr. Yaros and Attorney Haaz as a rejection of its offer when the University was under the impression Dr. Yaros was unaware of the offer at that time is beyond our understanding.

The University finally argues the settlement offer lapsed because, as a matter of law, Dr. Yaros did not accept it within a reasonable amount of time. It submits the trial court's factual finding that Dr. Yaros accepted the offer within a reasonable amount of time was against the weight of the evidence. Where an offer does not specify an expiration date or otherwise limit the allowable time for acceptance, the offer is deemed to be outstanding for a reasonable period of time. In *Vaskie*, this Court examined the issue of whether reasonableness is a question of law or of fact:

What is a reasonable time is ordinarily a question of fact to be decided by the jury and is dependent upon the numerous circumstances surrounding the transaction. Such circumstances as the nature of the contract, the relationship or situation of the parties and their course of dealing, and usages of the particular business are all relevant.

However, there are situations where the question of what is a reasonable time for acceptance may be decided by the court as a matter of law. As stated in *Boyd*:

What is a reasonable time for acceptance is a question of law for the court in such commercial transactions as happen in the same way, day after day, and present the question upon the same data in continually recurring instances; and where the time taken is so clearly reasonable or unreasonable that there can be no question of doubt as to the proper answer to the question. Where the answer to the question is one dependent on many different circumstances, which do not continually recur in other cases of like character, and with respect to which no certain rule of law could be laid down, the question is one of fact for the jury.

After holding numerous evidentiary hearings, the trial court treated this issue as a question of fact, finding the time period was reasonable under the circumstances. The University believes this is a question of law because trials happen in the same manner every day in the sense that the significant events of trial such as opening arguments, the presentation of evidence, and closing arguments proceed in the same manner in every trial. While trials do commence in the same manner, “the course and nature of settlement negotiations varies greatly from case to case.” There are individual circumstances distinct to this case, such as when and how the offer was made, which will not necessarily continually recur in other cases. Thus, we believe the trial court was correct in treating this as a question of fact.

As a reviewing court we will not disturb the findings of a trial judge sitting as the finder of fact unless there is a determination that those findings are not based upon competent evidence. In reviewing the trial court’s findings, the victorious party is entitled to have the evidence viewed in the light most favorable to him and all the evidence must be taken as true and all unfavorable inferences rejected. Moreover, the trial court’s decision should not be overturned unless the trial court’s factual findings were capricious or against the weight of the evidence.

In support of its contention that a reasonable amount of time to accept the offer had lapsed, the University rehashes the same arguments we have already addressed. The University maintains, although it did not articulate explicitly a definite time limit for acceptance, it limited the duration of the offer through its words and body language. As we have already found such conduct would not put Dr. Yaros on notice of any event condition on the offer, we will not discuss it further.

The University also submits the seventy minutes Dr. Yaros took to accept the offer was unreasonable in light of the fact the offer occurred during trial. It maintains there is an urgency that accompanies a response when an offer is made during the course of trial, and in such a context the actual amount of minutes from offer to acceptance is irrelevant. In effect, the University maintains where an offer is made immediately before closing arguments it is unreasonable for the offer to stay open beyond the commencement of closings, which in this case occurred approximately ten minutes after the offer was made.

In this regard the University makes much of the trial court's finding that closing arguments are not significant trial court events, instead arguing that "academic research, the wisdom of modern trial practitioners and more than two thousand years of jurisprudential history" require us to vacate the trial court's order. The University's argument is misplaced because the trial court made its observation regarding the significance of closings to address the University's argument that a rejection could be inferred when Dr. Yaros participated in closings. Whether or not closing arguments are significant trial events does not support the University's contention that the occurrence of closing arguments automatically causes a settlement offer to lapse. There are many significant events during the course of a trial. Settlement offers are accepted at all stages of trial. Even assuming a closing argument is a significant trial event, such an occurrence does not necessarily determine whether an offeree accepted an offer within a reasonable period of time. It is but one consideration.

Here, the trial court found the offer was accepted within a reasonable amount of time under the circumstances. We will not disturb that finding. Under the facts of this case, we cannot say the trial court erred in finding Dr. Yaros accepted the offer within a reasonable amount of time or such a finding was against the weight of the evidence. In conclusion, we find no abuse of discretion or error of law in the trial court's enforcement of the settlement.

Order affirmed.

Reflection

Yaros features a particularly interesting discussion on whether an offer ordinarily lapses at the end of a conversation. The general rule is that an offer ends along with the conversation that started it, unless circumstances indicate otherwise. If a Dunder Mifflin sales representative calls you and asks whether you would like to purchase ten reams of paper for a special discount of 20%, you cannot necessarily call back next week and expect that deal to still be available. But, of course, it all depends on the circumstances. If that is the third time in as many weeks that the representative called you with the same special price, a court would probably consider it reasonable if you called back an hour after the third call to accept the offer.

The *Yaros* court likewise held that, although the conversation rule is a useful default, not all offers lapse at the end of a face-to-face exchange. In *Yaros*, one lawyer made a settlement offer to opposing counsel during a brief trial recess, ending the conversation with the words, "you've got to get back to me." The offeror later argued that the offer terminated when the conversation ended or at the start of closing arguments. But the court was unconvinced. The phrase "get back to me" was ambiguous, and the surrounding circumstances—including the absence of an express time limit and the expectation that lawyers consult with their clients before accepting settlement offers—left room for reasonable disagreement. Summary judgment was therefore inappropriate. The court upheld the trial court's finding that the offer remained open

and had been accepted within a reasonable time, showing that the conversation rule can yield to context and interpretation.

The case also nicely reflects R2d § 41's reasoning. The rule for when an offer lapses is that it terminates at the time specified in the offer or, if unspecified, it terminates at the end of a reasonable time. A reasonable time may be until the end of a meeting or phone call, but this is not necessarily the end of an offer. An offeror who wishes to avoid contractual liability for an offer should make it clear when the offer has expired. Otherwise, there is room to argue that an acceptance was made within a reasonable time.

Discussion

1. What is the conversation rule? Is this rule based on formal legal principles or a realistic understanding of parties' likely intentions?
 2. What facts in the *Yaros* case indicate whether the conversation rule applies here? What did you learn from this specific case about when the conversation rule applies more generally?
 3. When the conversation rule does not apply, what other events or happenings, aside from the end of a conversation, should cause an offer to lapse?
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Problems

Problem 5.1. The Prisoners' Rejection and the Master Plan

In early 1978, prisoners at the Washington State Reformatory filed a class action on behalf of all present and future Reformatory inmates, alleging that the conditions of their confinement were unconstitutional. A trial date was set for January 15, 1981. As often happens on the eve before trial, the parties sought to reach a last-minute agreement before the trial began, and this was apparently effective. On January 13, the parties gave notice of a mutual settlement, and the trial was canceled. On January 19, a proposed consent decree was issued by the Washington State Reformatory. The proposed consent decree (a type of settlement that functions as a contract and which must be approved by a judge) provided that the Reformatory would reduce its population from 865 to 656 over the course of two years.

However, there was an error in the consent decree. The State's plan provided that the Reformatory's population reduction would be accomplished by March 1, 1983, instead of April 1, 1983. On February 13, 1981, the State submitted a revised consent decree listing April 1, 1983, as the deadline for the reduction. On February 26, the prisoners moved for approval of the consent decree with the March 1 date intact. The State moved for modification of the decree to incorporate the April 1 date.

On March 4, 1981, the magistrate denied both the State's and the prisoners' motions, finding there had been no meeting of the minds with respect to a key term of the agreement and therefore no contract had been formed.

On May 15, 1981, the prisoners filed a notice stating that they accepted the offer of settlement embodied in the proposed decree submitted by the State on February 13, which was the decree that listed April 1 as the deadline for reduction, not March 1.

Did the prisoners reject the decree that listed April 1 as the deadline for the reduction when they moved to approve the master plan with the March 1 deadline?

See Collins v. Thompson, 679 F.2d 168 (9th Cir. 1982).

Problem 5.2. A MINI Lapse

MINI is a British automotive marque that is now owned by the German automotive company BMW. BMW designed, manufactured, sold, and serviced MINI cars through its dealer network. Mini Works, a company that is not in BMW's dealer network, sold and serviced pre-owned MINI cars. BMW contacted Mini Works and offered to refrain from filing a lawsuit seeking monetary relief if Mini Works agreed in writing to cease and desist using MINI trademarks. BMW's letter stated:

It is our client's hope that this matter can be amicably resolved and that it will have your cooperation in discontinuing use of BMW's trademarks. Specifically, BMW requests that you:

- (1) Promptly drop "MINI" from your trade name and domain names;*
- (2) Cease and desist any and all other trademark use of MINI marks on your websites or elsewhere;*
- (3) Countersign and return the acknowledgment on page 4 of this letter, by June 21, 2007.*

If your company meets BMW's request to cease and desist, then BMW will consider the matter closed and will not seek monetary or other relief regarding this matter from you or your company. We look forward to your response by June 21.

On July 3, 2007, Mini Works signed and returned the acknowledgment. BMW sued Mini Works in an attempt to enforce the settlement agreement because Mini Works continued to infringe on its trademarks. Mini Works argued that BMW's offer expired on its own terms, and they could not have accepted it.

Did BMW's offer lapse by the time that Mini Works returned the letter?

See BMW of N.A., LLC v. Mini Works, LLC, 166 F. Supp. 3d 976 (D. Ariz. 2010).

Problem 5.3. Docked Out Settlement

Jason Varney is a master dock builder and was the star of a cable television show called *Docked Out*. He is also the president and sole shareholder of plaintiff Varney

Entertainment Group, Inc. (collectively, “Varney”). Avon Plastics Inc. manufactures products used to build docks.

In 2016, Varney and Avon entered into a written Endorsement Agreement, under which Mr. Varney agreed to promote Avon’s brand and products and allow Avon to use his name and likeness for two years in exchange for payment. The contract allowed Avon to terminate the contract early if *Docked Out* was no longer broadcast on television. It also contained a prevailing party attorney’s fee provision (meaning that the losing party in any litigation must pay the winning party’s attorney’s fees).

Midway through the contract term, *Docked Out* was canceled. Avon then unilaterally terminated the agreement and stopped paying Varney. Varney challenged the termination because *Docked Out* reruns remained available for viewing on the internet. A debate between the parties ensued regarding the meaning of the contractual term “broadcast.” Varney claimed that reruns counted as broadcasting, while Avon argued that they did not. The parties were unable to resolve their differences, and Avon refused to pay Varney any more money. Varney responded by suing Avon for \$250,000, which is the amount Varney claimed Avon still owed under the Endorsement Agreement.

Just before the lawsuit went to trial, Varney sent Avon a settlement offer in the form of a letter in which Varney offered to voluntarily dismiss his lawsuit in exchange for Avon’s paying Varney \$190,000. Three days later, before Avon replied, Varney sent a second letter in which he “clarified . . . that his offer is contingent on Avon entering into a stipulated judgment in favor of Varney,” effectively stating that Varney was the prevailing party in the suit. The next day, Avon initiated a wire transfer on a Monday for \$190,000 exactly, and then Varney voluntarily dismissed its suit.

Varney accepted the wire transfer and then sued Avon for \$60,000 in attorney’s fees. Avon refused to pay these fees, arguing that it accepted Varney’s initial offer to settle, and further arguing that the common meaning of settlement does not contemplate that either party wins, and, therefore, Varney is not entitled to attorney’s fees. Varney counter-argued that his second letter implicitly revoked his first offer and replaced it with his second offer so that Avon’s acceptance of the first offer was ineffective, and that Avon accepted his second offer to pay the settlement plus attorney’s fees.

How should a court rule on the question of whether Avon owes Varney attorney’s fees?

See Varney Ent. Group, Inc. v. Avon Plastics, Inc., 275 Cal. Rptr. 3d 394 (Cal. App. 4th Dist. 2011).

Chapter 6

Acceptance

When an offer to contract is made, it creates the “power of acceptance” in the offeree. This power is not infinite—it can be terminated by various methods, as discussed in Chapter 5. However, as long as the power of acceptance remains, the offeree can create a binding contract by sending an acceptance to the offeror.

A valid acceptance completes the process of contract formation, instantly transforming an offer into a contract. This chapter explores how to determine whether and when that magic moment of contract formation occurs.

Sometimes, the moment of acceptance is straightforward. For a simple offer with few terms, a clear “I agree” or “I accept” seals the deal. For instance, if Aaron says to Benjamin, “Will you commit to purchasing my Honda Civic next Tuesday for \$10,000 cash?” and Benjamin immediately replies, “I do,” the contract is formed as soon as Benjamin speaks. Simple offer, simple acceptance.

In the real world of commerce, however, offers often include more complex terms, such as promises, warranties, or conditions. (You will learn in Chapter 18 that a warranty is a contractual assurance about the future quality, condition, or performance of something, and in Chapter 19, that a condition is an event that triggers or relieves a contractual duty.) With added complexity, the process of acceptance becomes less obvious. For example, if Caitlin says to Deltona, “Will you commit to purchasing my Honda Civic next Tuesday for \$10,000 cash?” and Deltona replies, “I’ll bring the cash on Wednesday,” it’s unclear whether Deltona’s response is an acceptance that creates a contract or a counteroffer that rejects Caitlin’s original terms and proposes new ones.

The distinction between acceptance and counteroffer is one of the most important—and challenging—concepts in this chapter. An acceptance creates a binding contract, while a counteroffer terminates the original offer and replaces it with a new one. To complicate matters, the common law and the UCC approach this distinction differently.

There is also an important timing issue to address early in this chapter: the difference between when an action is sent and when it is received. Offers become effective when received by the offeree—after all, you cannot accept an offer you do not know about. Similarly, rejections, counteroffers, and revocations take effect only when received by the other party. But acceptance is different. Under the mailbox rule (or dispatch rule), an acceptance generally becomes effective the moment it is

dispatched—when it leaves the offeree’s possession. For example, if an offeree mails a letter of acceptance, the contract is formed as soon as the letter is sent, even if it takes days to arrive. This rule originated during the era of paper mail but still applies in modern communications and remains relevant on the bar exam. We will cover its details in this chapter.

Rules

A. Acceptance under the Common Law: The Mirror-Image Rule

The mirror-image rule is a common law rule that requires the offeree’s acceptance to “mirror” the offer by matching its terms exactly. This rule is based on the premise that the offeror is “the master of the offer” and gets to control its terms. The offeree, in order to accept the offer, must match all its terms *exactly* in the acceptance. The acceptance must truly be the mirror image of the offer.

Acceptance of an offer is a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer. R2d § 50(1).

An acceptance must comply with the requirements of the offer as to the promise to be made or the performance to be rendered. R2d § 58.

Under the common law, the offeree cannot change any of the terms of the offer when accepting; otherwise, the acceptance will not be valid. A purported acceptance which changes the terms of the offer, or a so-called “conditional acceptance”—which conditions the offeree’s acceptance upon the offeror’s acceptance of new terms—is not an acceptance at all. It is a counteroffer:

A reply to an offer which purports to accept it but is conditional on the offeror’s assent to terms additional to or different from those offered is not an acceptance but is a counter-offer. R2d § 59.

In the past, courts applied the mirror image rule strictly and required the terms of the offer and acceptance to match exactly. For example, in the 1867 case of *Myers v. Smith*, 48 Barb. 614, the offeror wrote an offer to sell malt “delivered on the boat at Weedsport.” The offeree responded by letter accepting and stating that the malt was to be “deliverable by boat on Weedsport.” The words “delivered” and “deliverable” were not synonymous and deemed different enough that it was a “manifest variance of the terms of the offer.” The New York Supreme Court found that the use of the word “deliverable” in the purported acceptance made that a counteroffer, such that no contract was formed, because “delivered” and “deliverable” are not strict mirror images.

Likewise, in the 1886 case of *Minneapolis & St. Louis Railway Co. v. Columbus Rolling-Mill Co.*, 119 U.S. 149, the iron mill offered to sell 2,000 to 5,000 tons of iron

rails at \$54 per ton to the railway. The railway responded via telegram requesting an order of one thousand two hundred tons of iron rails. The United States Supreme Court determined that the response was a rejection—not an acceptance—because it varied the number of tons.

Modern courts are not quite as strict in their application of the mirror image rule. For example, the R2d takes the position that, if a purported acceptance merely “requests” a change to the terms of the offer, without demanding such a change, then this can act as an acceptance or at least keep the offer alive without terminating it.

An acceptance which requests a change or addition to the terms of the offer is not thereby invalidated unless the acceptance is made to depend on an assent to the changed or added terms. R2d § 61.

For example, if the offer is for twenty-four hours of babysitting at the rate of \$20 per hour, an offeree could accept this offer, unequivocally manifesting agreement to the basic terms, but simultaneously request that the offeror consider a slightly lesser number of hours of babysitting—say, twenty hours. This would act as an acceptance of the original offer but also give the offeror the opportunity to agree to the twenty-hour term instead of the twenty-four-hour term, as the offeror chooses. In contrast, if the offeree indicates that her acceptance depends on (is conditional upon) the offeror’s assent to the twenty-hour term, then this would *not* be a valid acceptance. It would be a counteroffer.

Modern Mirror Image Rule Example: P & W Railroad. You’ve already encountered *Providence & Worcester Railroad* as an example of the modern, more flexible approach to the mirror image rule—and it’s often cited for that relaxed standard. But let’s look more closely—not just at what the court held, but why it might have reached that conclusion, and what this case reveals about how courts apply contract doctrine in the face of strategic behavior.

At first glance, the case seems to relax the mirror image rule. The State of Rhode Island accepted a statutory offer from the railroad company to buy land, but its response included two minor modifications: (1) correcting the buyer’s name, and (2) noting that the seller need not remove railroad tracks as the original offer stated. The railroad argued that these changes made the state’s letter a counteroffer, not a valid acceptance. But the court disagreed. It found both changes immaterial: one merely fixed an obvious clerical issue, and the other relieved the railroad of a costly obligation.

But step back. Why was the railroad trying so hard to invalidate the state’s acceptance? The answer lies in context. A statute gave the state a right of first refusal, requiring the railroad to offer the land to the state before selling it to anyone else. The railroad had already lined up a private sale and was hoping the state wouldn’t buy. When the state tried to accept, the railroad reached for a technical escape hatch: the mirror image rule.

The court saw what was happening. It acknowledged the acceptance wasn't a perfect mirror image, but refused to let formal doctrine be weaponized to avoid a statutory obligation. Instead, invoking the "rules of common sense," the court upheld the state's acceptance.

The deeper lesson of *Providence & Worcester Railroad* is that courts may apply seemingly rigid rules like the mirror image rule with flexibility—especially to prevent opportunism or bad-faith tactics. The case doesn't reject the mirror image rule outright. But it reminds us that context matters. The rule must yield when strict application would frustrate statutory purpose, undermine fairness, or allow one party to game the system.

In short: contract law isn't just about formal precision—it's about how rules operate in practice, where facts, fairness, and strategy often shape the outcome.

B. Acceptance under the UCC: Battle of the Forms

Under the common law, the mirror image rule requires that the terms of the acceptance exactly match the terms of the offer. Any deviation constitutes a counteroffer, rather than an acceptance, leaving no contract unless the original offeror explicitly agrees to the new terms. While some jurisdictions occasionally adopt a more lenient approach, the mirror image rule imposes a high standard for acceptance of offers.

The UCC rejects this strict rule in favor of a more flexible framework under § 2-207, often referred to as the "battle of the forms." This provision facilitates the formation of binding contracts for the sale of goods even when the exchanged forms—such as a purchase order and an invoice—contain different or additional terms. By recognizing that businesses often intend to proceed with transactions despite minor discrepancies, § 2-207 reduces the risk of transactional deadlock caused by rigid adherence to the common law rule.

The battle of the forms deals with situations where parties exchange non-matching forms—for example, a purchase order specifying "disputes to be resolved by arbitration in New York" and an invoice stating "disputes to be resolved by arbitration in California"—but still proceed with the transaction without a finalized written agreement. This situation commonly arises because merchants often use preprinted, standard forms containing generic, boilerplate language, which are designed to favor their own interests. As a result, the offer and acceptance frequently include conflicting terms.

Under the common law mirror image rule, there would be no contract in such a scenario, as the terms do not match. However, under the UCC's battle of the forms, a contract can still be formed if there is a "definite and seasonable expression of acceptance," as long as the acceptance is not expressly made conditional on assent

to the additional or different terms. The challenge then becomes determining what terms govern the contract.

UCC § 2-207 facilitates the formation of contracts even when the terms in the exchanged forms are not identical, recognizing that businesses often intend to proceed with agreements despite minor discrepancies. While it solves the problem of having no contract where one is clearly intended, it introduces the challenge of determining what that contract requires. Correctly applying UCC § 2-207 requires not only proceeding carefully through its applicable provisions but also recognizing how different jurisdictions interpret some aspects of the battle of the forms differently.

1. Formation

The first subsection addresses whether a contract has been formed. A contract arises if there is a “definite and seasonable expression of acceptance” or a written confirmation, even if the acceptance includes terms that differ from or add to the offer, unless the acceptance is explicitly made conditional on the offeror’s assent to those terms.

This flexibility ensures that minor discrepancies in the forms—such as differences in boilerplate terms—do not prevent the creation of a binding contract. It shifts the focus from achieving perfect alignment of terms to identifying whether the core terms reflect agreement and whether the parties intended to proceed with the transaction.

For example, a grocery store sends a purchase order for “15 dozen peaches at \$250, delivery within 10 days.” The farmer responds with an acknowledgment form stating, “Agreed: 15 dozen peaches at \$250, delivery within 7–10 days.” Despite the slight difference in the delivery window, this is a definite and seasonable acceptance because it reflects agreement on the material terms: quantity, price, and general timing of delivery.

An acceptance fails to form a contract if it includes terms that materially change the offer and if it makes the acceptance conditional on the offeror’s agreement to those changes. In such cases, the response is treated as a counteroffer, not an acceptance.

For example, a buyer submits a purchase order for “500 chairs at \$50 each, delivery within 30 days.” The seller responds with an acknowledgment form stating, “We accept your order for 500 chairs at \$50 each, delivery within 30 days, but only if you agree that all disputes will be resolved by arbitration in California.”

Here, the seller’s purported acceptance is expressly conditional on the buyer’s assent to the arbitration clause. This constitutes a counteroffer, not an acceptance. Until the buyer explicitly agrees to the arbitration clause, no contract is formed under UCC § 2-207(1), so no further analysis of the terms is necessary.

If there is a contract, then the next step is to analyze which terms govern the contract. To do this, it is important to distinguish between additional terms and different terms, as their treatment under the UCC varies.

a. Additional Terms

Additional terms are provisions included in the acceptance that address topics not covered in the original offer. These terms supplement the contract and do not directly conflict with the terms in the offer.

Suppose the purchase order for peaches is silent on the time of day for delivery, but the acknowledgment adds, “Delivery must be made between 9 a.m. and 5 p.m.” This time-of-day specification is an additional term because it introduces a new detail not addressed in the original offer.

The UCC specifies how to handle additional terms in subsection (2), discussed below.

b. Different Terms

Different terms are provisions in the acceptance that contradict terms in the original offer. These terms address the same topic as a term in the offer but propose a different resolution.

In the peaches example, the purchase order specifies delivery within ten days, while the acknowledgment specifies delivery within seven to ten days. Because both terms address the same topic (delivery timing) and propose conflicting conditions, the seller’s provision constitutes a different term.

The UCC does not specifically discuss how to handle different terms. This ambiguity led to a split in judicial interpretation, which is also discussed below.

2. *The Fate of Additional Terms*

Once a contract is formed under § 2-207(1), the next question is whether any additional terms included in the offeree’s acceptance become part of the agreement. UCC § 2-207(2) provides different rules depending on whether the parties are merchants.

a. Additional Terms Excluded Where at Least One Party Is Not a Merchant

If one or both parties are not merchants, then additional terms in the acceptance are treated as mere proposals to modify the contract. These proposals do not become part of the agreement unless the offeror explicitly agrees to them.

For example, a consumer orders a laptop from a retailer, including a purchase order that specifies a fourteen-day return policy. The retailer’s confirmation slip states, “Returns accepted only within 7 days.” Because the consumer is not a merchant, the retailer’s seven-day return policy is a proposed modification, not automatically part of the contract. Unless the consumer explicitly agrees to the change, the original fourteen-day policy governs.

b. Additional Terms Included Where Both Parties Are Merchants

When both parties are merchants, additional terms in the acceptance automatically become part of the contract unless one of the following exceptions applies:

(a) The offer expressly limits acceptance to its terms.

If the offer includes language such as “This order is subject to the terms stated herein, and no additional terms will be accepted,” the additional terms are excluded.

(b) The additional term materially alters the contract.

A term materially alters the contract if it would result in surprise or hardship to the offeror without their explicit awareness. For instance, terms like “disclaimers of warranties,” changes in liability allocation, or forum selection clauses often qualify as material alterations.

For example, a buyer’s purchase order specifies “Delivery within 30 days” and makes no mention of liability. The seller’s acknowledgment includes a clause stating, “Seller is not liable for any delays.” Because this clause shifts a significant risk to the buyer, it would likely be considered a material alteration and excluded unless explicitly agreed to.

Conversely, a buyer’s purchase order specifies “Delivery by common carrier.” The seller’s acknowledgment adds, “Seller will select the carrier.” This is a minor adjustment and does not cause undue surprise or hardship, so it becomes part of the contract unless the offeror objects.

(c) The offeror objects to the additional terms within a reasonable time.

If the offeror notifies the offeree promptly that they object to the additional terms, those terms are excluded. The UCC does not define what constitutes a “reasonable time,” so the determination depends on the context of the transaction and industry norms.

3. The Fate of Different Terms

While UCC §2-207(2) explicitly governs additional terms, it does not directly address how to handle different terms—those that contradict terms in the original offer. The lack of clear statutory guidance has led courts to adopt different approaches for resolving conflicts between terms.

a. The Knock-Out Rule (Majority View)

Under the knock-out rule, conflicting terms in the offer and acceptance cancel each other out, or “knock each other out,” and are replaced by default rules from the UCC (gap fillers). This approach treats the conflicting terms as evidence that the parties failed to agree on that specific issue. By eliminating the conflicting terms, the knock-out rule ensures that neither party’s term prevails over the other.

For example, a buyer's purchase order states, "Disputes to be resolved in New York courts," while the seller's acknowledgment form states, "Disputes to be resolved in California courts." Under the knock-out rule, both terms are excluded from the contract, and a court would rely on UCC gap fillers or general jurisdictional principles to resolve disputes.

The knock-out rule is the prevailing interpretation among courts, as it aligns with the UCC's intent to resolve disagreements pragmatically and maintain the validity of the contract.

b. The Last-Shot Rule (Minority View)

The last-shot rule is a common law doctrine that predates the UCC. Under this rule, the terms of the last document exchanged before performance govern the contract. Courts applying the last-shot rule effectively hold that by performing after receiving the final form, the other party implicitly assents to its terms, regardless of any conflicts with prior documents. This rule creates a "winner-takes-all" result for the party that sent the final document, often failing to account for the mutual intent of the parties and sometimes leading to unfair outcomes.

For example, a buyer sends a purchase order for one hundred widgets, specifying that disputes must be resolved in New York courts. The seller's acknowledgment form includes a conflicting term requiring arbitration in California. The seller ships the widgets, and the buyer accepts them. Under the last-shot rule, the seller's term prevails because it was included in the final document exchanged before performance.

Although UCC § 2-207 was designed to displace rigid common law rules like the last-shot rule, some courts still revert to it in limited circumstances. Specifically, the last-shot rule may apply (1) where the UCC does not apply (e.g., service contracts) or (2) where performance is viewed as assent.

In cases involving "conduct-based" contracts, a court may interpret the parties' performance as implicit agreement to the terms in the final document. Here, the last-shot rule could theoretically make the final document the governing document.

While the last-shot rule persists in some cases, it is generally inconsistent with the UCC's objectives, which favor resolving conflicting terms through more equitable mechanisms like the knock-out rule. Most courts addressing conflicting terms under UCC § 2-207 have moved away from the last-shot rule in favor of approaches that align more closely with the mutual intent of the parties, even in cases of acceptance by performance.

4. Conduct-Based Contracts

When the parties' writings fail to establish a contract under UCC § 2-207(1)—for example, because one party's acceptance is conditional on the other party's agreeing to additional or different terms—a contract may still be formed through the parties'

conduct. UCC § 2-207(3) governs these conduct-based contracts, focusing on the actions of the parties rather than on their written communications.

Under § 2-207(3), if the parties proceed with performance (e.g., the seller delivers the goods, and the buyer pays for them) despite unresolved conflicts in their forms, then a contract may be formed based on their conduct. The terms of the contract are determined as follows by two rules:

Agreed Terms Remain. The contract includes the terms on which the parties' forms agree.

Conflicting or Missing Terms "Fall Out." Any conflicting terms or terms left unresolved by the parties' forms are excluded from the contract. These gaps are filled by UCC default provisions, known as gap fillers, which supply reasonable and neutral terms.

For example, a buyer sends a purchase order specifying "Delivery within 30 days." The seller responds with an acknowledgment form specifying "Delivery within 60 days, disputes resolved by arbitration." The buyer replies to the seller, stating, "We cannot agree to the 60-day delivery term or the arbitration clause." However, despite this rejection of the modified terms, the buyer allows the seller to proceed with delivery. The seller delivers the goods on day 45, and the buyer accepts and pays for them.

Here, the parties' writings do not form a contract under § 2-207(1) because the buyer did not assent to the seller's modified delivery term. However, their conduct—delivery and payment—establishes a contract under § 2-207(3). The agreed terms include the quantity and price, while the delivery time frame and arbitration clause "fall out." UCC gap fillers, such as "reasonable time" for delivery, supply the missing terms.

Although § 2-207(3) often results in conflicting terms' being excluded, it is distinct from the knock-out rule. The knock-out rule specifically addresses how conflicting terms are treated when a contract is formed through writings under § 2-207(1) or (2). In contrast, § 2-207(3) applies when the forms do not establish a contract at all and the agreement arises solely from the parties' actions.

Conduct-based contracts under § 2-207(3) reflect the UCC's pragmatic approach to contract formation. By focusing on the parties' intent as demonstrated through their performance, § 2-207(3) ensures that agreements are recognized even when the forms are irreconcilable. However, it also emphasizes that conflicting terms will not be imposed unless expressly agreed upon, preserving fairness and neutrality in commercial transactions.

5. *Conclusions on the Battle of the Forms*

The UCC's flexible approach to contract formation promotes commercial efficiency by reducing the potential for transactional deadlocks caused by minor discrepancies. However, it also introduces complexity, which requires careful attention

to the interplay among statutory language, judicial interpretation, and the practical realities of commercial transactions.

The distinction between “knock out” and “fall out” emphasizes the importance of understanding when conflicting terms cancel each other versus when terms are excluded due to a lack of agreement. Students should be prepared to analyze these nuances to navigate the challenges of modern contracting effectively.

C. The Mailbox Rule

The so-called “mailbox rule,” also known as the “dispatch rule,” governs the timing of acceptance in contract formation when parties communicate using time-delayed methods, such as mail. Under this rule, an acceptance is valid upon dispatch, “as soon as put out of the offeree’s possession,” not upon receipt, provided that the acceptance is properly addressed, stamped, and sent. *See* R2d § 63(a).

Unless the offer provides otherwise, an acceptance made in a manner and by a medium invited by the offer is operative and completes the manifestation of mutual assent as soon as it is dispatched, *regardless of whether it ever reaches the offeror*. This rule facilitates contract formation by reducing uncertainty for offerees who rely on their acceptance being effective once sent.

The mailbox rule has many limitations and exceptions:

- It applies only to acceptances and only when there is a time delay between the dispatch and receipt of the communication. It does not apply to other communications in the contract formation process, such as offers, revocations, rejections, or counteroffers. These other communications are effective only upon receipt by the other party. *See* R2d § 66.
- It does not apply to face-to-face conversations, phone calls, or other forms of nearly instantaneous communication. In such cases, acceptance is generally valid only upon receipt. *See* R2d § 64.
- It does not apply to option contracts. An acceptance under an option contract is not effective upon dispatch but only when received by the offeror. Courts reason that because option contracts often involve strict time limits, the risk of delay must rest with the offeree, who has the burden of ensuring the acceptance arrives in time. *See* R2d § 63(b).
- It no longer applies when the offeree dispatches a rejection or counteroffer before dispatching an acceptance; in that case, whichever communication the offeror receives first governs. *See* R2d § 40.
- It is a default rule that parties can modify. For example, an offeror can specify that acceptance is valid only upon receipt. In such cases, the acceptance is not effective until the offeror receives it. *See* R2d § 63(a) (“... unless the offer provides otherwise.”).

- Its application may be limited as justice requires. When the offeree sends an acceptance but then sends a rejection or counteroffer, and the offeror receives the rejection or counteroffer first and reasonably relies on it, the offeree may be estopped from enforcing the original acceptance. This principle protects the offeror from detrimental reliance caused by conflicting communications. See R2d § 63 illustration 7.

Setting aside such exceptions, most mailbox-rule problems can usually be resolved simply by remembering that most of the communications during the contract formation process are effective upon receipt, except for acceptances sent by time-delayed mail, which are valid upon dispatch. If you remember the rule that acceptances are effective when they are sent, and everything else is effective when received, then you can work out most mailbox-rule problems.

1. Modern Applications of the Mailbox Rule

The traditional mailbox rule, which deems an acceptance effective upon dispatch rather than receipt, faces significant challenges when applied to modern forms of communication such as email, text messages, and instant messaging. While the rule was designed for time-delayed methods like postal mail, the near-instantaneous nature of electronic communication demands a reevaluation of its application. Courts have taken varied approaches, which reflects an ongoing legal and technological evolution.

In the context of digital correspondence, the presumption of receipt upon dispatch is less widely applied. Courts often favor the time-of-receipt rule for electronic communications, rejecting the mailbox rule due to the instantaneous or near-instantaneous nature of these mediums. For example, in *In re Bruce*, 610 B.R. 603 (Bankr. E.D. Wis. 2019), the court applied the time-of-receipt rule to electronic communications, holding the sender responsible if receipt did not occur. See also *Miller v. Plain Dealer Publ'g Co.*, 2015-Ohio-1016 (Ct. App.) (holding that the mailbox rule provides a rebuttable presumption of receipt for postal mail but *does not apply* to email communications; emphasizing that even if an analogous rule for email existed, the presumption of receipt could be rebutted by evidence of non-receipt or circumstances within the control of the party claiming the notice was not received, such as failure to update an email address.)

Some courts emphasize the immediacy of digital communication, likening it to face-to-face or telephone conversations, where acceptance is effective only upon receipt. *Trinity Homes, L.L.C. v. Fang*, 63 Va. Cir. 409 (Cir. Ct. 2003) (holding that the mailbox rule applies to facsimile transmissions, treating a faxed acceptance as effective upon dispatch if properly transmitted; however, the court concluded the sender failed to prove by a preponderance of the evidence that the facsimile was successfully transmitted, highlighting the importance of transmission logs or verification in establishing compliance with the rule), supports this approach, as it aligns with principles in R2d § 64 for near-instantaneous two-way communication.

The functionality of spam filters has been considered when rebutting the presumption of receipt. Courts recognize that the aggressiveness of a recipient's spam filter or the sender's email address triggering such filters can serve as evidence to rebut presumptions of receipt. See *Aitken v. Communs. Workers of Am.*, 496 F. Supp. 2d 653 (E.D. Va. 2007) (holding that spam filters blocking email communications could serve as evidence to rebut the presumption of receipt under the mailbox rule, emphasizing that the presumption is not absolute and can be challenged by showing that the message was not actually received); *Anania v. McDonough*, 1 F.4th 1019 (Fed. Cir. 2021) (emphasizing that the mailbox rule creates a *rebuttable* presumption of receipt, which can be challenged with evidence demonstrating non-receipt, including technical issues or other irregularities; rejected a rigid rule against using self-serving affidavits to invoke the presumption and emphasized the need to weigh all available evidence in context).

In addition, statutes like the Uniform Electronic Transactions Act (UETA) and the Electronic Signatures in Global and National Commerce (E-Sign) Act provide frameworks for validating electronic communications but remain neutral on the application of the mailbox rule.

As courts grapple with the modern application of the mailbox rule, they should consider risk allocation, technological factors, and future trends. Traditional postal mail risk allocations are less relevant when electronic systems enable almost immediate transmission and acknowledgment. Factors like email delivery failures, server errors, and message delays complicate the application of traditional rules. Emerging technologies, such as blockchain and virtual reality communication, are likely to require further adaptation of existing doctrines.

2. Traditional Applications of the Mailbox Rule

Why, then, is learning the traditional mailbox rule relevant? One reason is that bar examiners are still likely to test on quirky timing issues involving time-delayed correspondence. Another reason is that future developments in law will likely be based on reasoning established in traditional rules. For now, you should still learn the mailbox rule.

Mailbox Rule Hypo: Gallaway. Consider this tricky mailbox-rule problem.

On January 1, Gallaway posts an advertisement in a local newspaper that he is selling his car. He includes a price of \$10,000 and provides a mailing address to interested parties to write for more information. On January 5, Hernandez sends a letter to Gallaway offering to pay \$8,000 for the car. Gallaway receives Hernandez's offer on January 7 and replies on January 8 by posting a letter to Hernandez stating, "I cannot sell it for less than \$9,000." On January 9, Gallaway has a change of heart. At 9 a.m., he sends a second letter that states, "I accept your offer for \$8,000." Hernandez receives Gallaway's first letter

(proposing \$9,000) at 10 a.m. At 1 p.m., Hernandez writes back and states, “I accept your \$9,000 offer.” At 4 p.m., Hernandez receives Gallaway’s second letter (accepting his \$8,000 offer). On January 10, Hernandez writes Gallaway again, stating “I accept your \$8,000 offer.” On January 11, Gallaway receives both of Hernandez’s letters (the \$9,000 acceptance and the \$8,000 acceptance) in his mailbox at the same time.

On January 12, Gallaway drives the car to Hernandez and demands \$9,000. Hernandez insists on paying \$8,000. What is Hernandez required to pay, if anything?

Let us analyze this situation by applying the rules you have learned. Gallaway’s advertisement on January 1 is not an offer but rather an invitation to make offers. Advertisements generally lack the intent to be bound and are not treated as offers under contract law. Hernandez’s letter on January 5 offering \$8,000, however, is a valid offer. It demonstrates a present willingness to enter a bargain and provides reasonably certain terms that justify Gallaway in believing his acceptance will conclude the deal. Hernandez’s offer becomes effective upon receipt, which occurs on January 7. See R2d § 63(c).

Gallaway’s letter on January 8, stating, “I cannot sell it for less than \$9,000,” is a counteroffer. A counteroffer serves both to reject the original offer and to propose new terms. Under R2d § 39, this counteroffer terminates Hernandez’s original \$8,000 offer. The counteroffer is effective when Hernandez receives it, which occurs on January 9 at 10 a.m.

At 9 a.m. on January 9, Gallaway sends a second letter attempting to accept Hernandez’s original \$8,000 offer. Under the mailbox rule, R2d § 63(a), an acceptance is generally effective upon dispatch if properly addressed and sent. However, because Gallaway’s counteroffer terminated Hernandez’s original offer, the mailbox rule no longer applies. Instead, R2d § 40 governs: “Whichever communication is received first controls.” Hernandez receives Gallaway’s counteroffer at 10 a.m., before receiving Gallaway’s attempted acceptance, so the \$8,000 offer is no longer available to accept.

At 1 p.m. on January 9, Hernandez sends a letter stating, “I accept your \$9,000 offer.” This constitutes a valid acceptance of Gallaway’s counteroffer. Under Restatement § 63(a), Hernandez’s acceptance is effective upon dispatch, forming a binding contract for \$9,000 at 1 p.m. The parties are now legally bound to a contract for the sale of the car at \$9,000.

At 4 p.m. on January 9, Hernandez receives Gallaway’s second letter attempting to accept the \$8,000 offer. However, this letter has no legal effect. The \$8,000 offer had already been terminated by the counteroffer, and a binding contract for \$9,000 was formed earlier that day. Similarly, Hernandez’s January 10 letter to Gallaway stating, “I accept your \$8,000 offer,” is irrelevant. Once a binding contract is formed, subsequent

communications cannot alter its terms unless both parties agree to a modification. See R2d § 87(2) for modification rules.

On January 12, when Gallaway drives the car to Hernandez and demands \$9,000, Hernandez is legally obligated to pay that amount. The binding contract for \$9,000, formed on January 9 at 1 p.m., governs the transaction.

D. Reflections on Acceptance

This module on mutual assent initially may have seemed a little abstract. That is because the doctrine of mutual assent is best understood by exploring its specific elements, offer and acceptance, which we did after reviewing the general concepts. As the doctrine gets more specific, it also becomes clearer. See if you can now reconstruct the abstraction of mutual assent with a newfound appreciation for its purpose: mutual assent reflects the goal of contract law to effectuate the intent of the parties.

Yet this goal of enforcing two parties' original mutual intentions is in tension with the realities of contract law. Intentions can be obscure. Ephemeral memories of past feelings give courts little guidance on how they should rule today. Contracts must be clear and predictable if they are to govern the actions of two parties. For this reason, objective evidence—such as written terms, eyewitness testimony, or an expert in the trade—is preferred over parties' descriptions of their subjective perspective. In other words, although mutual assent is a subjective state of a meeting of the minds, courts will look for objective evidence that the parties expressed a common understanding, and that outward expression is what mutual assent entails.

Cases

Reading *State Department of Transportation v. Providence & Worcester Railroad Co.* You've already encountered *Providence & Worcester Railroad* as an example of the modern, more flexible approach to the mirror image rule—and it's often cited for that relaxed rule. But let's look more closely—not just at what the court held, but why it might have reached that conclusion, and what this case reveals about how courts apply contract doctrine in the face of strategic behavior.

At a surface level, the case appears to relax the mirror image rule. The State of Rhode Island accepted a statutory offer from a railroad company to buy land, but its letter included two modifications: (1) requesting to correct the buyer's name, and (2) noting that the seller need not remove the railroad tracks as previously stated. The railroad company argued these changes invalidated the acceptance, making it a counteroffer. But the court found both changes

immaterial: one corrected a clerical oversight, and the other conferred a benefit on the railroad by saving it the cost of track removal.

But take a step back. Why was the railroad so eager to invalidate the state's acceptance? The answer lies in context. A statute required the railroad to offer the land to the state before selling it to a private buyer. The railroad had already entered into a deal with a private developer, contingent on the state declining to purchase. Its technical argument about the mirror image rule was, in effect, a way to escape its legal obligation—a formal argument deployed to serve a strategic goal.

The court saw this. It acknowledged the letter wasn't a perfect mirror image of the offer, but it refused to let contract doctrine be used as a tool of evasion. Instead, the court applied "rules of common sense" and treated the state's response as a valid acceptance.

The deeper lesson of *Providence & Worcester Railroad* is that courts may apply seemingly rigid rules like the mirror image rule with flexibility—especially to prevent opportunism or bad-faith tactics. The case doesn't reject the mirror image rule outright. But it reminds us that context matters. The rule must yield when strict application would frustrate statutory purpose, undermine fairness, or allow one party to game the system.

In short: contract law isn't just about formal precision—it's about how rules operate in practice, where facts, fairness, and strategy often shape the outcome.

State Department of Transportation v. Providence & Worcester Railroad Co.

674 A.2d 1239 (R.I. 1996)

LEDERBERG, Justice.

This case arose following the sale of a parcel of land by the defendant, Providence and Worcester Railroad Co. (P & W or the railway company), to the codefendant, Promet Corp. (Promet). The conveyance was declared "null and void" by an amended judgment of the Superior Court that ordered P & W to convey the parcel to the plaintiff, the State of Rhode Island Department of Transportation (state), for the purchase price of \$100,000. The state was ordered to pay prejudgment interest on the purchase price, and P & W was required to reimburse Promet for interest on the purchase price and for property taxes that Promet paid while it was in possession of the parcel. The state appealed from the requirement that it pay interest on the purchase price; P & W appealed from the Superior Court's findings that the state was entitled to purchase the property and that P & W had to reimburse Promet for property taxes and for interest on the purchase price. Promet filed a brief in support of the amended Superior Court

judgment. For the reasons recited below, we sustain in part and reverse in part the judgment of the Superior Court.

In 1985, P & W owned a 6.97-acre parcel of waterfront property in East Providence, Rhode Island. Railroad tracks were situated on the property, but the property was, and remains, otherwise unimproved. The railroad tracks at one time ran from the former Union Station through a tunnel, and over a bridge. At that point the tracks reached the subject property where they split to form a Y, one of whose arms directed rail traffic north, and the other traveled south on what is known as the Bristol secondary track. The railroad company had acquired this property in 1982 from the Consolidated Rail Corporation (Conrail) as part of P & W's purchase of all Conrail's Rhode Island freight operations.

The property, however, was acquired by P & W subject to an order of the Special Court under the Regional Rail Reorganization Act of 1973. That order required P & W to "guarantee rail service [on the property] for four years from the date" of conveyance on May 1, 1982, and stipulated that P & W could "not seek to abandon or discontinue rail service . . . for such four-year period." It is undisputed that P & W never petitioned the Interstate Commerce Commission (ICC) to abandon or to discontinue rail service pursuant to the provisions [of a federal statute regarding the termination of rail services].

On December 12, 1985, P & W entered into a purchase and sale agreement with Promet for the sale of the subject property at the price of \$100,000. Although the tracks were still suitable for rail use, the property was not being used for rail purposes, or any other uses at the time of the transaction. The terms of the purchase and sale agreement expressly made the agreement "subject to a 30 day option in the State of Rhode Island to purchase the premises," as required by [Rhode Island's statute governing the sale of rail properties], which provided:

"All rail properties within the state offered for sale by any railway corporation after April 9, 1976 shall be offered for sale to the state in the first instance at the lowest price at which the railway corporation is willing to sell. The railway corporation shall notify the state in writing if it desires to offer for sale any rail properties. The state shall have a period of not more than thirty (30) days from receipt of the notification to accept the offer."

On November 20, 1985, Joseph Arruda (Arruda), assistant director for planning for the State Department of Transportation, wrote to P & W's agent, Joseph DiStefano (DiStefano). In that letter, Arruda referred to an October 22, 1985 meeting he had attended with DiStefano and principals of Promet at which "it was mentioned that Promet Property and P & W were discussing the sale of abandoned railroad properties." Arruda claimed that "the state must be given first option to acquire" the property and stated that "[i]f, in fact, P & W is pursuing the sale of any railroad property in this area, we would sincerely appreciate being notified at the earliest possible date." On December 12, 1985, DiStefano wrote to Arruda, stating:

Dear Mr. Arruda:

You are hereby notified, pursuant to Section 39-6.1-9 of the Rhode Island General Laws, that this company proposes to sell a certain parcel of land situated at East Providence, Rhode Island . . . for \$100,000 with a closing to be held on January 17, 1986.

Pursuant to statute, the State of Rhode Island has a period of thirty (30) days from the date of this notification within which to accept this offer to sell under the same terms and conditions as outlined in the enclosed Real Estate Sales Agreement.

If the State's rights are not exercised within such period, we shall deem ourselves free to sell the property to Promet Corp. in accordance with the terms of the enclosed Real Estate Sales Agreement.

This notice is sent to you although this company is of the opinion that the property in question is not covered by [Rhode Island's statute governing the sale of rail properties].

On January 7, 1986, Herbert DeSimone (DeSimone), director of transportation for the state, accepted the offer in writing. In his letter to DiStefano, DeSimone wrote, "Of course, you understand that certain wording in the Real Estate Sales Agreement relating to 'buyer' and obligations concerning the removal of track would be inappropriate to the purpose of the State's purchase." The closing between P & W and Promet had been originally scheduled for January 17, 1986, but the parties rescheduled several times, finally agreeing to April 14, 1986, at 10 a.m. The reason for rescheduling the closing date was to allow the state and Promet's engineers to determine whether the property could accommodate Promet's development plans while preserving the state's rail options. Such a plan proved to be impossible.

On April 11, 1986, the state filed a complaint in Superior Court, claiming that P & W was refusing to convey title to the property to the state but was going to "convey title to said land to the Promet Corporation on Monday, April 14, 1986 at 8:30 A.M. in derogation of the State's statutory rights." The state sought a temporary restraining order to enjoin the conveyance to Promet, but the Superior Court justice denied the state's request, indicating that the state had protected its rights and that P & W would be proceeding at its own risk.

Some minutes before 10 a.m. on April 14, 1986, Arruda appeared on behalf of the state at DiStefano's office and tendered a check for \$100,000. Arruda was informed that P & W had already delivered the deed to the property to Promet earlier that morning. The closing between P & W and Promet had taken place at a location and time (8:30 a.m. instead of 10 a.m.) different from those originally scheduled, and P & W had taken no affirmative steps to inform the state of these changes.

The state filed its amended complaint on December 9, 1986, naming both P & W and Promet as defendants, praying that the deed to Promet be declared null and void. Promet filed two counterclaims and a request for jury trial. The counterclaims were

later severed, and the parties waived by stipulation the demand for a jury trial. The trial was held before a justice of the Superior Court on November 15, 1991, and January 30, 1992. At trial, P & W and Promet argued that the subject property was not “rail property” subject to the statute because it was not being used for rail purposes at the time of the conveyance. The railroad company and Promet further argued that the state had waived any rights it possessed under the statute by having failed to tender payment for the property within the thirty days prescribed [by Rhode Island’s statute governing the sale of rail properties].

In his decision issued from the bench, the trial justice found that the property in question is “rail property” within the meaning of [Rhode Island’s statute governing the sale of rail properties], that it was dedicated for railroad use, and that it was available for rail purposes. The trial justice found “some of the testimony given by defendant’s witness disingenuous when he made the comment that there was no function in 1986 for rail property uses, when that was exactly the same condition when the Special Court order was entered into in 1982, which specifically says that no abandonment or discontinuance of rail use service should take place for a four-year period after the conveyance.” The trial justice further found that the state had validly accepted P & W’s offer within the thirty-day period and that the state was not required to tender payment at that time. Rather, the trial justice determined that the state had a “reasonable time” in which to pay for the property, and he indicated that such reasonable time coincided with the various closing dates scheduled by P & W and Promet.

The trial justice issued an amended judgment on March 17, 1994. In that judgment, the trial justice declared the deed from P & W null and void and ordered that the property be transferred to the state. In addition, the trial justice ordered P & W to repay to Promet the purchase price of \$100,000 plus interest and to reimburse Promet for real estate taxes that Promet had paid on the property, plus interest on that amount. Finally, the amended judgment required the state to pay P & W the \$100,000 purchase price plus interest.

On April 14, 1994, the state appealed that portion of the amended judgment that required the state to pay P & W the interest on the \$100,000 purchase price. The railroad company filed its notice of appeal on April 20, 1994.

Did the State’s January 7, 1986 Letter Constitute a Valid Acceptance of P & W’s Offer?

The trial justice found that on December 12, 1985, P & W extended an option to the state to purchase the subject property and that the January 7, 1986 letter from DeSimone to DiStefano was “a valid exercise of [Rhode Island’s statute governing the sale of rail properties] option.” The finding of a trial justice sitting without a jury in respect to the formation of a contract is entitled to great weight, and this Court will not disturb such a finding unless the trial justice “misconceived material evidence or was otherwise clearly wrong.” On appeal, P & W asserted that no contract for the sale of the subject parcel existed because the state’s January 7, 1986 letter did not constitute a valid acceptance of P & W’s December 12, 1985 offer. In support of its assertion,

P & W argued that the January 7 letter in fact proposed additional terms to the agreement. The letter from DeSimone to DiStefano provided in pertinent part:

Pursuant to [Rhode Island's statute governing the sale of rail properties], I am writing to you on behalf of the State of Rhode Island to exercise its right to accept the offer to purchase 6.9 acres of land.

Of course, you understand that certain wording in the Real Estate Sales Agreement [referring to the agreement between P & W and Promet] relating to 'buyer' and obligations concerning the removal of track would be inappropriate to the purpose of the State's purchase.

Please contact Mr. Joseph F. Arruda of this department to arrange for a meeting to revise the existing offer to conform the State's acceptance.

P & W argued that “[a]s a matter of law, [the state’s] letter was nothing more than an invitation to meet and attempt to reach agreement on the terms of the sale.” We disagree.

This Court has held that a valid acceptance “must be definite and unequivocal,” and that an “acceptance which is equivocal or upon condition or with a limitation is a counteroffer and requires acceptance by the original offeror before a contractual relationship can exist.” It is not equivocation, however, “if the offeree merely puts into words that which was already reasonably implied in the terms of the offer.” It is further the case that “an acceptance must receive a reasonable construction” and that “the mere addition of a collateral or immaterial matters [sic] will not prevent the formation of a contract.”

The state’s letter of acceptance points out that the name of the buyer in the original agreement would have to be changed. In our opinion, this statement simply reflected the obvious necessity to replace “the state” for “Promet” as the named buyer in the deed. Moreover, the letter’s reference to P & W’s obligation to Promet to remove tracks from the property as “inappropriate to the purpose of the State’s purchase” did not add any terms or conditions to the contract but, instead, constituted a clear benefit to P & W. In pointing out that the “wording” that obligated P & W to remove tracks would be “inappropriate” in an agreement between P & W and the state, the state, in fact, relieved P & W from the obligation and expense it otherwise would have incurred in selling the property to Promet.

When an offeree, in its acceptance of an offer, absolves the offeror of a material obligation, the “rules of contract construction and the ‘rules of common sense’” preclude construing that absolution as an additional term that invalidates the acceptance. Moreover, DeSimone explicitly and unequivocally stated, “I am writing to you on behalf of the State of Rhode Island to exercise its right to accept the offer to purchase 6.9 acres of land,” and requested the meeting with Arruda in order “to revise the existing offer to conform the State’s acceptance.”

Therefore, we concur, with the trial justice who found that the state validly accepted the option extended to it by P & W. Because the contract was valid, we need not

address P & W's contention that the parcel was not rail property within the meaning of [Rhode Island's statute governing the sale of rail properties].

[Discussion of whether the state had to pay interest on the purchase price of the property omitted.]

In conclusion, therefore, we sustain the state's appeal, and we deny and dismiss the appeal of P & W. We affirm the amended judgment of the Superior Court except that we vacate the requirement that the state pay interest to P & W on the purchase price of the property. The papers in this case may be returned to the Superior Court with direction to enter judgment consistent with this opinion.

Reflection

The *P & W Railroad* court recognized that a contract existed despite minor differences between the offer and acceptance. The rule for valid acceptance is that it must be definite and unequivocal (not open to more than one interpretation). If the acceptance includes additional terms, limitations, or conditions, then it is not a mirror image of the offer and is instead a counteroffer.

The court reasoned that the state did not add any new terms or conditions that invalidated the acceptance. The name of the buyer was changed out of an obvious necessity and the reference to removing the tracks was immaterial because it conferred a clear benefit to P & W. Moreover, the state also made it clear that it was making a positive acceptance by stating in its letter that it accepted the offer to purchase the land.

The court's decision reflects the modern view that the mirror image rule does not need to be strictly adhered to. Minor differences are usually immaterial matters or terms that have no major bearing on the original offer. Imagine if P & W were allowed to get out of the contract because the state said that P & W did not have to pay the expense of ripping up the railway tracks; it would be unfair if the mirror image rule were strictly applied. Therefore, courts are willing to recognize valid acceptances when there are minor discrepancies about immaterial matters between the offer and acceptance.

Discussion

1. What is the mirror image rule? Cite the R2d provision that contains this rule and then explain that provision in your own words.
2. What is the purpose of the mirror image rule? Why should an acceptance mirror an offer? Consider what advantages this provides to private parties, to society generally, and to the courts.

3. What are some problems with the strict application of the mirror image rule? Think of some situations where the strict application would lead to unjust results and explain why those results are unjust.
4. Consider whether or to what extent the *P & W Railroad* court followed the mirror image rule. When should courts follow this rule strictly, and when should they relax it?

Reading Flender Corp. v. Tippins International, Inc. Under the common law, if the offeree does not accept every single term in the offer, there is no contract. This is called the “mirror image rule.” However, the UCC expressly rejects the mirror image rule and adopts what is known as the “battle of the forms,” contained in UCC § 2-207. Under UCC § 2-207(1), so long as there is a “definite and seasonable expression of acceptance” which is not made “conditional” on assent to new terms, there is still a contract despite the presence of mismatching terms.

Flender Corporation v. Tippins International Incorporation, 830 A.2d 1279 (Pa. Super. 2003), represents a classic battle-of-the-forms scenario, but with a wrinkle. The parties’ mismatching terms directly conflicted with one another. They were “different” terms, rather than “additional” terms. *Flender* illustrates the majority approach to the battle of the forms in a scenario where the parties’ communications contain different terms.

Tippins, the buyer, mailed a purchase order to Flender, the seller, for the purchase of custom-made gear-drive assemblies. Tippins’s purchase order included an arbitration clause which specified that any dispute under the contract must be submitted to arbitration in Vienna, Austria, and be governed by Austrian law. Flender did not agree to Tippins’s purchase order; rather, Flender made and shipped the goods and included in the shipment its invoice. Flender’s invoice included a clause which specified that any dispute must be heard in Chicago, Illinois.

These forum clauses directly conflicted with one another. Thus, the court applied the knock-out rule, instead of the usual rule in UCC § 2-207(2). If the court had applied UCC § 2-207(2), the buyer’s (Tippins’s) clause would have controlled, and the court would have had to send the case into arbitration in Vienna. But under the knock-out rule, the contract is limited to any terms on which the parties’ writings agree. Any remaining gaps are filled by the UCC’s default terms or other appropriate default rules. Here, the court applied the default rules for forum selection and permitted the seller (Flender) to sue in Pennsylvania. Because the buyer was a Pittsburgh-based company, this was an appropriate forum for the dispute.

Flender Corp. v. Tippins International, Inc.

830 A.2d 1279 (Pa. Super. 2003)

JOHNSON, J.

This matter arose out of a “battle of the forms” in which the two contracting parties attempted to impose differing terms of the purchase of goods. Tippins, a Pittsburgh based company, engaged in the construction of a steel rolling mill in the Czech Republic. Tippins sought to purchase gear drive assemblies from Flender Corporation for installation at the new facility.

In January 1998, Tippins mailed a purchase order to Flender specifying terms of sale. The form required that the parties’ disputes under any resulting contract be submitted to arbitration. The order stated Tippins’s terms as follows:

“Tippins[s] purchase order is expressly limited to acceptance of ‘Standard General Conditions Nova Hut Purchase Order’ and special conditions of purchase, which take precedence over any terms and conditions written on the back of the purchase order.”

The “Standard General Conditions Nova Hut Purchase Order” included the arbitration clause at issue here, requiring that all claims or disputes arising out of the contract must be submitted to arbitration before the International Chamber of Commerce in Vienna, Austria and be governed by Austrian law.

Moreover, the order limited the form of Flender’s acceptance as follows: “AS PART OF THIS OFFER TO PURCHASE GOODS OR SERVICES THE ATTACHED ACKNOWLEDGMENT FORM OF THE PURCHASE ORDER ‘MUST’ BE SIGNED AND RETURNED. . . . [NEITHER] TIPPINS NOR ANY OF ITS AFFILIATES RECOGNIZES ANY OTHER DOCUMENT AS AN ACKNOWLEDGMENT.”

Flender did not sign the attached acknowledgment form or issue any other written acceptance of Tippin’s offer, but instead manufactured and shipped the finished drive assemblies. Flender’s invoice, which accompanied the drive assemblies, provided “Conditions of Sale and Delivery” that attached conditions to Flender’s acceptance of Tippins’s order. Flender’s conditions provided as follows:

“[T]hese terms and conditions will govern all quotations covering purchase orders for and sales of Seller’s products and are the sole terms and conditions on which the order of buyer will be accepted. Seller’s acceptance of Buyer’s order will not constitute an acceptance of printed provisions on Buyer’s order form which are inconsistent with or additional to these terms and conditions unless specifically accepted in writing by the Seller. Buyer’s agreement and Buyer’s form containing inconsistent, or material terms shall not be deemed a specific objection to any terms hereof.”

The invoice did not, however, require that Tippins accept these additional terms for the parties to form a binding contract. The invoice did provide a mechanism for

dispute resolution. The dispute resolution clause required that “exclusive jurisdiction and venue of any dispute arising out of or with respect to this Agreement or otherwise relating to the commercial relationships of the parties shall be vested in the Federal and/or State Courts located in Chicago, Illinois.”

Tippins accepted and installed the gear drives, but, subsequently, failed to pay the balance due on the shipment. Flender then commenced this action in the Court of Common Pleas of Allegheny County seeking to recover an amount outstanding of \$238,663.15, plus \$76,372.16 in service charges.

In the trial court, Tippins filed preliminary objection to Flender’s complaint, arguing that the parties’ contract of sale required that Flender submit its claim to arbitration in Vienna, Austria.

The Honorable Ronald W. Folino, denied Tippins’s objections, reasoning that the arbitration clause on which Tippins relied had been “knocked out” because it was materially different from the dispute resolution clause in Flender’s invoice.

Tippins raised the following question for review:

Did the Trial Court err in ruling that neither Flender’s nor Tippins’s forum selection provision became a part of their contract thus finding that the appropriate forum for Flender to bring this action was in Pennsylvania?

Section 2-207(a) provides that an expression of acceptance may operate to accept an offer, even if it contains terms additional to or different from those stated in the offer. Thus, mere nonconformance between competing forms will not undermine the formation of a contract, so long as the parties demonstrate their mutual assent to essential terms. Under such circumstances, a written contract is deemed to exist consisting of the essential terms of the offer, to which the offeree’s response has established its agreement. The formation of a written contract is defeated only where the offeree responds with different or additional terms and “explicitly communicates his or her unwillingness to proceed with the transaction” unless the offeror accepts those terms.

In this case, Flender, through its course of conduct and subsequent invoice, accepted the essential terms of Tippins’s offer. Although the invoice provided terms that did not appear in Tippins’s offer, Flender did not communicate its unwillingness to proceed without them or condition the transaction on Tippins’s acceptance of those terms.

Consequently, we agree with Tippins that the parties did form a written contract under section 2-207(a). The dispute provision in Flender’s acceptance, requiring resolution of the parties’ disagreements in state or federal courts in Chicago, is clearly at odds with and quite “different” from the clause in Tippins offer requiring arbitration of disputes before the International Chamber of Commerce in Vienna. By operation of the rule we adopt today, those provisions are both, quite clearly, “knocked out.” Neither became a part of the parties’ contract. Accordingly, the trial

court did not err in refusing to compel arbitration in response to Tippins's preliminary objections.

For the foregoing reasons, we affirm the trial court's order.

Order AFFIRMED.

Reflection

Flender is a great example of the battle of the forms. Flender and Tippins exchanged pre-printed forms for the purchase of goods. Both forms included dispute resolution clauses that expressly designated different locations. Even though the forms contained competing clauses, the court found a "definite and seasonable expression of acceptance" from the parties' course of performance and therefore applied the battle of the forms.

Since the dispute resolution clauses provided by both parties were clearly at odds with each other, the court applied the majority approach, the knock-out rule, and applied neither party's dispute resolution clause. The court "knocked out" all competing terms to simplify the contract to just the terms that were agreed upon. The court then utilized the default rules for deciding where litigation should take place.

Discussion

1. The R2d adopts the mirror image rule, but the UCC does not. Beyond generally observing that the R2d and UCC rules are different, can you specifically articulate all the ways in which they are different? Create a table comparing the elements of the two rules.
 2. Why does the UCC do away with the mirror image rule? Is there anything unique about contracts involving sales of goods that would obviate the need for this rule?
 3. Why does the UCC provide special acceptance rules for merchants? What makes contracts for sales of goods between merchants different from sales of goods generally? Note the merchant-specific rules in your table.
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Problems

Problem 6.1. Primo Ladders

Taylor, a housepainter, sent a text message to the Primo Ladder Company ordering Model No. 35E, a 35-foot aluminum extension ladder with safety harness, for \$325. Primo Ladder replied by text, stating, "We accept your offer. Model 35E is no

longer available. We have shipped Model 40E to you at no extra cost, payment due on delivery.” Taylor texts back, “I do not want the 40E, it’s too long for my truck.” Primo responds, “Product has already shipped, we demand payment on delivery.” Taylor refused to accept delivery of the ladder, and Primo sued Taylor for breach of contract.

Under UCC § 2-207, was a binding contract formed by Primo’s “acceptance”?

What if Primo’s initial text message had stated, “We accept. Model 35E has been shipped to your address, payment due upon delivery. Any and all disputes must be resolved by arbitration.”

Would this communication “operate as an acceptance” under UCC § 2-207(1)? Was a contract formed by the exchange of these communications?

Problem 6.2. An Earnest Letter

Erneste Ardente made a bid of \$250,000 for William & Katherine Horan’s residential property. After the bid was deemed acceptable, Ardente received and executed the purchase and sale agreement. Ardente’s attorney returned the agreement to the Horans along with a check for \$20,000 and a letter which read:

*My Client is concerned that the following items remain with the real estate:
a) dining room set and tapestry wall covering in dining room; b) fireplace fixtures throughout; c) the sun parlor furniture. I would appreciate your confirming that these items are part of the transaction, as they would be difficult to replace.*

After receiving the letter, the Horans refused to sell the enumerated items and did not sign the purchase and sale agreement. Ardente sued, seeking specific performance for the property.

Was Ardente’s letter a counteroffer or a valid acceptance?

See Ardente v. Horan, 366 A.2d 162 (1976).

Problem 6.3. Conditional Acceptance of a Court Order

Mr. Jameel Ibrahim lost a lawsuit in the United States Court of Federal Claims, which dismissed his complaint against the United States for an alleged breach of an implied-in-law contract. The contract Ibrahim refers to is a child support order from the state court system of New Jersey.

On January 23, 2019, Ibrahim sent a twelve-page letter to various officials of the State of New Jersey, cabinet secretaries, and the Supreme Court of the United States, titled “Conditional Acceptance for the Value/Agreement/Counter Offer to Acceptance of Offer.” In the letter, Ibrahim alleged that he had “received [these parties’] offer and accept[ed]” it, subject to conditions set forth in the rest of the letter—for the most part, demanding that the recipients justify the existence of various governmental

agencies and practices. The letter asserts that failure to do so would result in default, and in turn, an obligation to pay Ibrahim \$3.5 million in damages.

Did Ibrahim’s “Conditional Acceptance” letter constitute a valid acceptance of the state’s child support order, and, if so, on what terms?

See Ibrahim v. United States, 799 Fed. App’x 865 (Fed. Cir. 2020).

MODULE II

Consideration and Its Alternatives

Contract law supports the fundamental principle that promises, once made, should generally be kept. By enforcing voluntary bargains, contract law promotes several key goals: efficiency, reliance, autonomy, and fairness. The main rationale for enforcing bargains is that each party can assess whether a deal benefits them and freely choose to enter only those exchanges that improve their welfare. By facilitating these voluntary exchanges, contract law not only protects individual choice but also benefits society as a whole. However, contract law achieves these goals only when three preconditions are met.

First, the exchange must involve mutual assent. A contract cannot be imposed on someone without their consent. For example, if a painter arrives uninvited, paints your house in the dead of night, and demands payment, there is no evidence that you valued the service or agreed to it. You never opted in. Without mutual agreement, contract law does not support enforcing such transactions. As you learned in the prior module, valid offers and acceptances are essential to establishing mutual assent.

Second, the exchange must be truly voluntary. Promises made under conditions of mistake or fraud, or by parties lacking the capacity to understand them, may not be enforceable, as these factors undermine the voluntary nature of the agreement. You will learn about these defenses to formation and enforceability in the next module.

Third, even when there is mutual assent to an exchange, not all promises become enforceable contracts. In this module, we focus on the precondition of **consideration**, which requires a bargained-for exchange. By insisting that each party provides something of legal value in return for a promise, consideration offers evidence that both sides deliberately and voluntarily entered the agreement. This is why contracts requiring consideration are often called “bargain contracts.”

Consideration serves contract law’s dual goals of economic efficiency and autonomy. It signals that the parties expected mutual benefit from the exchange and chose to bind themselves freely. While not a perfect safeguard, this framework reduces disputes and ensures that obligations are intentional and consensual. Voluntary obligations supported by consideration lie at the heart of contract law.

Still, not all promises arise from bargains. Exceptions to the consideration doctrine, known as “alternatives to consideration,” reflect contract law’s broader goals of reliance and fairness. These exceptions allow courts to enforce certain promises even without a bargained-for exchange.

Promissory estoppel protects a party who reasonably relied on a promise to their detriment. Courts use this tool to avoid injustice. **Promissory restitution** is a fairness-focused doctrine that prevents unjust enrichment when one party confers a benefit on another without compensation. These exceptions create what are known as “non-bargain contracts” and reflect the law’s flexibility in pursuing justice.

By briefly introducing these doctrines and their goals here, we set the stage for deeper discussions. In the chapters ahead, you will examine consideration as the primary pathway for creating enforceable obligations grounded in efficiency and autonomy. You will then explore the exceptions—promissory estoppel and promissory restitution—that allow courts to enforce promises based on reliance or fairness. Together, these doctrines demonstrate how contract law balances competing objectives to achieve justice in private agreements.

Chapter 7

Consideration

To be enforceable, contracts must involve some form of exchange. Typically, contracts involve an exchange of promises; such contracts are known as a “bilateral contracts.” Consideration often takes the form of a promise exchanged for the other party’s promise.

Less commonly, contracts consist of a single promise exchanged for the completion of a requested performance. In such a unilateral contract, the only way to bind the promisor is to complete the requested performance. In a unilateral contract, the consideration supporting that singular enforceable promise is, of course, the completion of the performance itself.

This chapter focuses primarily on bilateral exchanges of promises, as these are far more common. Most contracts involve an exchange of promises. Each party’s promise provides consideration supporting the other party’s promise.

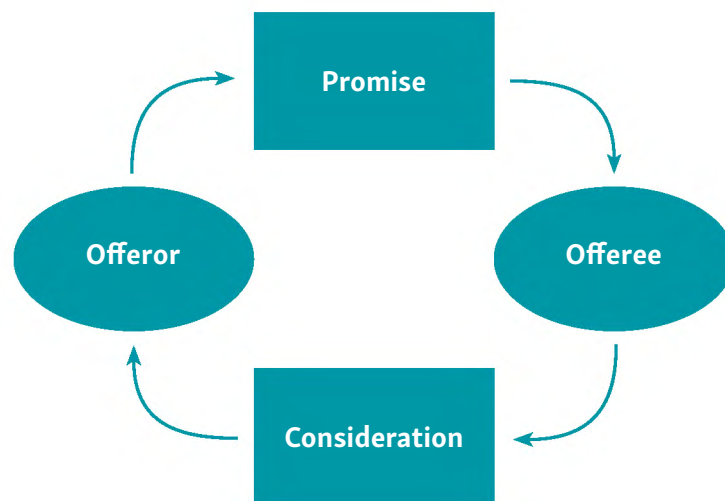


Figure 7.1. Consideration is what the offeree promises the offeror in exchange for the offeror’s promise to the offeree.

Consideration is a foundational concept in contract law. Why are some promises legally enforceable, while others remain unenforceable? Consideration is central to determining which promises are legally enforceable. As you learned earlier, a contract

is defined as “a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.” R2d § 1.

Consideration ensures that enforceable promises involve a mutual commitment rooted in a bargained-for exchange. Without it, most promises remain unenforceable, as contract law emphasizes voluntary obligations that reflect reciprocal benefit.

The doctrine of consideration serves three main purposes. First, it advances efficiency by enabling voluntary exchanges that allocate resources to their most valued uses, which improves social welfare. Second, consideration promotes autonomy by ensuring that enforceable promises reflect deliberate and voluntary commitments, which safeguards individual freedom to contract. Third, consideration acts as a gatekeeping tool by helping to distinguish between promises that the law ought to enforce—namely, promises supported by intentional mutual exchange—and those that do not really belong in court, such as casual or gratuitous promises. This balance ensures that contract law enforces only those commitments that align with its broader goals of fostering efficient cooperation and predictability.

Consideration is not just a legal formality—it is the glue that makes enforceable promises meaningful and ensures mutual benefit. How would commerce function if parties could not rely on each other’s promises?

For example, consider Frances, an apple orchard owner, and Benjamin, who owns an orange grove. Their fruits ripen at different times—apples in September and oranges in December—making direct barter impractical. Contract law allows them to bind themselves through enforceable promises. Frances promises to deliver half of her apple harvest in September, and Benjamin promises to deliver half of his orange crop in December.

With this agreement, both parties can rely on the other’s promise, which in turn prevents waste and enables them to enjoy fresh fruit at different times of the year. Without the ability to enforce such promises, Frances and Benjamin might hesitate to commit, which would lead to spoiled crops and lost opportunities for mutual gain.

This example illustrates the three main purposes of the consideration doctrine. Efficiency is achieved because consideration ensures that Frances and Benjamin exchange something of value in alignment with their mutual expectations of benefit. Autonomy is respected because the presence of consideration from each party signals that both parties voluntarily chose to enter into an agreement with reciprocal obligations. Finally, gatekeeping is achieved by limiting enforceability to promises that involve a bargained-for exchange.

This chapter will explore the rules that govern the consideration doctrine in light of these goals. The chapter begins by examining the evolution of consideration in the courts. Over the centuries, courts have developed different approaches to defining the consideration necessary to support a contractual promise.

There is significant overlap in these approaches, but understanding the differences between these theories will help you to appreciate how the concept of consideration

has evolved and what the modern standard really entails. The chapter begins by explaining the traditional “benefit/detriment” theory of consideration, which focused (often quite literally) on whether one party gained a benefit and the other party suffered a detriment.

The chapter then moves to the modern “bargained-for exchange” theory of consideration, which has become the dominant standard. This does not require a literal benefit or detriment; instead, it focuses on the presence of a voluntary exchange. Along the way, we will clarify the boundaries of consideration and distinguish enforceable promises from those that are gratuitous, illusory, or shams. This exploration will show how consideration functions both as a legal requirement and as a reflection of the economic, social, and moral goals underlying contract law.

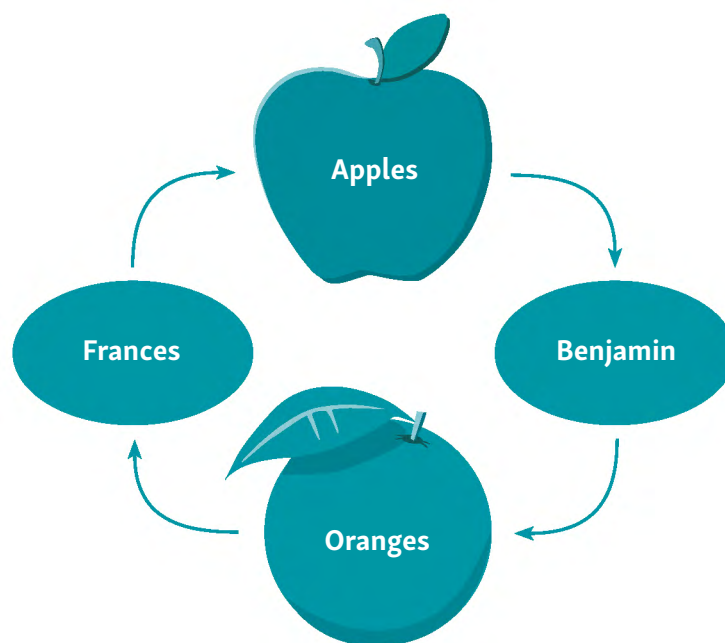


Figure 7.2. Illustration of promise and consideration.

Rules

A. The Historical Benefit/Detriment Theory

Historically, there have been two alternative theories for defining what consideration is and when it is, or is not, present. The older theory is what is sometimes called the “benefit/detriment” theory. This asks whether the promisor incurs a benefit in exchange for their promise and whether the promisee, in turn, incurs a detriment in exchange for that promise.

This historic test is now disfavored and has largely been replaced by the bargained-for exchange test of consideration. However, courts still refer to these concepts with some frequency. For this reason, law students should read and understand the historic case *Hamer v. Sidway*, 27 N.E. 256 (1891), which is perhaps the most famous articulation of the benefit/detriment test. The court in *Hamer* refined the theory, clarifying that what constitutes a detriment under the law is not as literal as some might believe.

Despite the name of the case, the facts revolve around an uncle named William E. Story (who happened to be a liquor dealer) and his nephew named William E. Story the Second.

... 'William E. Story agreed to and with William E. Story, 2d, that if he would refrain from drinking liquor, using tobacco, swearing, and playing cards or billiards for money until he should become twenty-one years of age, then he, the said William E. Story, would at that time pay him, the said William E. Story, 2d, the sum of \$5,000 for such refraining, to which the said William E. Story, 2d, agreed,' and that he 'in all things fully performed his part of said agreement.'

The uncle died before the nephew turned 21, but the nephew fulfilled the promise anyway. This was probably a unilateral contract. Do you see why? The nephew apparently accepted the uncle's offer by fully performing the requested abstention from vices rather than by promising to do so.

The administrator of the uncle's estate refused to pay the nephew, claiming that the nephew did not render any consideration for the uncle's promise. The administrator reasoned that the nephew actually *benefited* from abstaining from liquor, tobacco, swearing, cards, and billiards, and that the uncle received no personal benefit from his nephew's abstinence.

The court applied the benefit/detriment test to determine whether the nephew gave consideration in exchange for his uncle's promise:

The exchequer chamber in 1875 defined 'consideration' as follows: 'A valuable consideration, in the sense of the law, may consist either in some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility given, suffered, or undertaken by the other.'

The court found that the nephew did indeed incur a detriment under the law because he gave up his legal rights:

It is sufficient that [the nephew] restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle's agreement.

The nephew did not have to suffer or end up worse off because of this bargain in order to incur a detriment under this test; rather, merely giving up one's legal right is enough to pass as a detriment. The nephew incurred a detriment, the court reasoned, so he gave consideration for the promise. The court acknowledged that the benefit/

detriment test required either a detriment to the promisee or a benefit to the promisor. Upon finding this detriment to the promisee, the court did not have to opine on whether the promisor benefited, but, in dicta, it stated:

We see nothing in this record that would permit a determination that the uncle was not benefited in a legal sense.

Hamer shows how the benefit/detriment theory is applied to determine whether there is consideration. But the case also shows why the rule is problematic. From the economic perspective of increasing social welfare, how does requiring a person to incur a detriment help to ensure that enforceable contracts make society better off?

The benefit/detriment theory is also problematic because pain and pleasure are somewhat subjective. The court could not ask the uncle whether he benefited from his nephew's abstinence because the uncle was dead at the time of the trial. And whether the nephew suffered or enjoyed his abstinence from intoxicating liquors is also a subjective matter that is both hard to discover and difficult to enforce generally. The theory is difficult to apply, and courts have generally replaced it with a new theory that is both easier to objectively measure and more likely to result in an increase in social welfare.

B. The Modern Bargained-For Exchange Theory

Most modern courts have moved away from the benefit/detriment test and toward the bargained-for exchange test. The R2d clearly adopts this modern test.

To constitute consideration, a performance or a return promise must be bargained for. R2d § 71(1).

In this more modern test, the question is whether the contract is the result of both parties' desire to receive something from the transaction. This does not require bargaining per se, meaning that the parties do not have to haggle or dicker over terms. Rather, the test simply looks at whether promises are given in exchange for one another.

A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise. R2d § 71(2).

The bargained-for exchange test is flexible and inclusive. It includes a wide variety of actions that can count as consideration. The promise and the consideration in exchange for that promise can be affirmative actions, forbearance, promises, other acts, and anything that alters some legal relationship.

The performance may consist of (a) an act other than a promise, or (b) a forbearance, or (c) the creation, modification, or destruction of a legal relation. R2d § 71(3).

The consideration does not even have to flow to the original promisor. If a promisor bargains for the promisee to give consideration to a third party, that still counts as consideration.

The performance or return promise may be given to the promisor or to some other person. It may be given by the promisee or by some other person.
R2d §71(4).

This modern test fits better with the law-and-economics approach to contract law, which justifies enforceable agreements on the basis that they generally make the world more valuable by allocating property to the person who values it more.

The bargained-for exchange test is flexible enough to apply in cases where the benefit/detriment test would fail. In *Pennsy Supply, Inc. v. American Ash Recycling Corp.*, 895 A.2d 595 (Pa. Sup. Ct. 2006), American Ash was a business that converted hazardous waste into useful material. Businesses would pay American Ash to remove their waste and by-products, and then American Ash would process the material and give away the resulting recycled product, which it called AggRite, for free. American Ash thus avoided the cost of disposing of the hazardous waste and, hopefully, made a profit by charging more to remove the hazardous materials than it spent recycling, storing, and advertising the resulting recycled AggRite.

Pennsy Supply agreed to take about 11,000 tons of AggRite from American Ash and use it in a paving project. Pennsy used the product correctly. Unfortunately, the pavement developed extensive cracking within three months of its use. Pennsy then asked American Ash to remediate the defective work under the theory that American Ash owed Pennsy an implied warranty that the product would not crack and fail so quickly.

In Chapter 18, you will learn that contracts for sales of goods usually include implied warranties such as this. For present purposes, simply note that sales of goods include implied warranties of merchantability, meaning fitness for the ordinary purchase for which such goods are used, *see* UCC §2-314, and “fitness for a particular purpose,” meaning the buyer’s special purposes if the seller has reason to know of them, *see* UCC §2-315. In this case, the AggRite should be warrantied for its ordinary use in making pavement that would not crack, but this warranty only applies if American Ash sold the AggRite to Pennsy in a bargained-for contractual exchange and did not give it away as a gift.

Returning to our facts, the pavement made of AggRite cracked, and American Ash refused to fix the pavement, claiming that there was no contract because it had merely given Pennsy a gift, since it did not charge any money for the AggRite. Pennsy sued.

The trial court applied the benefit/detriment test and agreed with American Ash. It found that American Ash gave Pennsy a conditional gift. As explained below, a conditional gift is just a promise to give a gift, and the recipient must meet some condition in order to accept the gift. The trial court reasoned that, since the parties did not discuss disposal costs during any part of the bargaining process, American Ash did not give away the AggRite with the intent to avoid disposal costs. Instead, hauling

away the AggRite was simply a condition Pennsy had to meet in order to receive the gift of the product.

The appellate court disagreed for two reasons. First, it found that American Ash did seek people to haul away its AggRite. It advertised the material for free and would have otherwise paid to dispose of it. The trial court mistakenly thought that since the material was free, it was a gift. But the material had a negative value. It was a “bad,” not a “good.” It was made of hazardous waste that was expensive to eliminate. By removing a negative thing from American Ash, Pennsy gave American Ash a benefit. Therefore, under the benefit/detriment test, there was a benefit to the promisor, and therefore, there was consideration for the promise.

Second, the appellate court applied the bargained-for exchange theory of consideration. It found that the trial court misunderstood and misapplied the theory by finding that there was no bargain because the parties did not have a bargaining process. This was an error. There is no requirement for a bargaining process. What is required is that both parties seek something in exchange. The appellate court reasoned that, in this case, American Ash sought removal of hazardous waste from its property, and Pennsy sought paving material. Both parties expected to get something from this exchange, and therefore, there was consideration for the promise.

This case shows how the benefit/detriment test and the bargained-for exchange test overlap and can arrive at the same result. But it also shows that the benefit/detriment test can be difficult to apply, and the bargained-for exchange test is both easier to determine objectively and more analytically straightforward. This is why courts have moved toward the bargained-for exchange theory of consideration.

C. Gratuitous Promises Are Not Supported by Consideration

Gratuitous means given or done for free. Gratuitous, as in the word gratuity, is synonymous with free, gratis, complimentary, voluntary, unpaid, without charge, and pro bono. Likewise, a gratuitous promise is a promise to give a gift, to volunteer, or to do something for nothing. Contractual promises require consideration, which is something in exchange for the promise. By definition, a gratuitous promise seeks nothing in return. Therefore, gratuitous promises are not supported by consideration.

D. Conditional Gifts Are Not Supported by Consideration

Consideration is usually easy to spot where both parties to a contract are expecting and wanting to get some benefit from that transaction. However, there are cases where consideration appears to be present but is truly absent; one such situation involves the “conditional gift.”

The terms “condition” and “conditional” are used in different contexts within contract law, and their meanings can vary, leading to some understandable confusion. In particular, the concept of a conditional gift differs from that of a conditional promise in a contract. Both involve the occurrence or non-occurrence of an event, but the legal implications and underlying principles are distinct.

A conditional promise, as you will learn in Chapter 19, refers to an enforceable contract where a promise is not obligatory until some event occurs or fails to occur. In this book, when we discuss “conditions,” we are usually referring to this type of event.

For example, Laurel and Hardy decide to purchase a new wardrobe for their slapstick comedy act. Western Costume makes the following offer: “We’ll make you two fine suits for \$10 each. And if one stains the first time you get custard pie on it, we’ll make you a new one for \$1.”

If Laurel and Hardy accept, there is a bargain contract supported by consideration. Western Costume promises to deliver two suits, and Laurel and Hardy promise to pay \$10 for each. However, whether Western Costume has to make a third suit for \$1 depends on whether one of the first suits stains. Staining is a condition precedent—an event that must occur before the obligation to provide the third suit arises. If the condition does not happen (i.e., the suit does not stain), Western Costume is not obligated to make the third suit. Nevertheless, the contract remains valid, supported by the initial bargain.

A conditional gift, on the other hand, is a promise unsupported by consideration. Without some alternative to consideration (like reliance or unjust enrichment), a conditional gift cannot form a bargain contract. A conditional gift is, literally, a promise to give something and not a promise to make an exchange.

Consider a wrapped present you receive for Christmas. What do you need to do to receive the gift? You need to unwrap it. Unwrapping the gift is a necessary step—a “condition” in lay terms—for getting the gift, but it is not something the giver bargained for in exchange. The unwrapping is merely incidental to the receipt of the gift, not consideration.

Courts sometimes struggle to distinguish between conditional promises and conditional gifts. The analysis depends on whether the condition was intended as part of a bargained-for exchange or was simply incidental to the act of gift-giving.

Professor Samuel Williston provided a famous example of a conditional gift. In his example, a benefactor promises a tramp (an unhoused, transient person) that if the tramp goes to the corner store, the tramp may purchase a new coat on the benefactor’s account. The condition for receiving the benefactor’s gift is that the tramp walks to the store and charges the coat. But is this condition for receiving the gift also consideration for the benefactor’s promise?

At first glance, it might look like consideration. Under the benefit/detriment theory, the promisee (the tramp) incurs a detriment by walking to a store they otherwise

would not have gone to. Under the bargained-for exchange theory, one might reason that the tramp's walk was the "price" paid in exchange for the coat.

However, this is not the kind of detriment that counts as consideration. Professor John Murray explains the distinction:

If the promisor made the promise for the purpose of inducing the detriment, the detriment induced the promise. If, however, the promisor made the promise with no particular interest in the detriment that the promisee had to suffer to take advantage of the promised gift or other benefit, the detriment was incidental or conditional to the promisee's receipt of the benefit. Even though the promisee suffered a detriment induced by the promise, the purpose of the promisor was not to have the promisee suffer the detriment because [the promisor] did not seek that detriment in exchange for [the promisor's] promise.

JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 60 (3d ed. 1990).

Applying Murray's test, we must ask: Was the purpose of the benefactor's promise of the coat to induce the tramp to walk to the store? The most reasonable interpretation is that the benefactor did not care about the tramp's walk. Instead, walking to the store was simply the logistical step necessary for the tramp to obtain the coat. The walk was a condition for receiving the gift, not a detriment bargained for in exchange.

In sum, distinguishing true consideration from a mere conditional gift requires assessing the parties' objectively manifested intentions. Did the promisor's promise seek to induce the detriment as part of a bargained-for exchange, or was the detriment merely an incidental step in receiving a gift? As you evaluate consideration problems, think carefully about this distinction.

You will see this issue arise again in the *Pennsy* case, below, where the defendant argued that its promise to supply the AggRite was merely a promise to give a gift with a condition attached.

E. Past Consideration Is Not Consideration

Consideration must induce the promisor to give the promise to the promisee in exchange for the consideration. If the consideration has already been given to the promisor, then it cannot serve to further induce him. Therefore, there is no such thing as "past consideration." Sometimes the term is used to refer to a moral obligation to repay someone, but promises to repay someone for a benefit previously received are governed by the doctrine of promissory restitution.

For example, if Ezekial gives Kent a book on Day 1 as a gift, and then on Day 2, Kent promises to repay Ezekial \$10 for the book, Kent's promise obviously is not intended to induce Ezekial to give the book to Kent. Ezekial already gave Kent the book for free, and Kent already possesses and owns the book. If we diagram this situation, it looks quite different from situations where we find consideration.

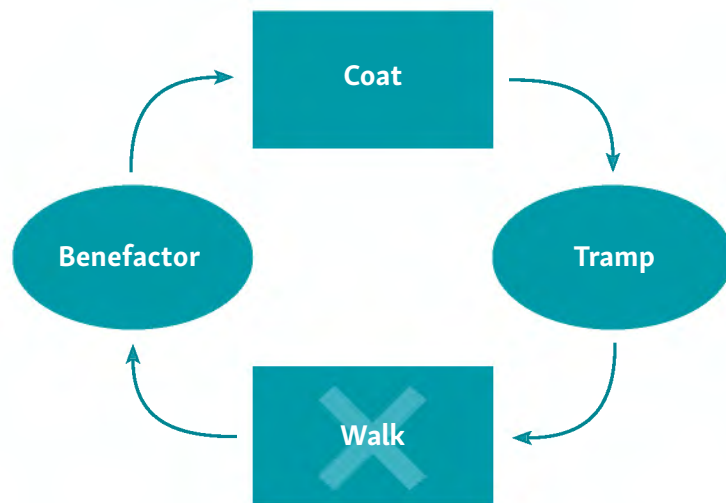


Figure 7.3. Illustrating a conditional gift, lacking consideration.

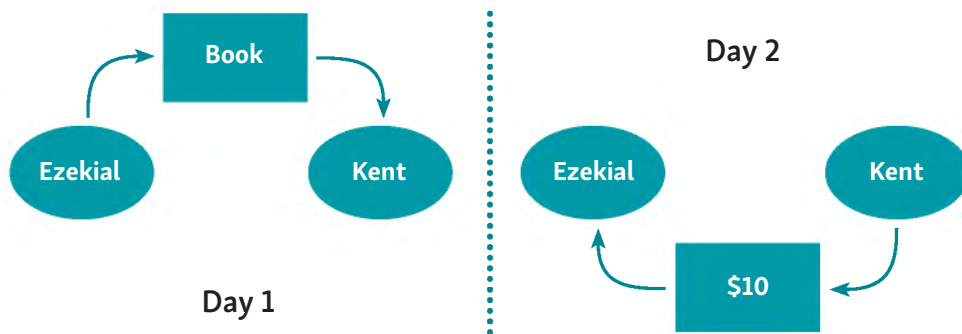


Figure 7.4. Illustration of past consideration.

There are situations where a promise to pay for a benefit previously received can be binding. But such situations do not form contracts-at-law. Rather, they are potentially enforceable promises pursuant to the equitable doctrine of promissory restitution. Moreover, such promises are only enforced when and to the extent that justice requires. In general, promises to pay for past benefits are not enforceable, and you will learn about the special and rare exceptions to that rule.

F. Illusory Promises Are Not Consideration

Illusory promises are promises that do not actually have to be performed by the promisor. For example, if Nancy says to Drew, “If you pay me \$20, I promise to drive you to the airport tomorrow, provided that I feel up to it,” that is an illusory promise because Nancy reserves total control of whether she fulfills her promise or not. There is the illusion of a promise, since Nancy spoke the words, “I promise,” but, in reality,

she did not commit herself to perform any task. In the terms of the R2d, Nancy has reserved a choice of alternative performance:

A promise or apparent promise is not consideration if by its terms the promisor or purported promisor reserves a choice of alternative performances unless (a) each of the alternative performances would have been consideration if it alone had been bargained for; or (b) one of the alternative performances would have been consideration and there is or appears to the parties to be a substantial possibility that before the promisor exercises his choice events may eliminate the alternatives which would not have been consideration.
R2d § 77.

There is, however, a doctrine which can serve to bind a promisor to what would otherwise be an illusory promise. The duty of good faith and fair dealing requires that contractual parties act in good faith to produce the fruits of their mutual agreement. A famous case authored by Justice Cardozo, *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88 (1917), reproduced in Chapter 16, dealt with precisely this issue.

Lady Duff-Gordon (1863–1935) was a leading British fashion designer who survived the sinking of the RMS *Titanic* in 1912. She was also booked to sail on the RMS *Lusitania*, a cruise ship that was sunk by a German submarine in 1915 as a precursor to the First World War, but she canceled her trip due to illness.

Around the time when the *Lusitania* set sail, Duff-Gordon offered to hire a certain Otis T. Wood, an American advertising agent, to help her turn her vogue into money, on the following terms:

[Wood] was to have the exclusive right, subject always to [Duff-Gordon's] approval, to place her indorsements on the designs of others. He was also to have the exclusive right to place her own designs on sale, or to license others to market them. In return, she was to have one-half of "all profits and revenues" derived from any contracts he might make. The exclusive right was to last at least one year from April 1, 1915, and thereafter from year to year unless terminated by notice of ninety days.

Today, we would call Duff-Gordon an “influencer,” and Wood was her public relations man. Their deal clearly included his exclusive right to her endorsements, yet Duff-Gordon violated this promise by placing her endorsements on other things without Wood’s knowledge, and she did not share profits with him. Wood sued Duff-Gordon for damages, and the issue upon which the case turned was whether Duff-Gordon’s promise to give Wood an exclusive right had been supported by a promise from Wood in exchange.

Duff-Gordon argued that Wood’s promise was illusory. Wood did not promise her anything, she reasoned, because the contract did not specify that Wood had to make any efforts to locate and suggest items for Duff-Gordon to endorse. Since Wood did not really bind himself to do anything for her, Duff-Gordon was equally free from contractual obligations to him.



Figure 7.5. Lady Duff-Gordon on the deck of the Titanic.
Library of Congress (1900). Public domain work.

Cardozo did not agree with this reasoning:

A promise may be lacking, and yet the whole writing may be “instinct with an obligation,” imperfectly expressed. If that is so, there is a contract.

If the contract does not have a term in which Wood makes a binding promise to Duff-Gordon, where can we find such an obligation? Cardozo finds it in the circumstances surrounding the deal. Wood created a business for the purpose of placing such endorsements as Duff-Gordon approved, which tends to show he intended to commit to this work.

The plaintiff [Wood] goes on to promise that he will account monthly for all moneys received by him, and that he will take out all such patents and copyrights and trademarks as may in his judgment be necessary to protect the rights and articles affected by the agreement.

Cardozo finds that these promises are nonsensical without the implication that Wood shall make his best efforts to place Duff-Gordon’s endorsements. One should not assume that business transactions, especially ones supported by formal written contracts prepared by lawyers and signed by the parties, are intended to be merely optional. Rather, one should presume that the parties intended to both make good faith efforts to bring about the fruits of the agreement.

If a party does indeed have total freedom to perform or not perform a promise at its own discretion, then that is an illusory promise that cannot constitute consideration. But courts will look for that obligation in law and facts:

A limitation on the promisor's freedom of choice need not be stated in words. It may be an implicit term of the promise, or it may be supplied by law. R2d § 77 cmt. d.

The doctrine of good faith and fair dealing implies limits on parties' freedom not to perform their obligations. This makes some obligations that would otherwise be illusory into binding promises that can constitute valid consideration.

G. Nominal Consideration Is Not Consideration

Courts do not generally inquire about the value of consideration. There is no obligation that the consideration be worth the same or more than the promise. In fact, the point of contract law is to allow parties to decide for themselves what they value and how much they value it. It is antithetical to this purpose for courts to police bargains based on how the judges value components of the parties' exchange.

If the requirement of consideration is met, there is no additional requirement of . . . equivalence in the values exchanged. R2d § 79(b).

Parties are free to agree to exchanges of unequal values. Moreover, many things have no fixed or general sense of market value or price. Beauty is in the eye of beholder, and valuation is left to private parties because they are in the best position to evaluate their own transaction.

Although courts generally do not inquire about the value of consideration, they may question whether gross inadequacy of consideration implies that the consideration is just a sham. Parties who are aware of the consideration doctrine may attempt to make a gratuitous promise binding by claiming in writing that it was for good and valuable consideration where that is in fact not the case. Or parties may offer some relatively tiny amount of payment as consideration for a promise in order to obtain the pretense of consideration through mere formality. Such tiny amounts are called nominal consideration, and nominal consideration is not sufficient to enforce a contract-at-law.

For example, in the historic case *Schnell v. Nell*, 17 Ind. 29 (1861), a widower (Schnell, defendant) wanted to honor his deceased wife's desire to bequeath \$200 to each of three heirs. To accomplish this, the widower wrote contracts by which he agreed to pay them \$200 each, and the writing recited three forms of consideration for this payment:

1. *A promise, on the part of the plaintiffs, to pay him one cent.*
2. *The love and affection he bore his deceased wife, and the fact that she had done her part, as his wife, in the acquisition of property.*

3. *The fact that she had expressed her desire, in the form of an inoperative will, that the persons named therein should have the sums of money specified.*

The court held, first, that one cent is nominal consideration with regard to a promise to pay \$200. It is obvious that no one desires \$0.01 more than \$200. This was a sham, and courts are not mindless wooden sticks.

Second, the court held that love and affection are not consideration, for two reasons. First, the wife had died, so her love and affection was in the past. As discussed earlier, past consideration is not consideration. Second, even present or future love and affection of a wife is not consideration to pay a third party. Consideration must be a thing of tangible value, not a moral obligation or a sense of endearment.

Third, his wife's desire is also not consideration. His wife failed to make a valid will. An invalid will is meaningless and valueless, so it cannot constitute consideration. The fact that Schnell now venerates the memory of his deceased wife is not valid consideration to pay any third person money.

H. Reflections on Consideration

The consideration doctrine notoriously troubles law students, but, in reality, it is rarely a problem in most commercial agreements. The debate on the doctrine is primarily an academic one. This chapter has shown you how to evaluate whether the element of consideration is present in a contract. Perhaps the best way to do this evaluation is by remembering the common situations in which consideration is likely to be absent. Gratuitous promises, conditional gifts, past consideration, illusory promises, nominal consideration, and the like are common scenarios where consideration must be examined more closely. These situations are rare in real-life contracting but obnoxiously common on the bar exam, so a wise student will learn to watch out for red flags that are meant to signal the necessity of a consideration analysis. If consideration is found to be lacking, all hope is not lost. A contract may still be enforceable based on some alternative to consideration, as the following chapters explore.

Cases

Reading Hamer v. Sidway. Historically, there have been two alternative theories that attempt to explain what consideration is and why the law should require it. The first, and older, theory is best understood as the benefit/detriment test. It asks whether the promisor incurs a benefit or the promisee incurs a detriment, to evaluate whether consideration is present such that a binding contract may be formed. This historic test is now disfavored by modern courts and has largely been replaced by the bargained-for exchange test of

consideration. However, the doctrine is varied, and courts still cleave to the old language. For this reason, and because *Hamer* is a hallmark of the classic contract law canon, students should read and remember the facts of this historic case, which is perhaps the most famous articulation of the benefit/detriment test in practice.

Although the case revolves around an uncle named William E. Story and his nephew, William E. Story II, the case is captioned *Hamer v. Sidway*. Louisa W. Hamer was the assignee of the nephew's financial interest in the uncle's promise. Franklin Sidway was the executor of the uncle's estate. The case is captioned this way because the nephew transferred his right to the promised money to his wife, who later assigned it to her mother, Louisa W. Hamer. When the uncle died, his executor, Sidway, refused to pay the money, so Hamer sued to collect. In short, *Hamer* was asserting the contractual right originally held by William E. Story II against the executor of William E. Story's estate, *Sidway*.

Hamer v. Sidway

124 N.Y. 538, 27 N.E. 256 (1891)

PARKER, J., The question which provoked the most discussion by counsel on this appeal, and which lies at the foundation of plaintiff's asserted right of recovery, is whether by virtue of a contract defendant's testator, William E. Story, became indebted to his nephew, William E. Story, 2d, on his twenty-first birthday in the sum of \$5,000.

The trial court found as a fact that 'on the 20th day of March, 1869, William E. Story agreed to and with William E. Story, 2d, that if he would refrain from drinking liquor using tobacco, swearing, and playing cards or billiards for money until he should become twenty-one years of age, then he, the said William E. Story, would at that time pay him, the said William E. Story, 2d, the sum of \$5,000 for such refraining, to which the said William E. Story, 2d, agreed,' and that he 'in all things fully performed his part of said agreement.'

The defendant contends that the contract was without consideration to support it and is therefore invalid. He asserts that the promisee, by refraining from the use of liquor and tobacco, was not harmed, but benefited; that that which he did was best for him to do, independently of his uncle's promise,—and insists that it follows that, unless the promisor was benefited, the contract was without consideration,—a contention which, if well founded, would seem to leave open for controversy in many cases whether that which the promisee did or omitted to do was in fact of such benefit to him as to leave no consideration to support the enforcement of the promisor's agreement. Such a rule could not be tolerated and is without foundation in the law.

Courts will not ask whether the thing which forms the consideration does in fact benefit the promisee or a third party, or is of any substantial value to anyone. It is enough that something is promised, done, forborne, or suffered by the party to whom

the promise is made as consideration for the promise made to him. In general, a waiver of any legal right at the request of another party is a sufficient consideration for a promise. Any damage, or suspension, or forbearance of a right will be sufficient to sustain a promise.

Pollock in his work on Contracts, after citing the definition given by the exchequer chamber, says:

'The second branch of this judicial description is really the most important one. "Consideration" means not so much that one party is profiting as that the other abandons some legal right in the present or limits his legal freedom of action in the future, as an inducement for the promise of the first.'

Now, applying this rule to the facts before us, the promisee used tobacco, occasionally drank liquor, and he had a legal right to do so. That right he abandoned for a period of years upon the strength of the promise of the testator that for such forbearance he would give him \$5,000. We need not speculate on the effort which may have been required to give up the use of those stimulants. It is sufficient that he restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle's agreement, and now, having fully performed the conditions imposed, it is of no moment whether such performance actually proved a benefit to the promisor, and the court will not inquire into it; but, were it a proper subject of inquiry, we see nothing in this record that would permit a determination that the uncle was not benefited in a legal sense.

Few cases have been found which may be said to be precisely in point, but such as have been, support the position we have taken. In *Shadwell v. Shadwell*, an uncle wrote to his nephew as follows:

My dear Lancey: I am so glad to hear of your intended marriage with Ellen Nicholl, and, as I promised to assist you at starting, I am happy to tell you that I will pay you 150 pounds yearly during my life and until your annual income derived from your profession of a chancery barrister shall amount to 600 guineas, of which your own admission will be the only evidence that I shall receive or require. Your affectionate uncle, CHARLES SHADWELL.

It was held that the promise was binding and made upon good consideration.

In *Lakota v. Newton*, the complaint averred defendant's promise that:

If you [meaning the plaintiff] will leave off drinking for a year I will give you \$100.

Plaintiff's assent thereto, performance of the condition by him, and demanded judgment therefor. Defendant demurred, on the ground, among others, that the plaintiff's declaration did not allege a valid and sufficient consideration for the agreement of the defendant. The demurrer was overruled.

In *Talbott v. Stemmons*, the step-grandmother of the plaintiff made with him the following agreement:

I do promise and bind myself to give my grandson Albert R. Talbott \$500 at my death if he will never take another chew of tobacco or smoke another cigar during my life, from this date up to my death; and if he breaks this pledge he is to refund double the amount to his mother.

The executor of Mrs. Stemmons demurred to the complaint on the ground that the agreement was not based on a sufficient consideration. The demurrer was sustained, and an appeal taken therefrom to the court of appeals, where the decision of the court below was reversed. In the opinion of the court it is said that:

The right to use and enjoy the use of tobacco was a right that belonged to the plaintiff, and not forbidden by law. The abandonment of its use may have saved him money, or contributed to his health; nevertheless, the surrender of that right caused the promise, and, having the right to contract with reference to the subject matter, the abandonment of the use was a sufficient consideration to uphold the promise.

Abstinence from the use of intoxicating liquors was held to furnish a good consideration for a promissory note in *Lindell v. Rokes*. The order appealed from should be reversed, and the judgment of the special term affirmed, with costs payable out of the estate. All concur.

Reflection

Hamer v. Sidway explains the benefit/detriment test. The benefit/detriment test requires that for there to be adequate consideration, the contract must either benefit the promisor or detriment the promisee. If the contract does not benefit the promisor or detriment the promisee, the contract is without consideration and therefore invalid. Adequate consideration can consist of “some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility given, suffered, or undertaken by the other.”

In *Hamer v. Sidway*, the nephew promised to forbear drinking, swearing, smoking, and some gambling until his twenty-first birthday. He did forbear these activities, and it does not matter how much he had to suffer because of it because he restricted his legal freedom to do so. The nephew restricted his legal freedom of action based on the inducement of his uncle’s promise. However, the benefit/detriment test is often disfavored by courts, since it leaves room for controversy in many cases as to whether the promisee either did or did not do something that was to his benefit, therefore leaving no consideration to support the enforcement of the promisor’s agreement. For the most part, courts apply a more modern test, the bargained-for exchange test, to evaluate whether a contract is supported by consideration.

Discussion

1. Why do courts require consideration?
 2. What is the role of (i) inducement and (ii) exchange in (a) the benefit/detriment test as articulated in *Hamer* and (b) the modern consideration test (R2d § 71)?
 3. Evaluate the facts of *Hamer* under the bargained-for exchange test of consideration. Is the result the same?
 4. The *Hamer* court analogizes to several cases, including *Lakota* and *Talbott*. What is similar about these three cases? Can you identify any distinctions that the court glossed over?
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Reading Pennsy Supply, Inc. v. American Ash Recycling Corp. Most modern courts and the R2d have moved away from the benefit/detriment test and toward the bargained-for exchange test. In this modern test (R2d § 71), the question is whether the contract is the result of both parties' desire to receive something from the transaction. This does not require bargaining per se, meaning that the parties do not have to haggle or dicker over terms. Rather, the test simply looks at whether promises are given in exchange for one another. This modern test fits better with the law-and-economics approach to contract law, which justifies enforceable agreements on the basis that they generally make the world more valuable by allocating property to the person who values it more.

But the bargained-for exchange test is not perfect. The *Pennsy* case, which involved a contract for the removal of a "bad"—hazardous waste—highlights one of the challenges in applying the bargained-for exchange test where the contract is not for a typical good. Fortunately, the test proves flexible enough to accommodate this circumstance, demonstrating one way in which it proves superior to the benefit/detriment test in terms of its ability to distinguish socially beneficial bargains from ones that should not necessarily be enforced by courts.

**Pennsy Supply, Inc. v. American Ash
Recycling Corp.**

895 A.2d 595 (Pa. Super. Ct. 2006)

ORIE MELVIN, J.:

Appellant, Pennsy Supply, Inc. (“Pennsy”), appeals from the grant of preliminary objections in the nature of a demurrer [Pennsylvania’s version of a motion to dismiss] in favor of Appellee, American Ash Recycling Corp. of Pennsylvania (“American Ash”). We reverse and remand for further proceedings.

The trial court summarized the allegations of the complaint as follows:

The instant case arises out of a construction project for Northern York High School (Project) owned by Northern York County School District (District) in York County, Pennsylvania. The District entered into a construction contract for the Project with a general contractor, Lobar, Inc. (Lobar). Lobar, in turn, subcontracted the paving of driveways and a parking lot to [Pennsy].

The contract between Lobar and the District included Project Specifications for paving work which required Lobar, through its subcontractor Pennsy, to use certain base aggregates. The Project Specifications permitted substitution of the aggregates with an alternate material known as Treated Ash Aggregate (TAA) or AggRite.

The Project Specifications included a “notice to bidders” of the availability of AggRite at no cost from [American Ash], a supplier of AggRite. The Project Specifications also included a letter to the Project architect from American Ash confirming the availability of a certain amount of free AggRite on a first come, first served basis.

Pennsy contacted American Ash and informed American Ash that it would require approximately 11,000 tons of AggRite for the Project. Pennsy subsequently picked up the AggRite from American Ash and used it for the paving work, in accordance with the Project Specifications.

Pennsy completed the paving work in December 2001. The pavement ultimately developed extensive cracking in February 2002. The District notified . . . Lobar as to the defects and Lobar in turn directed Pennsy to remedy the defective work. Pennsy performed the remedial work during summer 2003 at no cost to the District.

The scope and cost of the remedial work included the removal and appropriate disposal of the AggRite, which is classified as a hazardous waste material by the Pennsylvania Department of Environmental Protection. Pennsy requested American Ash to arrange for the removal and disposal of the AggRite; however, American Ash did not do so. Pennsy provided notice to American Ash of its intention to recover costs.

Pennsy also alleged that the remedial work cost it \$251,940.20 to perform and that it expended an additional \$133,777.48 to dispose of the AggRite it removed.

On November 18, 2004, Pennsy filed a five-count complaint against American Ash alleging breach of contract (Count I); breach of implied warranty of merchantability (Count II); breach of express warranty of merchantability (Count III); breach of warranty of fitness for a particular purpose (Count IV); and promissory estoppel (Count V). American Ash filed demurrers to all five counts. Pennsy responded and also sought leave to amend should any demurrer be sustained. The trial court sustained the demurrers by order and opinion dated May 25, 2005 and dismissed the complaint. This appeal followed.

Pennsy raises three questions for our review:

(1) Whether the trial court erred in not accepting as true . . . [the] Complaint allegations that (a) [American Ash] promotes the use of its AggRite material, which is classified as hazardous waste, in order to avoid the high cost of disposing [of] the material itself; and (b) [American Ash] incurred a benefit from Pennsy's use of the material in the form of avoidance of the costs of said disposal sufficient to ground contract and warranty claims.

(2) Whether Pennsy's relief of [American Ash's] legal obligation to dispose of a material classified as hazardous waste, such that [American Ash] avoided the costs of disposal thereof at a hazardous waste site, is sufficient consideration to ground contract and warranty claims.

[(3) Promissory estoppel question omitted.]

"Preliminary objections in the nature of a demurrer test the legal sufficiency of the complaint." [A demurrer is an older term in civil procedure for what is now more commonly known as a motion to dismiss.]

When reviewing the dismissal of a complaint based upon preliminary objections in the nature of a demurrer, we treat as true all well-pleaded material, factual averments and all inferences fairly deducible therefrom. Where the preliminary objections will result in the dismissal of the action, the objections may be sustained only in cases that are clear and free from doubt. To be clear and free from doubt that dismissal is appropriate, it must appear with certainty that the law would not permit recovery by the plaintiff upon the facts averred. Any doubt should be resolved by a refusal to sustain the objections. Moreover, we review the trial court's decision for an abuse of discretion or an error of law.

In applying this standard to the instant appeal, we deem it easiest to order our discussion by count.

Count I raises a breach of contract claim. "A cause of action for breach of contract must be established by pleading (1) the existence of a contract, including its essential terms, (2) a breach of a duty imposed by the contract and (3) resultant damages."

While not every term of a contract must be stated in complete detail, every element must be specifically pleaded. Clarity is particularly important where an oral contract is alleged.

Instantly, the trial court determined that “any alleged agreement between the parties is unenforceable for lack of consideration.” The trial court also stated, “the facts as pleaded do not support an inference that disposal costs were part of any bargaining process or that American Ash offered the AggRite with an intent to avoid disposal costs.” Thus, we understand the trial court to have dismissed Count I for two reasons related to the necessary element of consideration: one, the allegations of the Complaint established that Pennsy had received a conditional gift from American Ash, and two, there were no allegations in the Complaint to show that American Ash’s avoidance of disposal costs was part of any bargaining process between the parties.

It is axiomatic that:

Consideration is an essential element of an enforceable contract.

Consideration consists of a benefit to the promisor or a detriment to the promisee.

Consideration must actually be bargained for as the exchange for the promise.

It is not enough, however, that the promisee has suffered a legal detriment at the request of the promisor. The detriment incurred must be the “quid pro quo”, or the “price” of the promise, and the inducement for which it was made. . . . If the promisor merely intends to make a gift to the promisee upon the performance of a condition, the promise is gratuitous, and the satisfaction of the condition is not consideration for a contract. The distinction between such a conditional gift and a contract is well illustrated in Williston on Contracts, where it is said:

If a benevolent man says to a tramp, — “If you go around the corner to the clothing shop there, you may purchase an overcoat on my credit,” no reasonable person would understand that the short walk was requested as the consideration for the promise, but that in the event of the tramp going to the shop the promisor would make him a gift.

Whether a contract is supported by consideration presents a question of law. The classic formula for the difficult concept of consideration was stated by Justice Oliver Wendell Holmes, Jr.:

The promise must induce the detriment and the detriment must induce the promise.

As explained by Professor Murray:

If the promisor made the promise for the purpose of inducing the detriment, the detriment induced the promise. If, however, the promisor made the promise

with no particular interest in the detriment that the promisee had to suffer to take advantage of the promised gift or other benefit, the detriment was incidental or conditional to the promisee's receipt of the benefit. Even though the promisee suffered a detriment induced by the promise, the purpose of the promisor was not to have the promisee suffer the detriment because she did not seek that detriment in exchange for her promise.

This concept is also well summarized in AMERICAN JURISPRUDENCE:

As to the distinction between consideration and a condition, it is often difficult to determine whether words of condition in a promise indicate a request for consideration or state a mere condition in a gratuitous promise. An aid, though not a conclusive test, in determining which construction of the promise is more reasonable is an inquiry into whether the occurrence of the condition would benefit the promisor. If so, it is a fair inference that the occurrence was requested as consideration. On the other hand, if the occurrence of the condition is no benefit to the promisor but is merely to enable the promisee to receive a gift, the occurrence of the event on which the promise is conditional, though brought about by the promisee in reliance on the promise, is not properly construed as consideration.

Upon review, we disagree with the trial court that the allegations of the Complaint show only that American Ash made a conditional gift of the AggRite to Pennsy. In paragraphs 8 and 9 of the Complaint, Pennsy alleged:

American Ash actively promotes the use of AggRite as a building material to be used in base course of paved structures, and provides the material free of charge, in an effort to have others dispose of the material and thereby avoid incurring the disposal costs itself. . . . American Ash provided the AggRite to Pennsy for use on the Project, which saved American Ash thousands of dollars in disposal costs it otherwise would have incurred.

Accepting these allegations as true and using the Holmesian formula for consideration, it is a fair interpretation of the Complaint that American Ash's promise to supply AggRite free of charge induced Pennsy to assume the detriment of collecting and taking title to the material, and critically, that it was this very detriment, whether assumed by Pennsy or some other successful bidder to the paving subcontract, which induced American Ash to make the promise to provide free AggRite for the project. Paragraphs 8–9 of the Complaint simply belie the notion that American Ash offered AggRite as a conditional gift to the successful bidder on the paving subcontract for which American Ash desired and expected nothing in return.

We turn now to whether consideration is lacking because Pennsy did not allege that American Ash's avoidance of disposal costs was part of any bargaining process between the parties. The Complaint does not allege that the parties discussed or even

that Pennsy understood at the time it requested or accepted the AggRite that Pennsy's use of the AggRite would allow American Ash to avoid disposal costs. However, we do not believe such is necessary.

The bargain theory of consideration does not actually require that the parties bargain over the terms of the agreement. . . . According to Holmes, an influential advocate of the bargain theory, what is required [for consideration to exist] is that the promise and the consideration be in "the relation of reciprocal conventional inducement, each for the other."

Here, as explained above, the Complaint alleges facts which, if proven, would show the promise induced the detriment and the detriment induced the promise. This would be consideration. Accordingly, we reverse the dismissal of Count I. [Discussion of Counts II, III, IV (Breach of Warranty—Sales) and V (Promissory Estoppel) omitted.]

For all of the foregoing reasons, we reverse the trial court's order granting the demurrers and dismissing the Complaint and remand for further proceedings. Jurisdiction relinquished.

Reflection

The *Pennsy* case is an example of a court's using both the benefit/detriment test and the bargained-for exchange test. The benefit/detriment test states that "[c]onsideration consists of a benefit to the promisor or a [legal] detriment to the promisee." Here, there is both a benefit and detriment, though both do not need to be present. The promisor (American Ash) benefited by saving thousands of dollars in disposal costs. A legal detriment is something that the promisee is not obligated to do. Thus, Pennsy collecting and taking title to the AggRite was the detriment.

The court also applied the bargained-for exchange test. That test states "[c]onsideration must actually be bargained for as the exchange for the promise." The type of bargain required for consideration is not negotiating or bartering over terms but that "[t]he promise must induce the detriment and the detriment must induce the promise." In other words, a bargain induces (persuades/encourages) the other's response, and the other person is induced by it and acts on that inducement.

One way to tell the difference between a conditional gift and consideration is whether the occurrence of that condition would benefit the promisor. Unlike Williston's "tramp" example, where the walk around the corner was merely incidental to obtaining the coat, taking the AggRite was not. The promisor did not benefit from the promisee walking around the corner nor was the promisor's promise motivated by the walk. In *Pennsy*, American Ash benefited and induced others to get rid of the AggRite by offering it free of charge to avoid the disposal costs. Pennsy was induced by American Ash and acted on that inducement by taking and collecting the material, thereby suffering a legal detriment.

Discussion

1. How does the *Pennsy* court distinguish between a conditional gift and a promise supported by consideration? Why did the court find that AggRite offered its aggregate as part of a bargained-for exchange and not as a conditional gift?
 2. Would this case have come out differently if the court had applied the benefit/detriment test and not the bargained-for exchange test? Why or why not?
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Problems

Problem 7.1. An Aunt's Promise

Dougherty, a boy of eight years, received from his aunt a promissory note for \$3,000, payable at her death or before. While visiting her nephew, the aunt saw how well he was progressing in school and decided that she wanted to help take care of the child since she loved him very much. The aunt had the boy's guardian draft a promissory note for her. The aunt handed a note to her nephew, which read:

You have always done for me, and I have signed this note for you. Now, do not lose it. Someday it will be valuable.

Following the aunt's death, Dougherty sought to recover for the note.

Was there adequate consideration to form an enforceable contract?

See *Dougherty v. Salt*, 125 N.E. 94 (N.Y. 1919).

Problem 7.2. Betty and the Benefit

M.J.D., Inc. (MJD), applied to Bank for a loan to pay off its debt. Bank approved the loan subject to a guaranty (a contract where one person agrees to pay the debt of the other if the other fails to do so) by the Small Business Administration (SBA), a federal government agency. The SBA approved the loan but required the principals, Melton Meadors, Jay Judd, Harold Ducote, and Ducote's wife, Marie, to sign a guaranty on the SBA form. On the application, the guarantors had been "Melton E. Meadors—a single person, Jay A. Judd & Wife, Harold A. Ducote, Jr., & Wife."

At the signing, the four principals were all present, as well as Betty Meadors, Meadors' new wife, and Helen Judd, Judd's wife. The SBA was not present. All six signed the guaranty form. MJD defaulted on the loan, and SBA was to take over the guaranteed portion of the loan. The United States sued to collect the deficiency from the guarantors, including Betty Meadors.

Applying both the benefit-detriment test and bargained-for exchange test, did Betty Meadors receive consideration from the SBA for her signature on the guaranty form?

See *United States v. Meadors*, 753 F.2d 590 (7th Cir. 1985).

Problem 7.3. Shifting Sands

Peter was on a guided tour through the Sahara Desert when a sandstorm suddenly appeared. In the chaos of the storm, Peter got separated from his tour group. After the storm abated, Peter found himself lost in the desert. He wandered for two full days in the baking sun, growing weak and very thirsty, when he finally happened upon a village in the desert. Peter urgently ran up to the first person he saw, who was a man named Merzouga, and asked desperately for water. Merzouga said to Peter, “If you walk through my village and over the last dune beyond it, you will find a stream of clean water. If you promise to send me and my family \$1,000 upon your return to America, then you may go there and drink as much water as you like.” Peter agreed and shook Merzouga’s hand, then walked through the village and over the dune, where he found a cold, clear stream. Peter drank a great deal of water and refreshed himself.

Later that day, a search party found Peter and took him back to his tour group, which later returned to America. When he arrived, Peter remembered his promise to Merzouga, but he felt that \$1,000 was much too high a price, and so he decided not to pay Merzouga anything.

As a matter of law, has Peter formed a contract with Merzouga? If so, what is Peter’s obligation under that agreement?

Chapter 8

Promissory Estoppel

Promissory estoppel is an equitable doctrine designed to prevent injustice. It protects individuals who reasonably and detrimentally rely on a promise, even when that promise lacks the consideration typically required for a contract. According to R2d § 90, a promise may be enforced if the promisor should reasonably expect their promise to induce action or forbearance and if injustice can only be avoided through enforcement. By focusing on reliance rather than reciprocal exchange, promissory estoppel serves as an alternative to traditional bargain contracts.

Consider Sarah, a small business owner, who relocates her café to a newly developed retail space after the developer, Alan, promises her three months of free rent as an incentive. She incurs significant moving expenses, only for Alan to renege and demand rent from the first month. Although no formal contract exists, Sarah relied on Alan's promise to her detriment. This example demonstrates how promissory estoppel can be a vital tool for achieving justice in such cases.

Promissory estoppel requires three key elements: a clear promise, reasonable reliance, and detriment caused by that reliance. Yet promissory estoppel's application also hinges on the ultimate principle of justice, granting courts flexibility to weigh fairness in each case. This balance between enforcing promises and maintaining discretion makes promissory estoppel a powerful complement to traditional contract law, especially in cases where fairness demands recognition of an obligation.

Promissory estoppel frequently arises in specific contexts that highlight its equitable purpose. For instance, charitable subscriptions often depend on promissory estoppel when donors pledge large sums to organizations that rely on those commitments to fund their operations. Courts may enforce such promises to ensure fairness, particularly when charities act in reliance on those pledges by initiating projects or making financial commitments.

Similarly, promissory estoppel plays a significant role in employment contexts, where individuals rely on promises of job security, promotions, or relocation assistance. For example, if an employer promises a job candidate a position and the candidate resigns from their current role or relocates in reliance on that promise, courts may invoke promissory estoppel to prevent injustice if the employer later withdraws the offer.

Another key area involves family promises, such as assurances of financial support or inheritance. These situations often involve significant reliance by one party,

such as moving to care for a family member or investing resources in property with the expectation of future ownership. Promissory estoppel provides a mechanism to enforce such promises when fairness requires recognition of the detriment suffered.

This chapter examines the theory and purpose of promissory estoppel, its essential elements, and the role of justice in shaping its application. We explore specific contexts where the doctrine's equitable roots are most evident, such as charitable subscriptions, employment promises, and family arrangements. Finally, we reflect on promissory estoppel's broader implications, including its interplay with other legal doctrines like consideration and restitution, and its role in ensuring justice when traditional principles fall short.

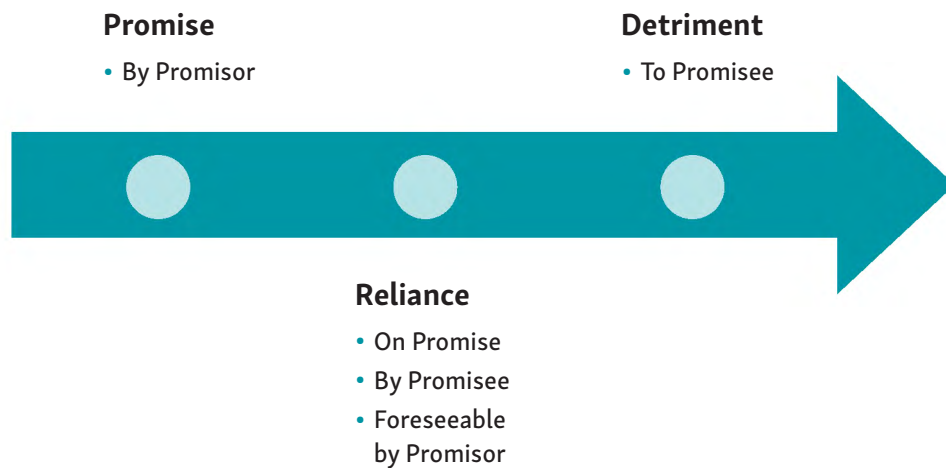


Figure 8.1. Promissory estoppel elements illustrated.

Rules

A. Theory of Promissory Estoppel

Promissory estoppel finds its roots in equity, a body of law designed to ensure fairness when strict legal rules fall short. Unlike traditional contract law, which supports economic efficiency by enforcing agreements based on the exchange of promises, promissory estoppel steps in to address the harm caused when someone reasonably relies on a promise that isn't supported by consideration. In this way, promissory estoppel protects reliance rather than reciprocity. The doctrine reflects a basic idea: when a promisor makes a commitment that reasonably induces the promisee to act or refrain from acting, the law may enforce that promise to prevent injustice.

The fairness principles behind promissory estoppel come into focus in situations where one party reasonably relies on another's promise to their detriment. For

example, suppose an employer assures a longtime employee that they will receive a retirement pension, and the employee relies on that promise by retiring earlier than planned. If the employer later revokes the promise, the employee may suffer serious harm—perhaps having passed up other job opportunities or forfeited income based on the belief that they would be financially secure. Promissory estoppel allows courts to address this kind of reliance-based injustice, even when the promise was not part of a formal bargain or supported by consideration.

But not every retirement decision would justify equitable intervention. If the employee had already planned to retire regardless of the pension promise, or if the only consequence of their reliance was placing a refundable deposit on a new boat, then there may be no substantial or irrevocable detriment. In such cases, promissory estoppel would likely not apply, because the reliance was not induced in a way that created serious harm or injustice.

This focus on fairness has deep historical roots. The doctrine evolved from courts of chancery, where judges were tasked with acting as “keepers of the king’s conscience.” These courts, less constrained by the equal application of rigid rules, focused on ensuring equitable outcomes in disputes. Promissory estoppel reflects that heritage. It prioritizes harm prevention. It recognizes the trust that people place in promises, which have moral dimensions as well as economic ones. Reliance on a promise often creates obligations as binding as those formed through mutual agreement.

Today, promissory estoppel serves as a safety net within contract law, filling the gaps left by doctrines like consideration. While traditional contracts are grounded in mutual exchange, many real-world promises do not involve formal bargains, yet they still create reasonable expectations. Promises of gifts, pensions, or even charitable donations often lack consideration but may predictably lead the promisee to take actions in reliance on them. By providing an equitable remedy in these cases, promissory estoppel reinforces trust and accountability, essential components of both personal and professional relationships.

B. Elements of Promissory Estoppel

R2d § 90 provides the framework courts use to determine whether a promise should be enforced under the promissory estoppel doctrine.

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires. R2d § 90(1).

Promissory estoppel requires proving three core elements: (1) a promise, (2) reliance, and (3) a detriment. These three elements set the stage for applying promissory estoppel, but they are not the whole story. Unlike bargain-based contracts, where

meeting the elements typically ensures enforcement, promissory estoppel includes an overarching requirement that enforcement be necessary to prevent injustice. Even when all the elements are present, a court may limit or deny enforcement if the result would be inequitable. In the sections that follow, we will examine each of these elements and explore how the doctrine balances the interests of fairness and justice.

1. The Promise

A promise lies at the heart of every claim for promissory estoppel. Without a promise, there is no assurance to induce reliance, and without reliance, the foundation of the doctrine collapses. However, not every casual assurance or vague statement constitutes a promise in the eyes of the law. Recall the R2d's definition of a promise:

A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made. R2d § 2(1).

To satisfy the first element of promissory estoppel, the promise must be clear and definite. Only a clear, definite promise can create a reasonable expectation in the promisee that the promisor intends to be bound.

The clarity and definiteness of a promise are evaluated from the perspective of a reasonable person. This objective standard ensures that the promisor's words and actions are interpreted in a way that aligns with societal norms rather than the subjective beliefs of the parties.

For instance, a promisor's saying, "I might help you out with rent next month if things go well," likely lacks the specificity to qualify as a promise. On the other hand, a statement like "I will cover your rent next month so that you can focus on your studies" demonstrates the kind of clear and definite assurance that could give rise to reliance.

Promises can be made orally or in writing, and even casual or informal language can suffice if it reasonably conveys a commitment. The key question is whether the promisee, upon hearing the statement and considering the context, could reasonably understand that a commitment has been made. Context matters greatly. The relationship between the parties, their past dealings, and the circumstances surrounding the statement all influence whether the words or actions rise to the level of a promise.

Consider *Ricketts v. Scothorn*, 77 N.W. 365 (Neb. 1898), where a grandfather wrote a promissory note to his granddaughter stating that she would not need to work any longer and that he would support her. The court found this to be a sufficiently clear and definite promise, especially in light of the family relationship and the granddaughter's subsequent reliance on it. This case underscores that courts do not evaluate promises in isolation but rather within the broader context of the parties' relationship and the promise's likely effect.

In sum, the promise element serves as the foundation of promissory estoppel; it ensures that the doctrine addresses only those commitments that a reasonable person would understand to be binding. A promise should *not* be lightly inferred. The doctrine of promissory estoppel will not provide recourse for misunderstandings or unmet expectations arising from casual conversations. This careful balancing ensures that promissory estoppel remains grounded in its equitable purpose.

Once a promise is established, the next phase of the inquiry assesses the promisee's reliance and the detriment that reliance may have caused.

2. Reliance

Reliance is the second essential element of promissory estoppel, building directly on the foundation of the promise. For a promise to give rise to legal enforcement under this doctrine, the promisee must have relied on it in a way that is actual, reasonable, and foreseeable. These requirements ensure a direct connection between the promise and the actions or inactions taken by the promisee, which potentially justifies judicial intervention.

First, there must be actual reliance. It is not enough for a promisee to claim they might have acted differently, absent the promise. Instead, the promisee must demonstrate that they actually changed their behavior, took specific steps, or forewent certain opportunities because of the promise. For example, a job applicant who turns down other offers in reliance on a promised position has engaged in actual reliance. In contrast, if the job applicant merely thought about declining offers but did not do so, there is no actual reliance. Courts examine the facts to ensure the reliance is more than speculative or hypothetical.

Second, the reliance must be "reasonable," based on an objective standard. Courts ask whether a reasonable person in the promisee's position under these specific circumstances would have acted similarly. This ensures that reliance is not based on an exaggerated interpretation of the promise or an irrational reaction to it. For instance, a tenant who declines an alternative lease based on a landlord's clear promise to renew their current lease may be seen as acting reasonably. Conversely, if the landlord said merely, "I think we'll renew your lease," reliance on that statement might not meet the reasonableness standard. Courts weigh factors like the clarity of the promise, the promisee's knowledge and sophistication, and the surrounding context to assess whether reliance was reasonable.

Finally, the promisee's reliance must have been foreseeable to the promisor. This, too, is based on an objective standard. Courts evaluate whether a reasonable person, in the same situation as the promisor, would have anticipated that their promise would induce the specific reliance at issue. This protects promisors from being held accountable for responses they could not have reasonably predicted. For example, if an employer promises an employee a pension in exchange for immediate retirement,

it should be extremely foreseeable to the employer that the employee would leave their job. However, if a casual acquaintance jokingly promises financial support to a friend, it would likely not be foreseeable for the friend to rely on that statement by quitting their job. The promisor's knowledge of the promisee's circumstances and the nature of their relationship often play key roles in this analysis.

Once reliance is established, the focus shifts to the final element: detriment. This element asks whether the promisee suffered some actual harm, which might warrant judicial intervention.

3. Detriment

The third element of promissory estoppel is detriment. Detriment ensures that courts intervene only when the promisee's reliance has meaningfully worsened their position, creating a situation where non-enforcement of the promise would be unjust. While the harm does not need to be overwhelming, it must be significant enough to justify judicial intervention.

Detriment requires the court to assess the actual consequences of the promisee's reliance. The promisee must demonstrate that they are worse off because of their reliance on the promise than they would have been had the promise never been made. This harm can take various forms, including financial loss, missed opportunities, or other significant setbacks.

Courts often seek evidence of out-of-pocket expenditures which can be clearly documented. For instance, if a contractor who is promised a construction project hires additional workers and purchases materials in preparation for the project, but the project is then cancelled, the contractor can demonstrate a clear detriment in the form of the direct, out-of-pocket expenses they incurred in hiring the workers and in purchasing the materials.

R2d §90 does not itself use the term "substantial" to describe the detriment required for promissory estoppel. But it does require that the harm create a compelling case for enforcement to avoid injustice, and the comments suggest that a promise that leads to a substantial detriment is more likely to be enforced to avoid injustice. *See* R2d §90 cmt. b. This implicitly excludes trivial inconveniences or speculative harms. If a promisee spends negligible time or resources in reliance on a promise, the court is unlikely to find detriment sufficient to warrant enforcement.

Although courts frequently find detriment where the reliance involves measurable out-of-pocket expenses, the detriment need not necessarily take the form of a direct financial expenditure. It can be a forfeiture of opportunities, an "opportunity cost," that results from relying on a promise. For example, in *Katz v. Danny Dare*, 610 S.W.2d 121 (Mo. Ct. App. 1980), the plaintiff retired early based on his employer's promise of a pension, foregoing other employment opportunities and income. The court found the employee's forfeiture of other employment opportunities to be a substantial detriment that made the employer's promise enforceable.

The detriment can also take unusual forms. For example, in *Cohen v. Cowles Media Co.*, 479 N.W.2d 387 (Minn. 1992), a newspaper promised anonymity to a source who supplied the newspaper with information. The bargained-for nature of the exchange was unclear, but the court enforced the promise on a promissory estoppel theory. The promisee provided sensitive information to the newspaper in reliance on the newspaper's promise of anonymity. When the newspaper broke its promise and identified the source, the source suffered harm to their career and reputation.

As should by now be obvious, the detriment as well as the reliance must actually be *caused* by the promise. Causation is critical to establishing both reliance and detriment in a promissory estoppel case. The promisee's reliance, and the harm it causes, must flow directly from the promise. If the promisee would have taken the same action, and suffered the same harm, regardless of the promise, there is no sufficient causal link between the promise and the detrimental reliance.

For example, imagine a landlord promises to renew a tenant's lease, and the tenant relocates to a more expensive apartment but does so for reasons unrelated to the promise. The tenant's action in renting the more expensive apartment is not causally tied to the promise. The causal connection ensures that the detrimental reliance addressed by a promissory estoppel claim was actually induced by the promise, rather than by independent or unrelated factors.

With the three core elements—promise, reliance, and detriment—established, promissory estoppel addresses the conditions under which promises become enforceable. Yet the inquiry does not end there. The ultimate element of promissory estoppel is justice.

C. Justice: The Ultimate Requirement

Justice is the ultimate element of promissory estoppel. It underpins the entire doctrine. Even when the promise, reliance, and detriment elements are satisfied, courts will not automatically enforce the promise unless enforcement is necessary to avoid injustice. R2d § 90 explicitly incorporates this principle by requiring enforcement of a promise only “if injustice can be avoided only by enforcement of the promise.”

The inquiry into justice is inherently case-specific. Courts assess the broader context to determine whether enforcement would prevent unfairness or whether alternative remedies might suffice. When considering justice, courts often weigh the promisor's conduct against the promisee's harm. On the one hand, courts ask, did the promisor make the promise negligently, recklessly, or in bad faith? Did the promisor reasonably foresee the reliance that occurred? On the other hand, courts ask, was the promisee's reliance reasonable, proportionate, and consistent with the promise? Were the promisee's actions excessive or disproportionate in comparison to the promise that was made? The balance of these considerations allows courts to determine whether enforcement is warranted as a matter of justice.

There is significant overlap with the other elements. For instance, if the reliance was unreasonable, or the detriment relatively minor, a court is more likely to conclude that the harm does not rise to the level requiring judicial intervention. In contrast, if the reliance was highly foreseeable, and the harm significant, a court is more likely to find justice requires enforcing the promise.

Justice also limits the scope of the remedy. In traditional contract cases, courts generally seek to enforce the full scope of the agreement the parties struck. The goal is to give the plaintiff the “benefit of their bargain,” either by awarding money (called damages) or by ordering performance of a promise (called specific performance.)

But in promissory estoppel cases, courts award remedies that are tailored to the specific harm suffered by the promisee. The goal is *not* to enforce the full scope of the promise, as if it were a fully bargained-for contract, but to compensate for the detriment caused by the promisee’s reliance. Thus, courts might award so-called “reliance damages,” which cover the costs or losses incurred because of the promise, rather than expectation damages, which seek to put the promisee in the position they would have occupied had the promise been fully performed. You will learn about these issues in later chapters.

The remedy in promissory estoppel cases often takes the form of compensation for harms suffered in the past. For example, in *Cowles Media Co.*, above, the court did not enforce the promise of confidentiality literally. Instead, it awarded damages to address the reputational and professional harm caused by the promisor’s breach. Similarly, in *Danny Dare*, above, the court awarded reliance damages to compensate for the plaintiff’s decision to retire early based on the promise of a pension, rather than enforcing the pension promise outright.

In sum, enforcement in promissory estoppel cases is limited to what justice requires. Justice is the doctrine’s ultimate safeguard, and it ensures that promissory estoppel remains true to its equitable roots. It ties together the three core elements of promise, reliance, and detriment and allows courts to address real harm without creating new inequities. By limiting enforcement and remedies to what justice requires, this element ensures that promissory estoppel remains a flexible and fair doctrine capable of adapting to the complexities of real-world disputes.

D. Charitable Subscriptions

Promissory estoppel is a versatile doctrine that is capable of addressing unique relational dynamics and specific policy concerns. The core elements of promise, reliance, and detriment, as well as the overarching goal to prevent injustice, are usually required and guide the doctrine’s application. However, special contexts may require departures from these traditional elements.

A major example is “charitable subscriptions.” A charitable subscription is a promise made to donate money or other resources to a charitable organization or cause.

You saw an example in *Pappas v. Bever*, 219 N.W.2d 720 (Iowa 1974), which you read earlier in the course. In that case, the court found that the donor (Mr. Bissonnette) never made a promise to donate to the Charles City College but rather made a mere statement of intent.

What happens if a donor makes a clear promise to give to a college but then backs out after the college has already taken action in reliance on the promise, such as taking out massive loans or starting to build a football stadium? This is an excellent contender for a promissory estoppel claim. But what if the college did not take any actions in reliance on the promise, and the donor backs out? Can the college use contract law to secure the money as promised?

The answer would normally be “no,” given that there is neither consideration nor detrimental reliance. However, you may be surprised to learn that courts will sometimes enforce charitable promises in the absence of either consideration or detrimental reliance. The R2d and the courts that follow it take a particularly lenient approach. R2d § 90(2) provides that a charitable subscription is binding without requiring proof that the promise induced action or forbearance, so long as enforcement is necessary to avoid injustice. R2d § 90(2) states:

A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance.

This approach reflects a public policy interest in encouraging charitable giving. It also recognizes the practical realities of how charities operate. Charities often rely on the aggregate expectations created by hundreds or thousands of pledges in order to plan their budgets and initiatives. Thus, reliance on any single promise may not be immediately evident.

For courts that follow this lenient approach, the societal importance of honoring charitable commitments can outweigh the traditional reliance requirement of promissory estoppel. For example, in *Salsbury v. Northwestern Bell Telephone Co.*, 221 N.W.2d 609 (Iowa 1974), a court upheld a charitable pledge to Charles City College in the amount of \$5,000, to be made over three years, despite lack of either consideration or a showing of reliance by the school on this specific promise.

But not all courts agree that this is the right approach. Courts in other jurisdictions insist on proof of actual reliance by the charity before enforcing a subscription under promissory estoppel. For example, in *St. Joseph's Foundation v. Bashas' Inc.*, 468 B.R. 381 (D. Ariz. 2012), the court rejected an attempt by St. Joseph's Foundation to enforce a \$250,000 charitable pledge made by Bashas' Inc., a grocery chain. Bashas' argued that its pledge was never intended to be binding and was instead a noncommittal gesture of support. The court agreed, also noting that St. Joseph's had not taken specific actions in reliance on the pledge, such as initiating a project or incurring expenses based on the promised funds. Arizona, unlike jurisdictions that have adopted R2d § 90(2), requires proof of either consideration or reliance for a

charitable subscription to be enforceable. Without evidence of reliance, the foundation could not enforce the promise.

Similarly, in *Local 107 Office & Professional Employees International Union v. Offshore Logistics, Inc.*, 380 F.3d 832 (5th Cir. 2004), a labor union sought to enforce a promise by Offshore Logistics to provide its members with certain benefits during a dispute. Offshore Logistics had made verbal assurances that the benefits would be granted, leading the union to refrain from escalating the conflict or pursuing alternative strategies. The court, however, found that the union failed to demonstrate clear and detrimental reliance on the promise. Offshore Logistics's assurances were vague and did not induce the union to take definitive actions that it otherwise would not have taken. The Fifth Circuit held that reliance is an essential element of promissory estoppel, rejecting the union's argument for enforcement based on the promise alone.

These cases illustrate the more traditional approach taken by some courts, which treat charitable subscriptions and other promises under the doctrine of promissory estoppel no differently than any other claim. Proof of actual reliance remains central to enforceability, emphasizing the need for a tangible connection between the promise and the promisee's actions or decisions.

However, even in jurisdictions requiring reliance, courts sometimes find ways to interpret reliance broadly in the context of charitable subscriptions. For example, in *Temple Beth AM v. Tanenbaum*, 6 Misc. 3d 373 (N.Y. Sup. Ct. 2004), the court enforced a congregation's claim for unpaid membership dues, emphasizing the congregation's reliance on aggregate contributions to budget its operations. Although the defendants, former members of the congregation, argued that their resignation relieved them of further obligations, the court found that the congregation's financial planning, which depended on total membership dues, constituted sufficient reliance. This decision illustrates how courts balance the practical realities of charitable giving with the traditional principles of promissory estoppel by interpreting reliance broadly in contexts where reliance on aggregate pledges is essential to organizational stability.

The enforceability of charitable subscriptions without proof of reliance thus depends heavily on the jurisdiction. While some courts, in line with the Restatement, prioritize public policy considerations, others adhere to a stricter application of the reliance requirement. These differing approaches illustrate the flexibility of promissory estoppel and its capacity to evolve as courts navigate the complexities of fairness and public interest.

E. Reflections on Promissory Estoppel

Promissory estoppel occupies a unique and flexible position in contract law, straddling the line between the formalistic requirements of traditional contract doctrines and the equitable principles aimed at preventing injustice. At its core, promissory estoppel challenges the notion that every enforceable promise must be supported by

consideration. Instead, it recognizes that in many real-world scenarios, the trust and reliance placed on a promise can be just as consequential as the mutual obligations formed in a bargained-for exchange.

A recurring theme in promissory estoppel is the tension between justice and predictability. The requirement that enforcement be limited to the extent that justice demands ensures that promissory estoppel remains rooted in equity, but it also introduces a level of uncertainty. Application of promissory estoppel can vary based on judicial philosophy, local policy concerns, and evolving societal values.

Another important dimension of promissory estoppel is its relationship with consideration. The doctrine does not seek to replace the traditional exchange model of contract law but rather to supplement it in situations where consideration is absent or inadequate. In doing so, promissory estoppel serves as a safety net ensuring that promises made in good faith and relied upon to the promisee's detriment do not result in inequitable outcomes. However, this raises the question of how far courts should go in enforcing promises absent a clear mutual agreement. Should promissory estoppel remain a narrowly applied exception, or does its equitable nature justify broader application?

Finally, promissory estoppel invites reflection on the role of context in contract enforcement. Unlike traditional contracts, which prioritize the formal elements of offer, acceptance, and consideration, promissory estoppel demands a deeper examination of the parties' relationship and the surrounding circumstances. This contextual approach allows courts to account for power imbalances, the foreseeability of reliance, and the magnitude of harm suffered by the promisee. At the same time, it imposes a responsibility on courts to exercise discretion judiciously, to ensure that promissory estoppel does not become a tool for enforcing vague or ill-considered promises.

In sum, promissory estoppel is both a doctrine of great promise and inherent complexity. It expands the reach of contract law to protect reliance and prevent injustice, while also raising important questions about its scope, application, and relationship with other doctrines. As courts continue to navigate these tensions, promissory estoppel remains a vital reminder that contract law is not merely about rigid rules but about achieving fairness in the myriad forms that human relationships can take.

Cases

Reading Ricketts v. Scothorn. The doctrine of promissory estoppel developed under common law during the nineteenth century, primarily to deal with contracts that were unenforceable for want of consideration. *Ricketts* illustrates the development of this doctrine, which is now also found in R2d § 90. As you read the case, consider how the elements of the modern doctrine would apply.

Ricketts v. Scothorn

57 Neb. 51, 77 N.W. 365 (1898)

SULLIVAN, J.

In the district court of Lancaster county the plaintiff, Katie Scothorn, recovered judgment against the defendant, Andrew D. Ricketts, as executor of the last will and testament of John C. Ricketts, deceased. The action was based upon a promissory note, of which the following is a copy: "May the first, 1891. I promise to pay to Katie Scothorn on demand, \$2,000, to be at 6 per cent. per annum. J.C. Ricketts." In the petition the plaintiff alleges that the consideration for the execution of the note was that she should surrender her employment as bookkeeper for Mayer Bros. and cease to work for a living. She also alleges that the note was given to induce her to abandon her occupation, and that, relying on it, and on the annual interest, as a means of support, she gave up the employment in which she was then engaged. These allegations of the petition are denied by the administrator.

The material facts are undisputed. They are as follows: John C. Ricketts, the maker of the note, was the grandfather of the plaintiff. Early in May—presumably on the day the note bears date—he called on her at the store where she was working. What transpired between them is thus described by Mr. Flodene, one of the plaintiff's witnesses:

A. *Well, the old gentleman came in there one morning about nine o'clock, probably a little before or a little after, but early in the morning, and he unbuttoned his vest, and took out a piece of paper in the shape of a note; that is the way it looked to me; and he says to Miss Scothorn, "I have fixed out something that you have not got to work any more." He says, none of my grandchildren work, and you don't have to.*

Q. *Where was she?*

A. *She took the piece of paper and kissed him, and kissed the old gentleman, and commenced to cry.*

It seems Miss Scothorn immediately notified her employer of her intention to quit work, and that she did soon after abandon her occupation. The mother of the plaintiff was a witness and testified that she had a conversation with her father, Mr. Ricketts,

shortly after the note was executed. In the note, he informed her that he had given the note to the plaintiff to enable her to quit work; that none of his grandchildren worked, and he did not think she ought to. For something more than a year the plaintiff was without an occupation, but in September, 1892, with the consent of her grandfather, and by his assistance, she secured a position as bookkeeper with Messrs. Funke & Ogden.

On June 8, 1894, Mr. Ricketts died. He had paid one year's interest on the note, and a short time before his death expressed regret that he had not been able to pay the balance. In the summer or fall of 1892 he stated to his daughter, Mrs. Scothorn, that if he could sell his farm in Ohio he would pay the note out of the proceeds. He at no time repudiated the obligation. We quite agree with counsel for the defendant that upon this evidence there was nothing to submit to the jury, and that a verdict should have been directed peremptorily for one of the parties.

The testimony of Flodene and Mrs. Scothorn, taken together, conclusively establishes the fact that the note was not given in consideration of the plaintiff pursuing, or agreeing to pursue, any particular line of conduct. There was no promise on the part of the plaintiff to do, or refrain from doing, anything. Her right to the money promised in the note was not made to depend upon an abandonment of her employment with Mayer Bros., and future abstention from like service. Mr. Ricketts made no condition, requirement, or request. He exacted no quid pro quo. He gave the note as a gratuity, and looked for nothing in return.

So far as the evidence discloses, it was his purpose to place the plaintiff in a position of independence, where she could work or remain idle, as she might choose. The abandonment of Miss Scothorn of her position as bookkeeper was altogether voluntary. It was not an act done in fulfillment of any contract obligation assumed when she accepted the note. The instrument in suit, being given without any valuable consideration, was nothing more than a promise to make a gift in the future of the sum of money therein named. Ordinarily, such promises are not enforceable, even when put in the form of a promissory note.

It has often been held that an action on a note given to a church, college, or other like institution, upon the faith of which money has been expended or obligations incurred, could not be successfully defended on the ground of a want of consideration. In this class of cases the note in suit is nearly always spoken of as a gift or donation, but the decision is generally put on the ground that the expenditure of money or assumption of liability by the donee on the faith of the promise constitutes a valuable and sufficient consideration. It seems to us that the true reason is the preclusion of the defendant, under the doctrine of estoppel, to deny the consideration. Such seems to be the view of the matter taken by the supreme court of Iowa in the case of *Simpson Centenary College v. Tuttle*:

Where a note, however, is based on a promise to give for the support of the objects referred to, it may still be open to this defense [want of consideration], unless it shall appear that the donee has, prior to any revocation, entered

into engagements, or made expenditures based on such promise, so that he must suffer loss or injury if the note is not paid. This is based on the equitable principle that, after allowing the donee to incur obligations on the faith that the note would be paid, the donor would be estopped from pleading want of consideration.

And in the case of *Reimensnyder v. Gans*, which was an action on a note given as a donation to a charitable object, the court said: "The fact is that, as we may see from the case of *Ryerss v. Trustees*, a contract of the kind here involved is enforceable rather by way of estoppel than on the ground of consideration in the original undertaking." It has been held that a note given in expectation of the payee performing certain services, but without any contract binding him to serve, will not support an action. But when the payee changes his position to his disadvantage in reliance on the promise, a right of action does arise.

Under the circumstances of this case, is there an equitable estoppel which ought to preclude the defendant from alleging that the note in controversy is lacking in one of the essential elements of a valid contract? We think there is. An estoppel *in pais* is defined to be "a right arising from acts, admissions, or conduct which have induced a change of position in accordance with the real or apparent intention of the party against whom they are alleged." Mr. Pomeroy has formulated the following definition:

Equitable estoppel is the effect of the voluntary conduct of a party whereby he is absolutely precluded, both at law and in equity, from asserting rights which might, perhaps, have otherwise existed, either of property, of contract, or of remedy, as against another person who in good faith relied upon such conduct, and has been led thereby to change his position for the worse, and who on his part acquires some corresponding right, either of property, of contract, or of remedy.

According to the undisputed proof, as shown by the record before us, the plaintiff was a working girl, holding a position in which she earned a salary of \$10 per week. Her grandfather, desiring to put her in a position of independence, gave her the note, accompanying it with the remark that his other grandchildren did not work, and that she would not be obliged to work any longer. In effect, he suggested that she might abandon her employment, and rely in the future upon the bounty which he promised. He doubtless desired that she should give up her occupation, but, whether he did or not, it is entirely certain that he contemplated such action on her part as a reasonable and probable consequence of his gift.

Having intentionally influenced the plaintiff to alter her position for the worse on the faith of the note being paid when due, it would be grossly inequitable to permit the maker, or his executor, to resist payment on the ground that the promise was given without consideration. The petition charges the elements of an equitable estoppel, and the evidence conclusively establishes them. If errors intervened at the trial, they could not have been prejudicial. A verdict for the defendant would be unwarranted. The judgment is right and is affirmed.

Reflection

In *Ricketts*, the promissory note was a clear and definite promise. The grandfather would have reasonably expected to induce his granddaughter to give up her job by his words and actions. The granddaughter relied on his promise and quit the job she had. The court found that allowing the executor to resist payment would be grossly inequitable, and therefore, enforced the promise under the doctrine of promissory estoppel.

Discussion

1. Promissory estoppel is a very fact-specific doctrine. What specific facts in the *Ricketts* case convinced the court that promissory estoppel was appropriate here?
 2. What is the purpose of the consideration doctrine? Were the purposes underlying the consideration doctrine served here?
 3. Does it matter whether Ms. Scothorn was worse off or better off for not having worked for some time? How does *Ricketts* compare with *Hamer*?
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Reading Conrad v. Fields. This case is a more recent illustration of how courts today still use this doctrine when a person relies on a promise to their detriment. In *Conrad*, Walker R. Fields offered to pay for Marjorie Conrad's legal education. Legal questions involve whether that promise was supported by consideration and, if not, whether it should be enforceable as a matter of justice under the doctrine of promissory estoppel.

As you read this case, pay attention to how it compares and contrasts with *Ricketts*. Do the courts use the same rules and tests? Which material facts are different, and which circumstances are similar?

Conrad v. Fields

2007 WL 2106302 (Minn. Ct. App. July 24, 2007)

PETERSON, Judge.

This appeal is from a judgment and an order denying posttrial motions. The judgment awarded respondent damages in the amount of the cost of her law-school tuition and books based on a determination that the elements of promissory estoppel were proved with respect to appellant's promise to pay for the tuition and books. We affirm the judgment and grant in part and deny in part respondent's motion to strike appellant's brief and appendix.

Facts

Appellant Walter R. Fields and respondent Marjorie Conrad met and became friends when they were neighbors in an apartment complex in the early 1990's. Appellant started his own business and became a financially successful businessman. Appellant built a \$1.2 million house in the Kenwood neighborhood in Minneapolis and leased a Bentley automobile for more than \$50,000 a year. Appellant is a philanthropic individual who has sometimes paid education costs for others.

In the fall of 2000, appellant suggested that respondent attend law school, and he offered to pay for her education. Respondent, who had recently paid off an \$11,000 medical bill and still owed about \$5,000 for undergraduate student loans, did not feel capable of paying for law school on her own. Appellant promised that he would pay tuition and other expenses associated with law school as they became due. Appellant quit her job at Qwest, where she had been earning \$45,000 per year, to attend law school. Appellant admitted at trial that before respondent enrolled in law school, he agreed to pay her tuition.

Respondent testified that she enrolled in law school in the summer of 2001 as a result of appellant's "inducement and assurance to pay for [her] education." Appellant made two tuition payments, each in the amount of \$1,949.75, in August and October 2001, but he stopped payment on the check for the second payment. At some point, appellant told respondent that his assets had been frozen due to an Internal Revenue Service audit and that payment of her education expenses would be delayed until he got the matter straightened out. In May 2004, appellant and respondent exchanged e-mail messages about respondent's difficulties in managing the debts that she had incurred for law school. In response to one of respondent's messages, appellant wrote, "to be clear and in writing, when you graduate law school and pas[s] your bar exam, I will pay your tuition." Later, appellant told respondent that he would not pay her expenses, and he threatened to get a restraining order against her if she continued attempting to communicate with him.

Respondent brought suit against appellant, alleging that in reliance on appellant's promise to pay her education expenses, she gave up the opportunity to earn income through full-time employment and enrolled in law school. The case was tried to the court, which awarded respondent damages in the amount of \$87,314.63 under the doctrine of promissory estoppel. The district court denied appellant's motion for a new trial or amended findings. This appeal followed.

Decision

The district court's "[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." In applying this rule, "we view the record in the light most favorable to the judgment of the district court." If there is reasonable evidence to support the district court's findings of fact, this court will not disturb those findings. While the district court's findings of fact

are reviewed under the deferential “clearly erroneous” standard, this court reviews questions of law de novo.

“Promissory estoppel implies a contract in law where no contract exists in fact.” “A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.” Restatement (Second) of Contracts § 90(1) (1981).

The elements of a promissory estoppel claim are (1) a clear and definite promise, (2) the promisor intended to induce reliance by the promisee, and the promisee relied to the promisee’s detriment, and (3) the promise must be enforced to prevent injustice. Judicial determinations of injustice involve a number of considerations, “including the reasonableness of a promisee’s reliance.”

“Granting equitable relief is within the sound discretion of the trial court. Only a clear abuse of that discretion will result in reversal.” But:

The court considers the injustice factor as a matter of law, looking to the reasonableness of the promisee’s reliance and weighing public policies (in favor of both enforcing bargains and preventing unjust enrichment). When the facts are taken as true, it is a question of law as to whether they rise to the level of promissory estoppel.

I.

Appellant argues that respondent did not plead or prove the elements of promissory estoppel. Minnesota is a notice-pleading state that does not require absolute specificity in pleading and, instead, requires only information sufficient to fairly notify the opposing party of the claim against it.

Paragraph 12 of respondent’s complaint states, “That as a direct and approximate result of the negligent conduct and breach of contract conduct of [appellant], [respondent] has been damaged. . . .” But the complaint also states:

- 4. That in 2000, based on the assurance and inducement of [appellant] to pay for [respondent’s] legal education, [respondent] made the decision to enroll in law school at Hamline University School of Law (Hamline) in St. Paul, Minnesota which she did in 2001.*
- 5. That but for the inducement and assurance of [appellant] to pay for [respondent’s] legal education, [respondent] would not have enrolled in law school. [Appellant] was aware of this fact.*

Paragraphs four and five of the complaint are sufficient to put appellant on notice of the promissory-estoppel claim.

At a pretrial deposition, respondent testified that negligence and breach of contract were the only two causes of action that she was pleading. Because promissory estoppel is described as a contract implied at law, respondent’s deposition testimony can be interpreted to include a promissory-estoppel claim.

In its legal analysis, the district court stated:

The Court finds credible [respondent's] testimony that [appellant] encouraged her to go to law school, knowing that she would not be able to pay for it on her own. He knew that she was short on money, having helped her pay for food and other necessities. He knew that she was working at Qwest and would need to quit her job to go to law school. He offered to pay for the cost of her going to law school, knowing that she had debts from her undergraduate tuition. He made a payment on her law school tuition after she enrolled. [Respondent] knew that [appellant] was a wealthy philanthropist, and that he had offered to pay for the education of strangers he had met in chance encounters. She knew that he had the wealth to pay for her law school education. She knew that [] he was established in society, older than she, not married, without children, an owner of a successful company, an owner of an expensive home, and a lessor of an expensive car. Moreover, [appellant] was a friend who had performed many kindnesses for her already, and she trusted him. [Appellant's] promise in fact induced [respondent] to quit her job at Qwest and enroll in law school, which she had not otherwise planned to do.

The circumstances support a finding that it would be unjust not to enforce the promise. Upon reliance on [appellant's] promise, [respondent] quit her job. She attended law school despite a serious health condition that might otherwise have deterred her from going.

These findings are sufficient to show that respondent proved the elements of promissory estoppel.

Appellant argues that because he advised respondent shortly after she enrolled in law school that he would not be paying her law-school expenses as they came due, respondent could not have reasonably relied on his promise to pay her expenses to her detriment after he repudiated the promise. Appellant contends that the only injustice that resulted from his promise involved the original \$5,000 in expenses that respondent incurred to enter law school. But appellant's statement that he would not pay the expenses as they came due did not make respondent's reliance unreasonable because appellant also told respondent that his financial problems were temporary and that he would pay her tuition when she graduated and passed the bar exam. This statement made it reasonable for respondent to continue to rely on appellant's promise that he would pay her expenses.

II.

[Court's discussion of appellant's misplaced reliance on
Olson v. Synergistic Techs. Bus. Sys., Inc. omitted.]

III.

[Discussion of statute of frauds omitted.]

IV.

[Discussion of damages omitted.]

V.

Appellant argues that because respondent received a valuable law degree, she did not suffer any real detriment by relying on his promise. But receiving a law degree was the expected and intended consequence of appellant's promise, and the essence of appellant's promise was that respondent would receive the law degree without the debt associated with attending law school. Although respondent benefited from attending law school, the debt that she incurred in reliance on appellant's promise is a detriment to her.

VI.

[Discussion of civil procedure omitted.]

Affirmed; motion granted in part.

Reflection

Both *Ricketts* and *Conrad* exemplify successful arguments for applying the doctrine of promissory estoppel where there is a lack of consideration. The basic elements to prove a promissory estoppel claim are: (1) a clear and definite promise, (2) the promisor should reasonably expect to induce reliance by the promisee, (3) the promisee relied on the promise to the promisee's detriment, and (4) the promise must be enforced to prevent injustice. Elements three and four are often combined, but either formulation works.

In *Conrad*, the defendant promised to pay tuition and other expenses associated with law school as they became due. He encouraged the plaintiff to go to law school at his expense, knowing she did not have the money and would have to quit her job to attend. She relied on his promise by enrolling in law school and assuming the debt. The trial court found that it would be unjust not to enforce the promise, and the Minnesota Court of Appeals affirmed.

Discussion

1. Reasonable reliance is a key element of any promissory estoppel claim. Did Conrad reasonably rely on Fields's promise? List specific facts that tend to show her reliance was reasonable. Then list other facts tending to show it was unreasonable for her to rely on Fields's promise. Can you weigh and balance the facts to determine which are more compelling?
 2. *Conrad* applied the bargained-for exchange test. Would this case have come out differently under the benefit/detriment test? Did Marjorie Conrad incur a detriment? Did Walter R. Fields incur a benefit?
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Reading Otten v. Otten. This case focuses on Wife's claim that Husband's promise to pay her \$4,500 is not sufficient consideration for her promise to relinquish her legal right to \$7,800 in past due child support. Wife is correct, but Husband may still merit enforcement of Wife's promise under the doctrine of promissory estoppel. *Otten* illustrates the limits of promissory estoppel and its element of foreseeable reliance.

Although foreseeable reliance is a flexible principle, it is not merely a blank check for the plaintiff to rubber stamp. The divorce settlement case *Otten v. Otten*, 632 S.W.2d 45 (Mo. App. 1982), circumscribes the limits of foreseeable reliance.

In 1976, Husband and Wife divorced, and their divorce decree granted Wife \$200 per month for child support. In 1981, Husband filed to modify the decree on the ground that one of the children had become emancipated. Wife responded that Husband owed her \$7,800 (three years' worth) of unpaid child support. The court found that Husband had been delinquent, and it ordered garnishment of Husband's bank account. The bank disbursed that sum (plus \$30) to Wife.

Husband appealed, alleging that Wife called Husband's attorney prior to the court's order and offered to settle the dispute for \$4,500 cash and \$100 monthly child support thereafter. Husband also alleged that after consulting Husband, Husband's attorney advised Wife that Husband could deliver \$1,000 cash immediately and \$3,500 via a stipulated promissory note, in exchange for Wife's withdrawing her claims, and that Wife orally agreed to this settlement. The appeal turns on whether her oral promise to abide by the settlement is enforceable. Courts will consider both legal and equitable enforceability.

Otten v. Otten

632 S.W.2d 45 (Mo. App. 1982)

WASSERSTROM, Judge.

This is a suit to specifically enforce an alleged settlement agreement. The trial court sustained defendant's motion to dismiss, and plaintiff appeals. We affirm.

In 1976, as part of a decree dissolving the marriage between the parties, the wife (defendant here) was granted \$200 per month as a single sum for the support of two minor children. On January 13, 1981, the husband (plaintiff here) filed a motion to modify the decree on the ground that one of the children had become emancipated. The next day, January 14, 1981, the wife filed execution for \$7,800 which she alleged to be accrued in unpaid child support and ordered garnishment on Third National Bank. The garnishment papers were served upon the bank on January 16, 1981. The bank paid \$7,830 into court, and disbursement of that sum to the wife was ordered by the court on February 26, 1981.

On March 2, 1981, the husband filed his petition in the present case. He alleged that the wife had called his attorney on January 21, 1981, offering to settle all questions with respect to back child support for the sum of \$4,500 and further offering that the decree of divorce be amended to provide child support on and after February 1, 1981, of only \$100. The petition further alleged that the attorney told the wife he would have to consult his client; and that after consultation, the attorney advised the wife that the husband could raise \$1,000 in cash immediately and would deliver to her his note for \$3,500 in full satisfaction of back child support payments. The petition goes on to allege that the wife then stated that she would accept the proposal and would stop in the attorney's office the following Wednesday to pick up the check for \$1,000 and the \$3,500 note and that she would at that time sign a stipulation for modification of the decree. The husband alleges that he performed his part of the agreement by executing his check and note and by signing the agreed stipulation.

Paragraph 8 of the petition then proceeds to allege as follows: "Relying to his detriment upon the fact that a compromise agreement had been reached, and the respondent would upon the following Wednesday, her next day off, stop by petitioner's attorney's office and execute Exhibit B and pick up her promissory note and check in full settlement of all back child support payments, borrowed a substantial sum of money in order to meet business obligations incurred by him and relying upon the fact that a compromise agreement had been made satisfying the judgment for all child support payments due respondent through January 31, 1981 caused said loan proceeds to be temporarily deposited in a business account in his name alone at Third National Bank, Sedalia, Missouri." The petition goes on to allege that the wife, in violation of her agreement said to have been orally agreed on January 26, 1981, caused execution and garnishment to be issued on January 14, 1981.

The petition concludes with a prayer that the wife be ordered to specifically perform the January 26 agreement by executing the Stipulation and that the court order the clerk of the court to return to the husband the sum of \$7,800 paid into court by Third National Bank.

On the same day that the petition was filed, the trial court entered a temporary order for escrow of the \$7,830 paid in by Third National Bank. Thereafter the wife filed her motion to dismiss the petition on the ground that it failed to state a cause of action. The court sustained that motion on the grounds that (1) the facts did not show an accord and satisfaction; and (2) there was no valid consideration for the alleged compromise agreement.

The husband's sole point on this appeal is that the court erred in dismissing his petition as an unsatisfied accord "because the contractual obligation alleged in the appellant's petition was a bilateral contract and not a full accord and satisfaction."

I.

The law is unclear as to whether an accord can be enforced where it is not followed by a completed satisfaction. The general texts show a conflict of authority on this point.

One eminent legal writer [Williston] states that there is strangely little authority upon the matter and the few cases on the point contain reasoning which is not very full or satisfactory. This writer goes on to say that:

As a court of law cannot give adequate relief, and as the promise of temporary forbearance necessarily included in the accord gives equity jurisdiction of the matter, there seems good reason for equity to deal with the whole matter by granting specific performance.

Some Missouri cases contain dicta bearing on this question. However, no Missouri holding squarely in point has been found. For purposes of this opinion we shall assume, without holding, that an agreement embodied in an accord is a proper subject for specific performance, even though the accord be not followed with a completed satisfaction.

II.

The trial court stated as an alternative ground for its ruling that: "It is clear upon the face of the pleadings there is no valid consideration for the alleged compromise agreement."

The wife devotes the bulk of her brief to an argument supporting that conclusion. The husband has omitted giving this court the benefit of his views as to wherein consideration may be found. Nevertheless we shall consider: (a) whether consideration need be shown by the petition; and (b) whether any consideration has been shown or can be reasonably inferred from the allegations made in this petition.

A.

An accord and satisfaction will not be given effect unless founded upon a sufficient consideration. Moreover the party relying upon the alleged contract of settlement is obligated to plead the matter of consideration.

B.

The first possible basis upon which to claim consideration would be the husband's promise to pay \$4,500. That must be considered, however, in the light of the fact that the wife was claiming \$7,800 in past due child support. Nowhere in his petition does the husband deny that he was delinquent in the amount of \$7,800. An agreement on his part to pay the partial sum of \$4,500 out of a total undisputed amount due of \$7,800 cannot be acceptable consideration.

Nor can the husband's promise to pay \$100 child support on and after February 1, 1981, be accepted as legal consideration. The husband was already under a continuing obligation to pay \$200 per month. Even though one of the children may have become emancipated, that did not automatically result in a reduction of the \$200 figure. The law in this state is clear that when support is awarded for more than one child in a single lump sum for all of them, the same total amount continues for the remaining child or children even after the emancipation of any one of the children, until

reduction of that amount by court order. Furthermore, the reduction of child support is not a valid subject of contract between the parents.

The only remaining basis upon which the requirement of consideration might possibly be satisfied would have to rest upon the allegations of paragraph 8 of the petition, in which the husband alleged that he had borrowed money for his general business purposes and in reliance upon the wife's promises had deposited the borrowed sum in Third National Bank. Those allegations seem to represent an effort on the part of the husband to bring himself within the theory of promissory estoppel, set forth in Restatement (Second) of Contracts Section 90 (1981).

That doctrine, which permits a promise without consideration to be enforced if the elements of estoppel are present, has been adopted in this state.

However, such a promise will be enforced only where the promisor should have expected or reasonably foreseen the action which the promisee claims to have taken in reliance upon the promise. Thus, Comment b to Section 90 of the Restatement (Second) of Contracts states:

The promisor is affected only by reliance which he does or should foresee.

Henderson, *Promissory Estoppel and Traditional Contract Doctrine*, 78 Yale L.J. 343, 346 (1969), puts the matter this way:

In short, Section 90 states the proposition that, in situations where traditional consideration is lacking, reliance which is foreseeable, reasonable, and serious will require enforcement if injustice cannot otherwise be avoided.

In all of the Missouri cases involving the application of promissory estoppel, the facts clearly showed that the promisor should have and in fact clearly did foresee the precise action which the promisee took in reliance. Thus in *Coffman Industries, Inc. v. Gorman-Tabor Co.*, *supra*, the opinion states: "Fidelity should reasonably have expected that its promise of payment would induce the change of position by Gorman-Tabor." And in *Katz v. Danny Dare, Inc.*, the opinion states: "It is conceded Dare intended that Katz rely on its promise of a pension. . . ."

In the present case the nature of the situation would not impel a reasonable expectation by the wife that the oral agreement allegedly made by her would lead the husband to borrow money for his business and deposit it in Third National Bank. Nor does the husband's petition allege any special facts which would support a conclusion that the wife expected or should have foreseen such borrowing and deposit by the husband. Accordingly, the present case is not within the doctrine of promissory estoppel.

The husband has not carried the burden of pleading consideration for the alleged contract of settlement. The trial court therefore properly sustained the motion to dismiss.

Affirmed.

All concur.

Reflection

Otten v. Otten illustrates several key principles in contract law. Courts aim to enforce and preserve agreements that parties intended to be binding, even if further documentation or negotiation is needed to determine the obligations of the parties. Courts are often willing to accept extrinsic evidence to determine what the parties intended by their writing (intrinsic) agreement, especially in personal cases such as this one. The interpretation of contract terms can be influenced by the parties' subsequent conduct.

Contract law also seeks to prevent a party from benefitting from its own breach. While contract law allows both parties to benefit from efficient breach, it generally does not permit one party to extract the value of the contract from another via its own breach.

Finally, the distinction between tort law and contract law is important, as they serve different purposes. An important principle of contract law is the implied covenant of good faith. But contract law will not impose punitive damages for its breach. The goal of contract law is to put parties in the position for which they bargained—no more and no less.

Discussion

1. The court finds that Ms. Otten's offer to settle the lawsuit was not supported by consideration. Why? Cite and use the definition in the R2d when analyzing this issue.
2. Mr. Otten argues that Ms. Otten's promise to settle the lawsuit is enforceable on the basis of promissory estoppel. List the elements of promissory estoppel and explain whether Mr. Otten meets each of them.
3. Unlike contracts-at-law, contracts-at-equity need only be enforced to the extent that justice requires. Were there any facts or circumstances in this case that may have led the court to decide that justice did not need to enforce Ms. Otten's promise to Mr. Otten?

Reading Maryland National Bank v. United Jewish Appeal Federation of Greater Washington, Inc. In some jurisdictions, charitable subscriptions (promises to donate money to non-profit organizations and good causes) are enforceable even without consideration. Other jurisdictions do not distinguish charitable subscriptions in this way. The following case carefully decides whether to accord an equitable exception to the consideration doctrine for charitable subscriptions unsupported by consideration.

As you read this case, decide for yourself whether charitable subscriptions should be subject to or excepted from the consideration doctrine.

**Maryland National Bank v. United Jewish Appeal
Federation of Greater Washington, Inc.**

286 Md. 274 (1979)

ORTH, Judge.

The issue in this case is whether a pledge to a charitable institution survives the death of the pledgor and is an enforceable obligation of his estate.

I

Milton Polinger pledged \$200,000 to the United Jewish Appeal Federation of Greater Washington, Inc. (UJA) for the year 1975. He died on 20 December 1976. His last will and testament was admitted to probate in the Orphans' Court for Montgomery County and letters were issued to Melvin R. Oksner and Maryland National Bank as personal representatives. At the time of Polinger's death, \$133,500 was unpaid on his pledge.

The personal representatives disallowed the claim for the balance of the pledge. UJA filed a petition praying that the claim be allowed and moved for summary judgment. The personal representatives answered and filed a cross-motion for summary judgment. The court granted UJA's motion for summary judgment, denied the personal representatives' motion for summary judgment, allowed UJA's claim against the estate in the amount of \$133,500, and assessed the costs against the personal representatives. The personal representatives noted an appeal to the Court of Special Appeals and petitioned this Court to issue a writ of certiorari to that court before decision by it. We did so.

II

The facts before the court were undisputed in material part. They showed the nature of UJA and its relationship with its beneficiaries. UJA, chartered in the District of Columbia, is a public non-profit corporation. In general, its objective is to solicit, collect and receive funds and property for the support of certain religious, charitable, philanthropic, scientific and educational organizations and institutions, and it enjoys tax exempt status federally and in Maryland, Virginia and the District of Columbia. Based on monies received and pledged, it makes allocations to tax exempt organizations. No formal commitment agreement is executed with respect to the allocations, but UJA undertakes to pay pursuant to the allocation and the beneficiary organizations "go ahead to act as though they are going to have the money and they spend it." In other words, UJA makes allocations to various beneficiary organizations based upon pledges made to it, and the beneficiary organizations incur liabilities based on the allocations. Historically 95% of the pledges are collected over

a three-year period, and allowance for the 5% which may be uncollected is made in determining the amount of the allocations. So, according to Meyer Brissman, Executive Vice-President Emeritus of UJA: “We always pay (the allocated amount). I don’t know of any case where we haven’t paid.” Pledges to “emergency funds” are not paid on the basis of an allocation by UJA. All monies actually collected on those pledges are paid to the emergency funds.

The facts before the court showed the circumstances surrounding the pledge of Polinger with which we are here concerned. It was evidenced by a card signed by Polinger under date of 9 November 1974. It recited:

In consideration of the obligation incurred based upon this pledge, I hereby promise to pay to the United Jewish Appeal the amount indicated on this card.

The amount indicated as his “1975 pledge” was \$100,000 for “UJA including local, national and overseas,” and \$100,000 for “Israel Emergency Fund.”

UJA organized a “mission” to Israel in the fall of 1974. The mission was in no sense a tour. It was at the time of the missile crisis in Israel, and the members of the mission were to meet with Golda Meir, then Prime Minister, and with other government leaders to be briefed on the problems the country faced. It was to be involved with “people in the troubled settlements.” Certain community leaders, including Polinger, went on the mission. Polinger had been active in the affairs of UJA and had regularly made substantial contributions to it.

“Pre-solicitation” is a process whereby it is determined who can be expected to make large pledges and specifically who will likely substantially increase their pledges of previous years. Pre-solicitation is part of a well-conceived plan to obtain large contributions. It leads to a “high-pressure meeting” at which, according to Brissman,

[T]here is no question that the technique is the interchange and people knowing everyone else in the room, and if this one is thinking of a need of being so great as to be willing to do something unusual, the others thought it was similarly important for them to demonstrate it.

The idea is that “if somebody thought it was important enough to give more than he gave before, (others would think) that they ought to give more, and they (give) more money. . . . [W]e get together and discuss reactions to what they have seen, what the needs are, and people sometimes make a speech before they decide what they are going to say about the money, and it is a free-flowing thing, and nobody knows in advance what anybody is going to say, but some of the people are talked to one by one privately to condition them to make some kind of a special response to influence the group. The whole purpose of fund raising is to get an example.”

Polinger was selected to be an example on the Israel mission. He had pledged \$65,000 for 1973. He had “participated willingly” in such a meeting in connection with the 1974 fund raising campaign and had pledged \$150,000. He was one of those

it was “felt was ready to do something unusual. . . .” He was pre-solicited by three or four individuals and went up to two hundred thousand dollars for 1975. It was agreed that his pledge would be made in a “caucus” at the King David Hotel in Jerusalem. The caucus was held and Polinger “came into the caucus,” as Brissman said, “so we could announce all the gifts and influence other people of different levels.” Polinger was to be a “pacesetter.”

There were about thirty men at the caucus. About four of them had pledged an amount as large as \$200,000 before Polinger made his announcement. Brissman thought that “there was an emotional impact that develops when a man has seen things that influence him to believe that there is something desperate and earth-shaking going on and he could do something about it beneficially, and he responds.” When Polinger said he would give \$200,000, he indicated that he wanted everybody to give as much as they could. He thought he was giving the greatest amount that he possibly could find himself able to so do. Of course, Polinger was only one of many people who spoke and made a pledge. Whether anyone in fact increased his pledge because of Polinger was never discussed at the meeting, and Brissman was unable to say whether anyone was influenced by Polinger’s pledge.

It is just a dynamics of an involvement where after two weeks of being together night and day in a setting of that kind after a major war, meeting with individuals who lived through three or four such wars, that everybody is strung out and you are like a family, and in the process of interchange, speeches are made, and maybe somebody made a gift of \$5,000.00 influenced people just as much as the man who gave \$200,000.00 because of what the money meant in their view of this person’s ability to give.

It is just not the biggest number, but it is the concept of response to a need that these people are reacting to. And I don’t know that you verbalize it in that way necessarily, but it does come out that one influences another in the interchange, because you are going around a room and everybody is talking about how they were moved by what they were into. So there is no question one influences another.

Brissman was asked “whether aside from the specific group of people who were present in Israel with Mr. Polinger, are there any other people here in the Washington area or anywhere else that you are aware of who made pledges, gifts, or increased gifts as a result of Mr. Polinger’s gift?” He could not say. He could only give the procedure followed:

I solicited personally hundreds of people, some face to face, some by telephone, some by appointment with two or three people talking to an individual. And frequently I, personally, and I know of others who do likewise, start to tell people what kind of response we are getting when we get to the question of what is a standard for giving, or what you ought to consider as your share, and in the process I have used Milton Polinger as an example talking to individuals. They know who Milton is. And I would tell them what Milton had done

in 1973 and in 1974 in trying to get them to respond in some way to move further ahead in their extension as far as they can, because we are talking of stretching. If you can give so much, can you give a little but more type of thing, and I frequently would use Milton as an illustration.

There is no question in my mind when I do it I know others do it, and I have seen at the time that we are talking about people reporting on the mission to others who were not there, soliciting gifts at meetings or in individual confrontations, telling what happened at the mission, and they would go down line by line everybody who made gifts, they had a list in front of them as a tool.

So it was used. There is no question about it. I cannot tell you this one increased his gift only because of that one's response, but it is part of a package. That is how you raise money.

III

We find that the law of Maryland with regard to the enforcement of pledges or subscriptions to charitable organizations is the rule thus expressed in the Restatement of Contracts § 90 (1932):

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

We reach this conclusion through opinions of this Court in four cases, *Gittings v. Mayhew*; *Erdman v. Trustees Eutaw M.P. Ch.*; *Sterling v. Cushwa & Sons*; and *American University v. Collings*.

Gittings concerned the building of an Atheneum. The subscription contract authorized the calling of payment of installments by the subscribers when a certain amount had been pledged. The amount was reached, installments were called for and paid, contracts to erect the building were made and the Atheneum was completed. It was in these circumstances that the Court said:

In whatever uncertainty the law concerning voluntary subscriptions of this character may be at this time, in consequence of the numerous decisions pronounced upon the subject, it appears to be settled, that where advances have been made, or expenses or liabilities incurred by others, in consequence of such subscriptions, before notice of withdrawal, this should, on general principles, be deemed sufficient to make them obligatory, provided the advances were authorized by a fair and reasonable dependence on the subscriptions. . . . The doctrine is not only reasonable and just, but consistent with the analogies of the law.

This statement of the law appeared to be *Obiter dictum* in *Gittings*, but if it were, it became the law in *Erdman*.

Erdman dealt with a suit on a promissory note whereby there was a promise to pay the Eutaw Methodist Protestant Church the sum of \$500 four years after date with interest. The consideration for the note was a subscription contract made with the trustees of the church for the purpose of paying off a building debt, which had been incurred for the erection of a new church building. It had been entered on the books of the church, the trustees had subsequently borrowed \$2,000 on that subscription and other subscriptions to pay off the indebtedness for the erection of the church building. The Court held that in such circumstances the subscription contract was a valid and binding one and constituted a sufficient consideration to support the note, observing that “[t]he policy of the law, to sustain subscription contracts of the character of the one here in question, is clearly stated by this court, and by other appellate courts, in a number of cases.” The only Maryland case cited was *Gittings*.

The holding in *Gittings* was said to be “that as the party had authorized others by the subscription to enter into engagements for the accomplishment of the enterprise, the law requires that he should save them harmless to the extent of his subscription.” *Erdman*. One case in another appellate court was discussed, *Trustees v. Garvey*, and two cited as to like effect, *McClure v. Wilson* and *United Presbyterian Church v. Baird*.

In *Garvey* the court noted that:

As a matter of public policy, courts have been desirous of sustaining the legal obligation of subscriptions of this character, and in some cases . . . have found a sufficient consideration in the mutuality of the promises, where no fraud or deception has been practiced. But while we might be unwilling to go to that extent and might hold that a subscription could be withdrawn before money had been expended or liability incurred, or work performed on the strength of the subscriptions, and in furtherance of the enterprise, the church trustees had, on the faith of the subscriptions, borrowed money, relying on the subscription as a means of payment and incurred a specific liability.

Thus, it seems that *Erdman* made law of the dictum in *Gittings*, but that law was that charitable subscriptions to be enforceable require reliance on the subscriptions by the charity which would lead to direct loss to the organization or its officers if the subscriptions were not enforced.

This principle of the law was applied in *Sterling*. In that case pledges were made to support a failing bank, to restore confidence in it and protect its depositors and creditors, to comply with demands of the bank commissioner so as to keep the bank open and to prevent impairment of its capital. There were, therefore, substantial considerations for the subscriptions. “Not only was every subscription expressly made in consideration of the agreement of other subscribers, who have fulfilled their pledges, but a prior subscription agreement was to be, and was, in fact, released to the specified extent, when the new one became binding, and consent of the bank commissioner to the continued functioning of the bank was thereby induced.” In such circumstances, the Court declared: “The sufficiency of such considerations cannot be doubted.”

Gittings and *Erdman* were referred to in *American University v. Collings* as cases “which hold that where one has made a subscription and thereby authorized the entering into engagements to accomplish the purpose for which the subscription was made, the subscription was upon a valuable consideration.” The Court carefully pointed out that “[in those] cases, however, the promisee had actually incurred obligations relying upon the promises,” but that in the case it was considering there was no claim “that any such obligations had been entered into.” The case turned on the finding that the pledge was testamentary in nature.

In summary, the rule announced in *Gittings*, referred to in *Collings* and applied in *Erdman* and *Sterling*, is in substance the rule set out in § 90 of the Restatement of Contracts (1932). It is the settled law of this State.

IV

UJA would have us “view traditional contract law requirements of consideration liberally” in order to maintain what it believes to be a judicial policy of favoring charities. We deeply appreciate the fact that private philanthropy serves a highly important function in our society. This was well expressed by the Court some hundred and twenty-five years ago in observing that the maintenance of charitable institutions was “certainly of the highest merit”:

Whether projected for literary, scientific or charitable purposes, they address themselves to the favorable consideration of those whose success in life may have enabled them, in this way, to minister to the wants of others, and at the same time promote their own interests, by elevating the character of the community with whose prosperity their fortunes may be identified.

But we are not persuaded that we should, by judicial fiat, adopt a policy of favoring charities at the expense of the law of contracts which has been long established in this state. We do not think that this law should be disregarded or modified so as to bestow a preferred status upon charitable organizations and institutions.

It may be that there are cases in which judgments according to the law do not appear to subserve the purposes of justice, but this, ordinarily, the courts may not remedy. “It is safer that a private right should fail, or a wrong go unredressed, than that settled principles should be disregarded in order to meet the equity of a particular case.” *Gittings*. If change is to be made it should be by legislative enactment, as in the matter of the tax status of charitable organizations.

In advocating its position, UJA points to this statement in *Gittings*:

In some cases, the courts, in furtherance of what they deemed a recognized public policy, have felt themselves warranted in relaxing, to some extent, the rigor of the common law, and have held the subscribers liable, when, perhaps, upon strict principles, there was not a legal consideration for the contract.

That this was no more than an observation and not an adoption of the principle was made manifest by the further comments of the Court:

Indeed, considering the number of these [charitable] institutions, erected and maintained by private munificence alone, the cases are very rare in which subscribers have refused compliance with their engagements. Instances may occur in which parties, feeling themselves released in consequence of a failure of expectations reasonably entertained at the time of making the subscription, might avail themselves of legal defenses, without justly forfeiting the good opinion of those who embarked with them in the enterprise. The propriety, however, of employing such means of resisting payment the parties must determine for themselves. Upon that portion of the present case, therefore, so much contested at the bar, we decline expressing any opinion.

In *Collings* the Court noted that American University had cited cases from other jurisdictions which, the educational institution stated, “represents the general trend of judicial authority, and it is in accordance with the better reasoned opinion, that contracts for subscriptions or donations to churches or charitable or kindred institutions which have been duly accepted are based upon a valid consideration because of the mutual obligations of other subscribers.”

But the Court also observed Professor Williston’s criticism of this view. In any event, as we have indicated, the Court had no occasion to decide whether the pledge involved in *Collings* was given for a valid consideration.

Restatement (Second) of Contracts (Tent. Draft No. 2, 1965) proposes changes in § 90. It would read:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

This deletes from the existing section the qualification “of a definite and substantial character” with regard to the inducement of action or forbearance and has the inducement of forbearance apply to “a third person” as well as the promisee. It also adds the discretionary limitation as to the remedy. Comment c to the proposed Section concerns “[c]haritable subscriptions, marriage settlements, and other gifts.” It begins:

One of the functions of the doctrine of consideration is to deny enforcement to a promise to make a gift. Such a promise is ordinarily enforced by virtue of the promisee’s reliance only if his conduct is foreseeable and reasonable and involves a definite and substantial change of position which would not have occurred if the promise had not been made.

This reflects the previous section and the Maryland rule. The comment then notes that “[i]n some cases, however, other policies reinforce the promisee’s claim.” It states:

American courts have traditionally favored charitable subscriptions and marriage settlements and have found consideration in many cases where the element of exchange

was doubtful or nonexistent. Where recovery is rested on reliance in such cases, a probability of reliance is likely to be enough, and no effort is made to sort out mixed motives or to consider whether partial enforcement would be appropriate.

Illustration 7 is of a charitable subscription:

A orally promises to pay B, a university, \$100,000 in five annual installments for the purposes of its fund-raising campaign. The promise is confirmed in writing by A's agent, and two annual installments are paid before A dies. The continuance of the fund-raising campaign by B is sufficient reliance to make the promise binding on A and his estate.

Section 90 of the tentative draft No. 2 of the Restatement (Second) of Contracts, 1965, has not been adopted by the American Law Institute, and we are not persuaded to follow it.

"Cases throughout the country clearly reflect a conflict between the desired goal of enforcing charitable subscriptions and the realities of contract law. The result has been strained reasoning which has been the subject of considerable criticism." *Salsbury v. Northwestern Bell Telephone Company*. When charitable subscriptions, even though clearly gratuitous promises, have been held either contracts or offers to contract, the "decisions are based on such a great variety of reasoning as to show the lack of any really sufficient consideration." Williston on Contracts. "Very likely, conceptions of public policy have shaped, more or less subconsciously, the rulings thus made. Judges have been affected by the thought that 'defenses of [the] character [of lack of consideration are] breaches of faith towards the public, and especially towards those engaged in the same enterprise, and an unwarrantable disappointment of the reasonable expectations of those interested.'" *Allegheny College v. National Chautauqua County Bank*. Therefore, "[c]ourts have . . . purported to find consideration on various tenuous theories. . . . [The] wide variation in reasoning indicates the difficulty of enforcing a charitable subscription on grounds of consideration. Yet, the courts have generally striven to find grounds for enforcement, indicating the depth of feeling in this country that private philanthropy serves a highly important function in our society." J. Calamari & J. Perillo, *The Law of Contracts*, § 6-5 (1977). Some courts have forthrightly discarded the facade of consideration and admittedly held a charitable subscription enforceable only in respect of what they conceive to be the public policy. See, for example, *Salsbury v. Northwestern Bell Telephone Company*; *More Game Birds in America, Inc. v. Boettger*.

We are not convinced that such departure from the settled law of contracts is in the public interest. A charitable subscription must be a contract to be enforceable, unless we characterize it as some other type of agreement, unknown to established contract law, for which a valid consideration is not essential. We said in *Broaddus v. First Nat. Bank*:

It is unnecessary at this time to cite authorities in this state and elsewhere to the effect that every contract must be supported by a consideration; and this must be regarded as one of the elementary principles of the law of contract.

And, we recently cited *Broadbudd* in *Peer v. First Fed. S. & L. Ass'n*, in asserting, after noting several other requirements of a valid contract: “Finally, the agreement must be supported by sufficient consideration.” We abide by that principle in determining the validity of the charitable subscriptions.

V

When the facts concerning the charitable subscription of Polinger are viewed in light of the Maryland law, it is manifest that his promise was not legally enforceable. There was no consideration as required by contract law. The incidents on which *Gittings* indicated a charitable pledge was enforceable, and on which *Erdman* and *Sterling* held the subscriptions in those cases were enforceable are not present here. The consideration recited by the pledge card was “the obligation incurred based upon this pledge.” But there was no legal obligation incurred in the circumstances. Polinger’s pledge was not made in consideration of the pledges of others, and there was no evidence that others in fact made pledges in consideration of Polinger’s pledge. No release was given, nor binding agreement made by the UJA on the strength of Polinger’s pledge. The pledge was not for a specific enterprise; it was to the UJA generally and to the Israel Emergency Fund. With respect to the former, no allocation by UJA to its beneficiary organization was threatened or thwarted by the failure to collect the Polinger pledge in its entirety, and, with respect to the latter, UJA practice was to pay over to the Fund only what it actually collected, not what was pledged. UJA borrowed no money on the faith and credit of the pledge. The pledge prompted no “action or forbearance of a definite and substantial character” on the part of UJA. No action was taken by UJA on the strength of the pledge that could reasonably be termed “definite and substantial” from which it should be held harmless. There was no change shown in the position of UJA made in reliance on the subscription which resulted in an economic loss, and, in fact, there was no such loss demonstrated. UJA was able to fulfill all of its allocations. Polinger’s pledge was utilized as a means to obtain substantial pledges from others. But this was a technique employed to raise money. It did not supply a legal consideration to Polinger’s pledge. On the facts of this case, it does not appear that injustice can be avoided only by enforcement of the promise.

To summarize, there was no specific goal prompting the pledge such as existed in *Gittings*, *Erdman* and *Sterling* with a mutual awareness of future reliance on the subscription. UJA did not enter into binding contracts, incur expenses or suffer liabilities in reliance on the pledge. UJA’s function was to serve as a conduit or clearinghouse to collect gifts of money from many sources and to funnel them into various charitable organizations. It did, of course, plan for the future, in that it estimated the rate of cash flow based on the pledges it received and told its beneficiaries to expect certain amounts. In so doing, however, it expressly did not incur liabilities in reliance on specific pledges. It seems that none of the organizations to which it allocated money would have legal rights against UJA in the event of failure to pay the allocation, and, in any event, UJA, cognizant of the past history of collections, made due allowance for the fact that a certain percentage of the pledges would not be paid.

We hold that Polinger's pledge to UJA was a gratuitous promise. It had no legal consideration, and under the law of this State was unenforceable. The Orphans' Court for Montgomery County erred in allowing the claim for the unpaid balance of the subscription, and its order of 5 January 1979 is vacated with direction to enter an order disallowing the claim filed by UJA.

ORDER OF 5 JANUARY 1979 OF THE ORPHANS' COURT FOR MONTGOMERY COUNTY VACATED;

CASE REMANDED TO THAT COURT WITH DIRECTION TO ENTER AN ORDER DISALLOWING THE CLAIM FILED BY THE UNITED JEWISH APPEAL FEDERATION OF GREATER WASHINGTON, INC.;

COSTS TO BE PAID BY APPELLEE.

Reflection

The issue in *UJA* is whether a pledge to a charitable institution survives the death of the pledgor and is an enforceable obligation of his estate. When Polinger died, \$133,500 of his pledge remained unpaid.

In contract law, where advances have been made or expenses or liabilities have been incurred by others in consequence of such subscriptions, before notice of withdrawal, this should, on general principles, be deemed sufficient to make them obligatory, provided the advances were authorized by a fair and reasonable dependence on the subscriptions.

Polinger's pledge was not supported by consideration. The only "consideration" recited on the pledge card was "the obligation incurred based upon this pledge," but that language refers circularly to a legal obligation that never materialized. Polinger did not make the pledge in consideration of others' pledges, nor is there evidence that any other donors made their pledges in reliance on his. Likewise, no allocation by UJA to any of its beneficiary organizations was shown to have been made in reliance on collecting the Polinger pledge. In fact, UJA's own practice was to pay over to its beneficiary funds only the amounts actually collected—not the amounts merely pledged. So, even if UJA had allocated funds while anticipating full payment from Polinger, that would not have created a binding obligation or material risk of loss. No change in UJA's position was shown, no detrimental reliance occurred, and no economic harm was demonstrated. UJA was able to meet all its funding commitments regardless. In short, there was no reliance—detrimental or otherwise—with respect to anyone that would support enforcement of the pledge under promissory estoppel.

When looking at whether a charitable donation should be enforced, it is important to consider whether injustice can be avoided only by enforcement of the promise. On the facts of this case, it does not appear that injustice can be avoided only by enforcement of the promise. UJA did not enter into binding contracts, incur expenses, or suffer liabilities in reliance on the pledge.

Discussion

1. The *UJA* court declines to follow the R2d approach. Why? Which, in your opinion, is the right approach?
 2. Would the case have come out differently if the court applied the R2d approach? Analyze the claim based on R2d § 90.
 3. The R2d gives special preference to promises to give charity and promises to give alimony. Why are these two categories of promises singled out?
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Problems

Problem 8.1. Escaped Bull

Martin Fitzpatrick owned a small farm in Vermont on which lived a prized bull. Somehow, in September 1860, that bull escaped Fitzpatrick's farm and wandered across Chittenden, Vermont, eventually arriving upon a pasture owned by Bishop Boothe in Pittsford, Vermont, about eleven miles away. Boothe then cared for the bull by providing for its food and shelter while Boothe attempted to determine who owned the bull, but he was not able to quickly ascertain the owner.

In November, Boothe determined that Fitzpatrick owned the bull, and the two men met in Pittsford. At the meeting, Fitzpatrick said that the bull was indeed his and that he would pay for its care but could not drive it away until the winter ended. Boothe kept the bull through the winter, and Fitzpatrick drove him home in spring.

Boothe sent Fitzpatrick a bill for the cost of the care. The amount charged was reasonable, but Fitzpatrick refused to pay.

What is Fitzpatrick's best legal argument for why he does not have to pay Boothe?

What is Boothe's counterargument for why Fitzpatrick must pay him?

Which party is more likely to prevail if this case was brought to court?

See Boothe v. Fitzpatrick, 36 Vt. 681 (1864).

Problem 8.2. Plantations Steel

Plantations Steel Co. (Plantations) manufactured steel reinforcing rods for use in concrete construction. The company was the employer of Edward J. Hayes. In January 1972, Hayes planned to retire the next year. Approximately one week before his actual retirement, Hayes spoke to Hugo R. Mainelli, Jr., an officer and stakeholder of Plantations. Mainelli said that he would "take care" of Hayes. There was no mention of a sum of money or a percentage of salary that Hayes would receive. Nor was there any

formal authorization from other shareholders or formal provision for a pension for employees other than unionized employees. Hayes was not a union member. Hayes received \$5,000 per year as part of his pension.

Mainelli testified that his father had authorized the first payment “as a token of appreciation for the many years of Hayes’s service.” It was implied that that check would continue on an annual basis and would continue as long as Mainelli was still around. After retirement, Hayes would visit the company, thanking Mainelli for and discussing with him the payments he was receiving. He also asked how long they would continue so that he could plan his retirement. Hayes testified that he would not have retired had he not expected to receive a pension. After he stopped working for Plantations, he sought no other employment.

The payments stopped in 1976, when the Mainellis, including Hugo Mainelli, Jr., and his father, lost the company in a takeover by the DiMartino family. Hayes sued Plantations for three years’ worth of pension payments.

Under R2d § 90, does Hayes have an affirmative claim of promissory estoppel for the lack of consideration?

See Hayes v. Plantations Steel Co., 438 A.2d 1091 (R.I. 1982).

Chapter 9

Promissory Restitution

Imagine this: A construction worker, Joe, sees his foreman, Hank, in the path of a speeding forklift. Joe pushes Hank aside, saving Hank's life but crushing his own foot in the process. Grateful, Hank promises lifelong financial support. After Hank dies ten years later, his estate refuses to continue payments. Should the estate be held to its word? Promissory restitution provides a framework for answering this question that balances fairness and the prevention of unjust enrichment with the traditional boundaries of contract law. To state the question more generally: should courts enforce promises rooted in gratitude and moral obligation, or should they strictly adhere to traditional doctrines of consideration?

Promissory restitution bridges the gap between contract and restitution law. It remedies situations where fairness demands enforcing a promise made after a benefit is conferred. The doctrine ensures that those who receive a significant benefit and later promise compensation in recognition of that previously received benefit can be held accountable, even without traditional consideration. To understand how promissory restitution applies, consider the following question: When does fairness demand that a promise made after receiving a benefit should be enforced? This chapter explores situations that justify deviation from traditional consideration doctrine, illustrated through key cases that show when such promises become binding.

Promissory restitution involves three key elements:

- (1) The promise must be made in recognition of a benefit previously conferred on the promisor by the promisee.
- (2) The benefit must be such that the promisor would have been unjustly enriched if allowed to retain it without compensating the promisee.
- (3) Enforcement of the promise must be necessary to prevent injustice, with courts' tailoring remedies as justice requires.

When all three elements are present, a promise made after a benefit is conferred may be enforceable, even without traditional consideration. As summarized in R2d § 86: A promise made in recognition of a benefit previously received by the promisor from the promisee is binding to the extent necessary to prevent injustice.

This chapter introduces a foundational example that demonstrates the general rule of unenforceability, followed by five contexts where fairness and justice justify

deviations from this rule to enforce promises. Each scenario corresponds to an exception to the traditional consideration doctrine and is supported by a key case.

We begin with *Mills v. Wyman*, 20 Mass. 207 (1825), a case that highlights the general rule that promises based solely on past benefits are unenforceable. Why should moral obligation alone be insufficient to create a binding promise? This case serves as a baseline for understanding the doctrine's exceptions. In this case, a father's promise to reimburse a stranger who cared for his adult son lacked consideration because the benefit had been conferred before the promise was made. This foundational case establishes that moral obligation alone is insufficient to create a binding promise.

Mistakenly conferred benefits provide an exception to the general rule. Promissory restitution enforces subsequent promises to correct errors and compensate benefactors. In *Drake v. Bell*, 55 N.Y.S. 945 (App. Div. 1899), a contractor mistakenly repaired the wrong house but significantly improved its value. The homeowner's later promise to pay for the improvements was enforceable because the promise rectified an unintended but valuable enrichment.

Emergency situations may preclude formal agreements, raising the question, should a life-saving act be rewarded even if no contract existed beforehand? Promissory restitution applies when a subsequent promise acknowledges the value of such actions or critical assistance. In *Webb v. McGowin*, 27 Ala. App. 82 (1936), an employee saved his employer's life at great personal cost and received a promise of lifelong financial support in recognition of the benefit. The court enforced the promise, emphasizing the material benefit received and the justice of compensation.

In commercial contexts, actions that appear to be gifts may implicitly carry expectations of compensation. In *Haynes Chemical v. Staples*, 133 Va. 82 (1922), an advertising agency created a marketing campaign without an explicit agreement for payment but later received a promise of reimbursement. The court enforced the promise, finding that it acknowledged the significant investment of labor and resources that conferred a benefit on the promisor.

When a benefit is conferred pursuant to a valid but unpaid contract, a third party's promise to compensate the benefactor can be enforceable. In *Edson v. Poppe*, 124 N.W. 441 (S.D. 1910), a tenant's contractor built a well that improved the landlord's property. The landlord's subsequent promise to pay for the well was enforced because it recognized the material benefit conferred by the contractor's performance.

Finally, promissory restitution addresses situations where a legal technicality renders a contract unenforceable but a subsequent promise revives the obligation. In *Muir v. Kane*, 55 Wash. 131 (1909), a real estate broker's oral agreement to receive a commission was void under the statute of frauds. However, the seller's later written promise to pay the commission was enforced because it acknowledged the broker's valuable services.

Promissory restitution enforces promises made in recognition of past benefits when fairness requires it. By bridging contract and restitution law, the doctrine offers

remedies in exceptional cases where traditional rules fall short. The cases in this chapter demonstrate how courts navigate these exceptions and balance the equitable goal of preventing unjust enrichment with the foundational principles of contract law.

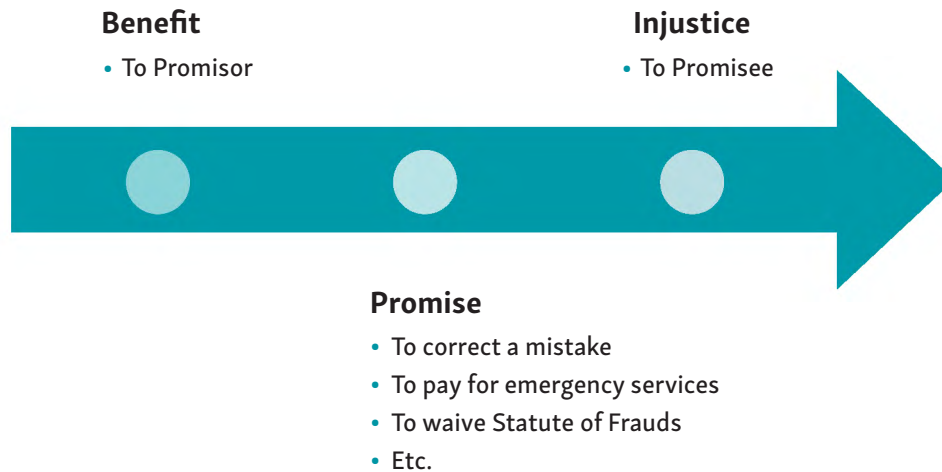


Figure 9.1. Illustration of the elements of promissory restitution as they occur across time.

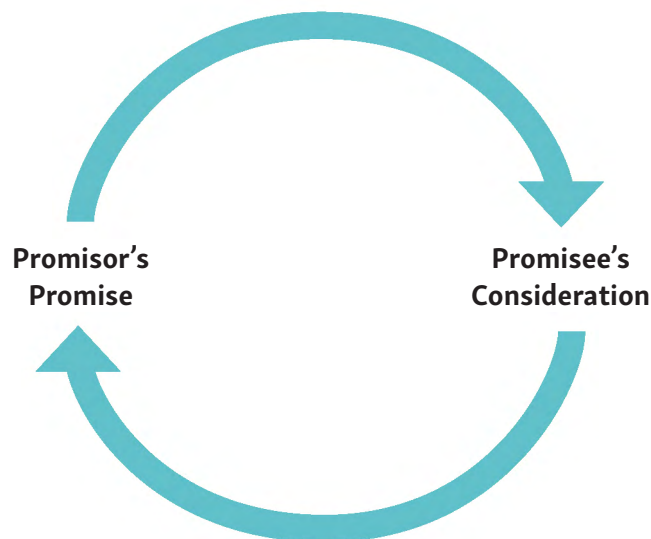


Figure 9.2. Comparison of the timing of a promissory restitution situation (where the promise occurs after the benefit) to a traditional bargain contract (where the exchange of promises happens simultaneously, at the moment of contract acceptance).

Rules

A. Promise to Pay for Benefit Received

Contract law requires consideration to ensure mutuality and prevent parties from being bound by mere promises without reciprocal obligations. A simple promise to pay for a benefit previously received, without more, does not justify any deviation from this foundational rule. Promissory restitution, however, provides a narrowly tailored exception. To understand the need for this doctrine, we begin with a case that exemplifies the general rule: most promises unsupported by consideration are unenforceable.

The classic case *Mills v. Wyman*, below, took place in Hartford, Connecticut, in 1825. Levi Wyman, a 25-year-old sailor, fell ill after a sea voyage. Daniel Mills cared for him at his own expense until Levi died. Upon learning of Mills's efforts, Levi's father, Seth Wyman, wrote a letter promising to reimburse Mills for his expenses. However, Wyman failed to pay, and Mills sued.

The court found this was a typical example of an unenforceable promise to pay for a past benefit. The promise was made to compensate Mills for a benefit already conferred. Without more, such promises are unenforceable due to a lack of consideration. The promisor (Seth Wyman) did not seek to induce any action by Mills, and the promisee (Mills) was not induced by Wyman's promise. The lower court dismissed the case.



Figure 9.3. The Sick Man by Laurits Andersen Ring (1902).

Public domain work.

Mills v. Wyman underscores the principle that moral obligations alone do not create legally binding promises. While Seth Wyman may have had a moral duty to compensate Mills, the court emphasized that contract law does not enforce these so-called moral obligations:

If moral obligation, in its fullest sense, is a good substratum for an express promise, it is not easy to perceive why it is not equally good to support an implied promise. What a man ought to do, generally he ought to be made to do, whether he promise or refuse. But the law of society has left most of such obligations to the interior forum, as the tribunal of conscience has been aptly called.

The court's decision reflects the broader goals of contract law: maintaining predictability and avoiding the imposition of obligations based solely on subjective notions of morality. The refusal to enforce Wyman's promise aligns with these principles. Legal liability arises only when mutual intent and consideration exist.

While *Mills v. Wyman* reaffirms the importance of consideration, subsequent cases reveal circumstances where fairness and justice compel courts to enforce promises despite the absence of consideration. These cases illuminate the boundaries of promissory restitution, which will be explored in the following sections.

B. Promise to Correct a Mistake

In all cases of promissory restitution, the promise to pay for a benefit occurs after the benefit has been conferred. Because of this, it is impossible for the original benefit to induce the promise. Time flows in only one direction, and events in the future cannot influence past intentions. However, subsequent events can reveal what intentions a person would have had if circumstances were different.

Consider this streamlined hypothetical: In a household, one partner routinely cooks dinner while the other cleans up. If the cooking partner mistakenly prepares a meal different from what was expected but the other partner still promises to clean up, this promise substitutes for consideration. It retroactively signals that the cleaning partner would have agreed to the bargain had the correct meal been prepared. This post-benefit promise reflects a voluntary agreement that satisfies the consideration requirement by substituting for it.

A similar situation arose in *Drake v. Bell*. Just as the cleaning partner's promise in the hypothetical acknowledges the value of the meal and corrects the mistake, Bell's promise to pay for the contractor's repairs corrected an unintended enrichment caused by the contractor's error. In *Drake*, a contractor hired by Drake mistakenly repaired Bell's house instead of Drake's. The repairs significantly enhanced Bell's property value. After realizing the mistake, Bell promised to pay the contractor for the work. This promise functioned as a substitute for an initial agreement, acknowledging the benefit Bell received and ensuring fairness.

This demonstrates a key feature of promissory restitution: when a benefit is conferred by mistake, the promisor's subsequent promise ensures that the recipient does not unjustly retain the benefit without compensation. By enforcing such promises, courts balance the prevention of unjust enrichment with the need for voluntary agreements, which ensures equitable outcomes in cases where initial mistakes occur.

C. Promise to Pay for Emergency Services and Necessaries

As a policy matter, society wants to encourage people to help each other in times of need and struggle. In such situations, it may be impossible to formally contract. Imagine a man finds an unconscious woman in the street and drives her one hundred miles to the nearest hospital. While she has no legal obligation to repay him under contract law, she might later promise compensation. This promise addresses a benefit she received during an emergency when formal contracting was impossible.

If the story ends here, the man cannot sue the woman for the services he rendered, at least not under contract law. Allowing such claims could lead to unintended consequences. For example, a person might look for incapacitated individuals and provide unnecessary or extravagant services—such as hiring expensive personal care nurses or administering gold-plated IVs—and then attempt to recover exorbitant sums from them. This would discourage genuine altruism and create perverse incentives. To prevent such outcomes, there must be a “plus factor” before the law will enforce a promise to pay for emergency services.

The plus factor arises when the beneficiary voluntarily promises to pay for the services received. Such promises often occur after the emergency has passed, when the beneficiary has the capacity to reflect on and recognize the value of the services provided. The promise acts as a substitute for consideration by acknowledging the fairness of compensation and preventing unjust enrichment. Courts enforce such promises to ensure equity and encourage altruistic behavior during emergencies.

A landmark case illustrating this principle is *Webb v. McGowin*. Joe Webb and J. Greeley McGowin worked at the W.T. Smith Lumber Company in Alabama. Webb's job involved dropping 75-pound pine blocks from the upper floor of a mill to the ground floor. During one such task, Webb noticed McGowin standing below, directly in harm's way. To prevent the block from striking McGowin, Webb held onto it and fell to the ground, severely injuring himself. Webb's actions saved McGowin's life but left Webb permanently disabled and unable to work.

In gratitude, McGowin promised to care for Webb for the rest of his life by paying him \$15 every two weeks. McGowin honored this promise for nearly nine years, but after McGowin's death, his estate refused to continue the payments, arguing that the promise lacked consideration. Webb sued to enforce the promise.



Figure 9.4. William Arthur Cooper, *Lumber Industry* (1934). Credit: Smithsonian American Art Museum. Public domain work.

The court held that McGowin's estate was bound by the promise. While the initial benefit—saving McGowin's life—occurred before the promise, the court reasoned that the emergency nature of the situation precluded bargaining. McGowin's subsequent promise recognized the substantial benefit he received and served as a substitute for consideration. By enforcing the promise, the court upheld the equitable principle that beneficiaries of emergency services should not unjustly retain those benefits without compensation.

As a thought experiment, imagine what Webb and McGowin might have agreed upon if time froze just as Webb began to divert the falling block. Webb could ask, "Will you compensate me if I risk injury to save your life?" McGowin's subsequent promise reflects what they likely would have agreed to under normal circumstances. By enforcing such promises, courts prevent unjust enrichment and promote fairness in cases where emergencies preclude formal agreements.

D. Promise to Pay for a Past Gift

The *Mills* case establishes the basic rule that promises to pay for past gifts are unenforceable. For example, if I give my mother an iPhone as a birthday present and, a week later, she calls me and says that I should not have spent so much on her and

that she will pay me back the purchase price, this promise is unenforceable. In fact, this situation is a simple example of past consideration, which is not consideration at all.

Not all gifts are true gifts, however. Sometimes, especially in business situations, parties offer something for free with the intention of gaining more business later. For example, a contractor might offer a homeowner a “free estimate” of the cost to repair a roof. This is not a true gift because the contractor is not looking to give charity to the homeowner. Rather, the contractor is hoping that the homeowner will hire the contractor to repair the roof. The free estimate is not a true gift but rather a loss leader, a strategy in which a seller gives away something for free or sells it for less than it is worth in order to attract more business in the future.

Promissory restitution provides a framework for enforcing promises that follow self-interested gifts, recognizing that these gifts often create a moral or practical expectation of compensation. While the Latin terms *gratuitum* (pure gift) and *largitio* (self-interested gift) are not used in modern American law, the concepts remain relevant. A promise to pay for a truly gratuitous gift that was given in the past is unenforceable. But a promise to pay for a gift given with self-interested motives may be enforceable if it reflects the recipient’s acknowledgment of value received and their intent to compensate.

For example, a company offering a free trial for its software expects that customers will later purchase a subscription. While the trial may appear as a gift, its purpose is to create future business. This makes it a *largitio*, not a *gratuitum*. If a customer later



Figure 9.5. Peter Jungen (on the right) presents a gift to ambassador Philip D. Murphy (on the left). Credit: Raimond Spekking (2013). CC BY-SA 4.0.

promises to pay for the trial's value, that promise is enforceable under the principles of promissory restitution.

The law generally assumes that family members give *gratuitum*, true gifts, to each other. Family relationships presume true gifts motivated by love, such as a grandfather's offering to pay for his granddaughter's law school without expecting anything in return. Of course, there are exceptions. A parent might say to their child, "I will pay you \$5 to mow the lawn." This clearly has the form of a contract and overrides the presumption of a gift. Family members may also enter into enforceable contracts with each other when their agreements resemble commercial transactions.

In the business world, where strangers engage in arm's-length transactions, the presumption is flipped. Courts assume that commercial activities involve contracts and bargaining, not gifts. A construction worker who agrees to "help out" their boss by working on Sunday probably expects to be paid for their work, not to give a gift of their time. However, exceptions exist here as well. For example, a corporation may give charity to causes that do not directly or indirectly benefit the corporation, such as donating leftover food to a local food bank. While uncommon, businesses can make promises to give gratuitous gifts.

The key point to remember is that the law distinguishes between gifts given purely out of generosity and those given with expectations of future benefit. Business strategies that give away services or products for free, sometimes referred to as loss leaders, aim to entice the recipient into a future transaction. These so-called gifts are not true gifts because they come with strings attached.

Ultimately, when a gift is given with expectations and the recipient later promises to compensate, promissory restitution ensures that such promises are enforceable—reflecting both the intent and the fairness inherent in the transaction. This fairness is not established by any single gesture or vague hope, but by the combination of a material benefit conferred and a voluntary promise to repay it. Promissory restitution does not impose liability for kindness or generosity alone; it applies only when enforcing the promise is necessary to prevent unjust enrichment. In this way, the law avoids imposing obligations unilaterally but honors voluntary commitments that acknowledge value received and meet the demands of justice.

E. Promise to Pay for an Unpaid Contract

In some cases, a party who benefits from another's performance under an unpaid contract may promise to pay for the benefit received. This promise can be enforceable under the doctrine of promissory restitution when certain factors demonstrate fairness and intent.

The doctrine of consideration ensures that enforceable promises are grounded in a voluntary exchange. Courts generally do not enforce promises unsupported by consideration, instead preserving their resources for disputes involving mutual

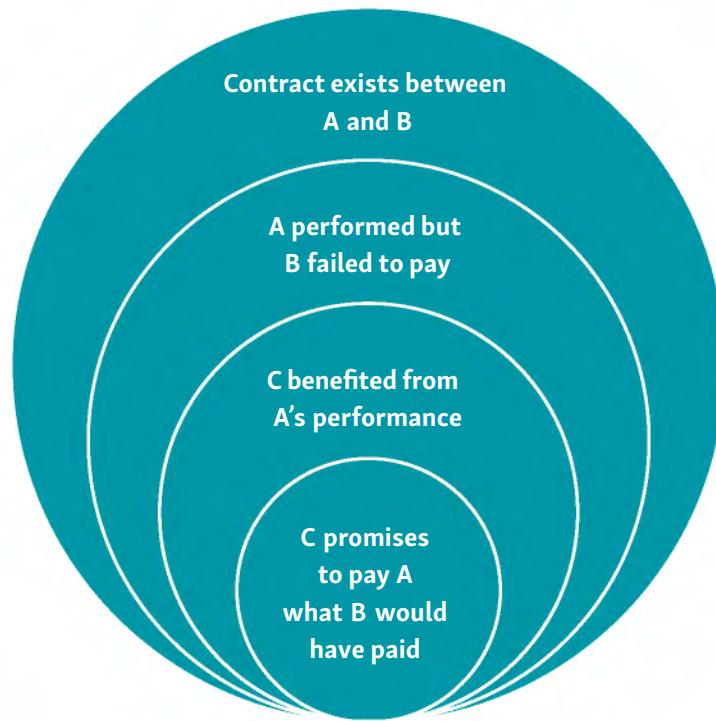


Figure 9.6. Stacked Venn diagram showing the circumstance where promise to pay for another's contract will be enforceable under promissory restitution.

agreements. However, exceptions exist when fairness and equity demand enforcement. These exceptions often hinge on a plus factor—circumstances demonstrating the promisor's intent to recognize and compensate the benefit received.

The plus factor refers to additional circumstances, such as the existence of a prior contract or direct benefit to the promisor, that show the promise was not merely gratuitous but rooted in fairness and intent to compensate. This principle arises particularly in cases where one party performs under a valid contract, but the benefit conferred is not compensated due to unforeseen circumstances, and a third party promises to pay.

A classic example is *Edson v. Poppe*. In this case, George Poppe rented and lived on land owned by his brother, William Poppe. George Poppe contracted with George Edson, a local well digger, to construct a well on William Poppe's land. Edson completed the work, but George Poppe failed to pay him. Recognizing the value that the well added to his property, William Poppe agreed to pay Edson \$250, the reasonable value of the work. However, like his brother, William Poppe ultimately did not pay, prompting Edson to sue him.

The court held that William Poppe's promise to pay was enforceable. The benefit—the well—arose from a valid contract with George Poppe, and William Poppe

directly benefited from its construction. The existence of the contract demonstrated that the benefit was not foisted upon William. His promise to pay reflected an acknowledgment of the value received, thus providing the necessary plus factor to make the promise enforceable under promissory restitution.

By enforcing promises in such cases, courts ensure fairness in situations where one party benefits from another's labor while also encouraging third-party beneficiaries to resolve disputes without unnecessary litigation. This principle exemplifies the flexibility of promissory restitution, which seeks to balance contractual principles with equitable outcomes in cases where the promisor voluntarily acknowledges and compensates a benefit received.

F. Promise to Pay for an Unenforceable Contract

Promises may become unenforceable for various reasons, such as insufficiently defined terms, failure to comply with formalities like the statute of frauds, mutual mistakes, or changed circumstances after contract formation. These barriers often arise despite the parties' clear intent to form a valid agreement.

Although gratuitous promises are generally unenforceable, the common law recognizes an exception for promises to pay for otherwise unenforceable contracts. The plus factor in these cases lies in the original intent of the parties to form a valid agreement and the fairness of holding the promisor accountable for obligations that were clear but legally unenforceable due to technicalities. By enforcing such promises, courts encourage parties to honor their obligations while ensuring equitable outcomes.

The 1909 case *Muir v. Kane* provides a clear example. In this case, M. Francis Kane and his wife Ida Kane orally agreed to pay B.L. Muir & Co. a commission for helping to sell their property. Muir succeeded in finding a buyer, and the parties later executed a formal written agreement stating that Muir would receive \$200 from the sale proceeds. However, the Kanes refused to pay, arguing that the original oral agreement was unenforceable under the statute of frauds, which required commission agreements for real estate sales to be in writing, and that the later written agreement lacked consideration because Muir's services had already been performed, thus making the promise to pay unsupported by past consideration.

The court disagreed. While the original oral agreement was unenforceable under the statute of frauds, it was a valid contract formed by offer, acceptance, and consideration. The subsequent written agreement revived the earlier obligation and made it enforceable. The court reasoned:

Contracts formerly valid but unenforceable due to statutory bars may furnish sufficient consideration for a subsequent promise to perform, while agreements void from their inception due to legal defects cannot.

This distinction is critical. Promises reviving obligations under initially valid contracts reflect a continuation of the parties' intent and are fundamentally different from gratuitous promises. The court upheld the written agreement, emphasizing that the Kanes' promise was rooted in fairness and recognition of Muir's fulfilled contractual role.

By enforcing such promises, courts promote fairness, prevent unjust enrichment, and uphold the principle that legal technicalities should not undermine validly formed agreements. This principle illustrates the adaptability of promissory restitution in ensuring equitable outcomes: it bridges gaps where rigid contract rules might otherwise fail to honor legitimate obligations.

G. Reflections on Promissory Restitution

Over time, exceptions to the consideration doctrine have emerged, weakening its rigidity. While some argue that the doctrine is outdated, it remains central to contract law. Perhaps during your career, you will be the lawyer who successfully argues for its demise in your jurisdiction. For now, however, the best way to understand this requirement of a bargained-for exchange, and the exceptions to it, is by studying the equitable paths that precedent has carved through the doctrine.

Studying these precedents provides tools for lawyers to navigate exceptions to consideration, which equips them to argue for enforceability when justice and fairness demand it. For pedagogical reasons, this chapter features more cases than the rest. Each case illustrates a specific scenario where a judge felt compelled to eschew the consideration requirement in the interest of justice and fairness. This process is akin to navigating pathways carved by precedent through the once-solid foundation of the consideration doctrine.

Identifying an analogous case and arguing for a similar outcome is an important step. However, mastering equitable doctrines requires understanding and articulating the deeper principles that justify exceptions to the consideration requirement. For example, recognizing the values behind promissory restitution can help a lawyer argue that a promise to pay for emergency services or an unpaid benefit should be enforced. The goal is to demonstrate why a novel promise warrants relief from traditional rules—not just because of precedent, but because justice requires it. These generalized equitable arguments demand higher-order thinking and creativity, allowing lawyers to craft principled and persuasive claims.

The equitable exceptions to the consideration doctrine fall into two main categories: promissory restitution (promises for benefits received), which you have just studied, and promissory estoppel (promises reasonably inducing action or forbearance), which are covered in the next chapter. Promissory restitution enforces promises for benefits already conferred, focusing on fairness for past actions. In contrast, promissory estoppel addresses promises that induce future reliance. Together, these doctrines provide equitable alternatives to consideration.

Despite their differences, both doctrines share a critical feature: both require a promise. Without a promise, there is no contractual liability. Other legal doctrines, such as restitution and unjust enrichment, allow claims for damages without alleging a promise, but these doctrines involve quasi-contracts—agreements that resemble contracts but are not legally recognized as such. These doctrines are beyond the scope of this book and course, as they do not belong to contract law. Ultimately, promises remain the cornerstone of contractual liability, distinguishing contract law from related doctrines. Without a promise, there can be no contractual liability, even under equitable alternatives to the consideration doctrine.

Cases

Reading Mills v. Wyman. Establishing whether there is promissory restitution starts with determining whether there was a promise. In the case below, a father promised to compensate a stranger who took care of his dying adult son. The promise was made to compensate the stranger for a benefit that had happened in the past. The promisor (the father) did not seek to induce some kind of action, and the promisee (the stranger) was not induced, so there was no consideration, and the case was dismissed in the lower court. If there was no consideration, then there needed to be an alternative—one based on a sense of fairness and justice.

If the father failed to keep this promise, wouldn't it feel like a violation of some kind of moral obligation or duty? Can moral obligation alone be an alternative to consideration? As you read the *Mills* case below, determine whether moral obligation alone can be an alternative to consideration or if there needs to be something more.

Mills v. Wyman

20 Mass. 207 (1825)

PARKER C. J.

General rules of law established for the protection and security of honest and fair-minded men, who may inconsiderately make promises without any equivalent, will sometimes screen men of a different character from engagements which they are bound *in foro conscientiae* [before the tribunal of conscience] to perform. This is a defect inherent in all human systems of legislation. The rule that a mere verbal promise, without any consideration, cannot be enforced by action, is universal in its application, and cannot be departed from to suit particular cases in which a refusal to perform such a promise may be disgraceful.

The promise declared on in this case appears to have been made without any legal consideration. The kindness and services towards the sick son of the defendant were not bestowed at his request. The son was in no respect under the care of the defendant. He was twenty-five years old, and had long left his father's family. On his return from a foreign country, he fell sick among strangers, and the plaintiff acted the part of the good Samaritan, giving him shelter and comfort until he died. The defendant, his father, on being informed of this event, influenced by a transient feeling of gratitude, promises in writing to pay the plaintiff for the expenses he had incurred. But he has determined to break this promise, and is willing to have his case appear on record as a strong example of particular injustice sometimes necessarily resulting from the operation of general rules.

It is said a moral obligation is a sufficient consideration to support an express promise; and some authorities lay down the rule thus broadly. However, upon examination of the cases, we are satisfied that the universality of the rule cannot be supported, and there must have been some preexisting obligation, which has become inoperative by positive law, to form a basis for an effective promise. The cases of debts barred by the statute of limitations, of debts incurred by infants, of debts of bankrupts, are generally put for illustration of the rule.

Express promises founded on such preexisting equitable obligations may be enforced. There is a good consideration for them. They merely remove an impediment created by law to the recovery of debts honestly due, but which public policy protects the debtors from being compelled to pay. In all these cases there was originally a *quid pro quo*; and according to the principles of natural justice the party receiving ought to pay; but the legislature has said he shall not be coerced. Then comes the promise to pay the debt that is barred, the promise of the man to pay the debt of the infant, of the discharged bankrupt to restore to his creditor what by the law he had lost. In all these cases there is a moral obligation founded upon an antecedent valuable consideration.

These promises therefore have a sound legal basis. They are not promises to pay something for nothing. Not naked pacts; but the voluntary revival or creation of obligation which before existed in natural law, but which had been dispensed with. It was not for the benefit of the party obliged solely, but principally for the public convenience.

If moral obligation, in its fullest sense, is a good substratum for an express promise, it is not easy to perceive why it is not equally good to support an implied promise. What a man ought to do, generally he ought to be made to do, whether he promise or refuse. But the law of society has left most of such obligations to the interior forum, as the tribunal of conscience has been aptly called. Is there not a moral obligation upon every son who has become affluent by means of the education and advantages bestowed upon him by his father, to relieve that father from pecuniary embarrassment? To promote his comfort and happiness, and even to share with him his riches,

if thereby he will be made happy? And yet such a Son may, with impunity, leave such a father in any degree of penury above that which will expose the community in which he dwells, to the danger of being obliged to preserve him from absolute want. Is not a wealthy father under strong moral obligation to advance the interest of an obedient, well disposed son? To furnish him with the means of acquiring and maintaining a becoming rank in life, to rescue him from the horrors of debt incurred by misfortune? Yet the law will uphold him in any degree of parsimony, short of that which would reduce his son to the necessity of seeking public charity.

Without doubt there are great interests of society which justify withholding the coercive arm of the law from these duties of imperfect obligation. As they are called; imperfect, not because they are less binding upon the conscience than those which are called perfect, but because the wisdom of the social law does not impose sanctions upon them.

A deliberate promise, in writing, made freely and without any mistake, one which may lead the party to whom it is made into contracts and expenses, cannot be broken without a violation of moral duty. But if there was nothing paid or promised for it, the law, perhaps wisely, leaves the execution of it to the conscience of him who makes it. It is only when the party making the promise gains something, or he to whom it is made loses something, that the law gives the promise validity. And in the case of the promise of the adult to pay the debt of the infant, of the debtor discharged by the statute of limitations or bankruptcy, the principle is preserved by looking back to the origin of the transaction, where an equivalent is to be found. An exact equivalent is not required by the law; for there being a consideration, the parties are left to estimate its value: though here the courts of equity will step in to relieve from gross inadequacy between the consideration and the promise.

These principles are deduced from the general current of decided cases upon the subject, as well as from the known maxims of the common law. The general position, that moral obligation is a sufficient consideration for an express promise, is to be limited in its application, to cases where at some time or other a good or valuable consideration has existed.

A legal obligation is always a sufficient consideration to support either an express or an implied promise; such as an infant's debt for necessities, or a father's promise to pay for the support and education of his minor children. But when the child shall have attained to manhood, and shall have become his own agent in the world's business, the debts he incurs, whatever may be their nature, create no obligation upon the father; and it seems to follow, that his promise founded upon such a debt has no legally binding force.

The cases of instruments under seal and certain mercantile contracts, in which considerations need not be proved, do not contradict the principles above suggested. The first import a consideration in themselves, and the second belong to a branch of the mercantile law, which has found it necessary to disregard the point of consideration

in respect to instruments negotiable in their nature and essential to the interests of commerce.

The opinions of the judges had been variant for a long course of years upon this subject, but there seems to be no case in which it was nakedly decided, that a promise to pay the debt of a son of full age, not living with his father, though the debt were incurred by sickness which ended in the death of the son, without a previous request by the father proved or presumed, could be enforced by action.

It has been attempted to show a legal obligation on the part of the defendant by virtue of our statute, which compels lineal kindred in the ascending or descending line to support such of their poor relations as are likely to become chargeable to the town where they have their settlement. But it is a sufficient answer to this position, that such legal obligation does not exist except in the very cases provided for in the statute, and never until the party charged has been adjudged to be of sufficient ability thereto. We do not know from the report any of the facts which are necessary to create such an obligation. Whether the deceased had a legal settlement in this commonwealth at the time of his death, whether he was likely to become chargeable had he lived, whether the defendant was of sufficient ability, are essential facts to be adjudicated by the court to which is given jurisdiction on this subject. The legal liability does not arise until these facts have all been ascertained by judgment, after hearing the party intended to be charged.

For the foregoing reasons we are all of opinion that the nonsuit directed by the Court of Common Pleas was right, and that judgment be entered thereon for costs for the defendant.

Reflection

Mills demonstrates that, in general, a promise based on moral obligation to compensate for a benefit already received cannot be enforced without a preexisting obligation. In other words, moral obligation alone is insufficient to be an alternative to consideration. It needs to be based on something that is already recognized as legal consideration, like a preexisting legal duty. One of the court's examples was that if someone filed for bankruptcy, the law could discharge certain debts, and they would not have to pay the debt back. However, if that same person decided to pay it back out of a sense of moral obligation, then that promise could be enforced by law because it was once supported by consideration. The debtor had a legal duty to pay back his creditor, but the law allowed the forgiveness of the debt due to public policy. Though the debtor revived the promise out a sense of moral obligation, it is supported by the preexisting legal duty to pay back the creditor.

Arguably, the father was morally obligated to pay the stranger what he had promised. But since the stranger helped the son in the past without the inducement of the father's words and actions, it cannot be consideration. Moral obligation alone cannot be an alternative to consideration; therefore, the court cannot enforce the promise.

Discussion

1. The *Mills* court case found that Seth Wyman (the father of Levi Wyman) did not have to pay Daniel Mills (the caregiver of Levi Wyman). Do you think this is the right result? Justify your opinion by making a policy argument.
 2. The *Mills* court determined that Seth Wyman's promise to Daniel Mills lacked consideration. What specific facts led the *Mills* court to this holding, and what have you learned generally about what is consideration from this case?
 3. Would the case have come out differently if Levi Wyman was an unemancipated minor? Why?
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Reading Drake v. Bell. Contracts are usually enforceable as a matter of law only where both parties were mutually induced to perform an exchange. But promises could alternatively be enforceable on the basis of equity, even where there is no inducement, pursuant to the doctrine of promissory restitution. Restitution refers to the return of ill-gotten gains or the disgorgement of unjust enrichment. Promissory restitution is where one party makes a promise to return some money or property that it is not entitled to hold. By definition, promissory restitution cannot induce a material transfer that already occurred; as mentioned above, time flows in only one direction, and events in the future cannot influence intentions in the past.

In *Drake v. Bell*, Bell received valuable home improvements from Drake that were not bargained for. Bell later promised to pay Drake's contractor. The *Drake* court found Bell's promise enforceable under the doctrine of promissory estoppel. What makes the *Drake* case different from the *Mills* case, where a father's promise to pay a stranger for previously rendered care of his son was deemed unenforceable?

Drake is distinguishable from *Mills* because Daniel Mills gave care out of pure charity, expecting nothing in return, whereas the contractor in *Drake* performed his work because he believed he was to be paid for it. In other words, the promise to pay the contractor related to a prior legal obligation. Chancellor Kent said:

It is an unsettled point whether a moral obligation is of itself a sufficient consideration for a promise, except in those cases in which a prior legal obligation or consideration had once existed.

In *Drake*, there was consideration for the promise to repair Drake's house, so consideration had once existed with regard to the promise Bell made. This distinguishes *Drake* from *Mills*, where there was never any consideration.



Figure 9.7. Old House in Rector Street (from *Scene of Old New York*), Henry Farrer (1870). Public domain work.

Note that this obligation still required a voluntary promise from Bell. He would not have had to pay for the repairs if he did not promise to do so. Bell was not obligated to pay the contractor for the repairs, even though the repairs improved his house, because those repairs were thrust upon him, without his manifestation of assent to pay for them. However, when Bell promised to pay the contractor for the repairs, the contract became binding. Bell's promise to pay the contractor was not solely based on a moral obligation; Bell reaped a benefit from the contractor's repairs to his house, and the contractor performed those repairs pursuant to a contract supported by consideration; therefore, Bell's promise was supported by consideration and was binding.

Drake v. Bell

55 N.Y.S. 945 (App. Div. 1899)

GAYNOR, J.

The defendant was under no legal obligation to pay for the work. Nor is there any question of acceptance as of a chattel, for there was nothing capable of being rejected or taken away. Did, then, his promise bind him? Lord Mansfield with his keen perception, broad mind, and aversion to alleged rules of law resting on misunderstood or inadvertent remarks of judges, instead of on foundations of reason and justice, said in *Hawkes v. Saunders*, that:

Where a man is under a moral obligation, which no court of law or equity can enforce, and promises, the honesty and rectitude of the thing is a consideration.

Buller, J., said in the same case:

If such a question were stripped of all authority it would be resolved by inquiring whether law were a rule of justice, or whether it was something that acts in direct contradiction to justice, conscience and equity.

If the rule so plainly stated by Lord Mansfield, that a moral obligation was of itself sufficient consideration for a subsequent promise, had been followed, the sole question in each case would be whether there was a moral obligation to support the promise. That would resolve the present case for the plaintiff. But it has not been always followed. I have examined the cases on the subject in England and here from the beginning. They are irreconcilable, and it would be no use to cite and review them.

But notwithstanding much stray remark by judges may be cited to the contrary, it seems to me that a promise to pay for antecedent value received by the promisor from the promisee binds, although there was never any obligation to pay which could be enforced. Why not? Such a case is not one of mere moral obligation resting on no consideration received, if there can be any such abstract moral obligation. The case is one of moral obligation created by a past valuable consideration derived from another.

For instance, a promise after coming of age to pay a debt incurred during infancy, and which cannot be enforced, or by a woman after coming discovers to pay a like debt incurred while covert, is binding. On the other hand, a subsequent promise by a father to pay for the care of his adult son while sick among strangers, or of a son to pay for like care of his father, is not binding. *Mills v. Wyman*. The distinction is that in the former class of cases there was past valuable consideration to the promisor, while in the latter not. The promise in the one class is not a naked pact, for it is not to pay something for nothing, while in the other class just that is the case.

[Case law] is construed to mean that only a subsequent promise which revives an obligation formerly enforceable either at law or in equity, but which has grown extinct, is binding. "But a mere moral or conscientious obligation, unconnected with any prior legal or equitable claim, is not enough," is the rule reduced from the said

note in a number of cases. And yet the same opinions say that the moral obligation “to pay a debt contracted during infancy or coverture, and the like,” is sufficient to support a subsequent promise; as though in such cases the moral obligation rested on a prior legal or equitable claim, which it does not. Such is true though of a promise to pay a debt barred by the statute of limitations or by a discharge in bankruptcy, which all of the cases hold to be binding.

The actual decisions most worthy of attention (not feeling bound by mere general remarks of judges and their citation) make two classes. In one of them the promise is held binding because based on a former obligation enforceable at law or in equity, which obligation it revives; in the other because the promisor though never under any such obligation nevertheless received an antecedent valuable consideration, Hence the rule seems to be that a subsequent promise founded on a former enforceable obligation, or on value previously had from the promisee, is binding.

It does not seem to me there is any actual decision in this state opposed to this. Some decisions may seem to be until something more than the head note and bare opinion are considered. The actual decision cannot be broader than the actual facts.

The promise in *Frear v. Hardenbergh*, was by the owner of land to pay a trespasser in possession the value of his improvements if the owner prevailed in his action of ejectment then pending. The plaintiff had entered knowing that he had no title, and it was held that no moral obligation for the promise could arise out of the willful trespass.

The language of the opinion in *Eastwood v. Kenyon* is very large, but the point decided does not seem controlling of cases like the present one. After coming of age the woman promised to pay back moneys expended by her father’s executor for her benefit upon her real property during her infancy. Having afterwards become covert, her husband promised to pay the same. An action against him on his promise was not sustained, the opinion saying:

If the ratification of the wife while sole was relied on, then a debt from her would have been shown, and the defendant could not have been charged in his own right without some further consideration, as of forbearance after marriage, or something of that sort.

The debt was the wife’s, and while the husband was liable for it by the common law in an action against both of them, he was not liable in an action against him in his own right on his said assumpsit. The point is technical.

Chancellor Kent does not confine the validity of such promises to cases of past legal obligation, but extends it to cases of the existence of a prior consideration. He says it is an unsettled point whether a moral obligation is of itself “a sufficient consideration for a promise, except in those cases in which a prior legal obligation or consideration had once existed.”

I do not pretend that this question is free from doubt, but to use the words of Chief Justice Marshall, “I do not think that law ought to be separated from justice

where it is at most doubtful,” and that has no doubt influenced me some in reaching a conclusion.

Judgment for the plaintiff.

Reflection

Drake v. Bell illustrates that a promise made after receiving a benefit can be binding if it rests on a former legal obligation or material value—but not on moral obligation alone. The court ruled that Bell’s promise to pay for mistaken repairs was enforceable because he received a material benefit. Although he had no legal obligation at the time of the repairs, his subsequent promise was treated not as a gratuitous gesture but as a binding commitment grounded in fairness and value received.

Discussion

1. How does the court distinguish *Drake* from *Mills*? Do you agree with this distinction?
 2. Why does the *Drake* court argue that the *Frear* case referenced in its opinion is not on point?
 3. What have you learned about when promissory restitution applies, based on the distinctions between *Drake* on the one hand and *Mills* and *Frear* on the other?
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Reading Webb v. McGowin. The next case illustrates how the contract law doctrine of consideration and its alternatives evolved as it entered the modern era. In 1905, James Greeley McGowin (along with his brothers and a brother-in-law) purchased the W.T. Smith Lumber Company in Chapman, Alabama. In 1925 McGowin became president of the company, which employed Joe Webb. On August 3, 1925, while Webb was working on the upper floor of the mill, and McGowin was on the ground below, Webb diverted a falling 75-pound block of lumber, which would otherwise have hit and probably killed McGowin. Webb suffered serious injuries in diverting this block. In recognition of Webb’s action, McGowin promised to pay Webb \$15 every two weeks for the rest of Webb’s life. McGowin died on January 1, 1934. His estate refused to continue to pay Webb, on the grounds that there was no consideration for McGowin’s promise. Webb sued. The result is found in this landmark case, which discusses whether material benefit plus moral obligation can function as a substitute for consideration.

Webb v. McGowin

27 Ala. App. 82 (1936)

BRICKEN, Presiding Judge.

This action is in *assumpsit*. [*Assumpsit* is the perfect active indicative of the Latin verb *assumere*, meaning, “he has undertaken.” In this historical context, it means that the plaintiff has filed an action to recover money owed due to an implied promise. The modern significance is that this is essentially an equitable pleading, meaning that the plaintiff seeks justice to remedy some unjust enrichment or failed quasi-contractual obligation.]

The complaint as originally filed was amended. The demurrers to the complaint as amended were sustained. [A demurrer is a historical civil procedure that is closely related to a modern motion to dismiss. If the defendant’s demurrer is granted, then the plaintiff’s case is dismissed.]

Because of this adverse ruling by the court the plaintiff took a nonsuit. [A voluntary nonsuit is where the plaintiff dismisses its own case without a court order to do so. Plaintiffs may have some opportunity to refile the claim. The specific rules regarding nonsuit are governed by Fed. R. Civ. Pro. 41 and similar provisions in state civil procedure codes.]

The assignment of errors on this appeal are predicated upon said action or ruling of the court.

A fair statement of the case presenting the questions for decision is set out in appellant’s brief, which we adopt.

“On the 3d day of August, 1925, appellant while in the employ of the W.T. Smith Lumber Company, a corporation, and acting within the scope of his employment, was engaged in clearing the upper floor of mill No. 2 of the company. While so engaged he was in the act of dropping a pine block from the upper floor of the mill to the ground below; this being the usual and ordinary way of clearing the floor, and it being the duty of the plaintiff in the course of his employment to so drop it. The block weighed about 75 pounds.

As appellant was in the act of dropping the block to the ground below, he was on the edge of the upper floor of the mill. As he started to turn the block loose so that it would drop to the ground, he saw J. Greeley McGowin, testator of the defendants, on the ground below and directly under where the block would have fallen had appellant turned it loose. Had he turned it loose it would have struck McGowin with such force as to have caused him serious bodily harm or death. Appellant could have remained safely on the upper floor of the mill by turning the block loose and allowing it to drop, but had he done this the block would have fallen on McGowin and caused him serious injuries or death. The only safe and reasonable way to prevent this was for appellant to hold to the block and divert its direction in falling from the place where McGowin was standing and the only safe way to divert it so as to prevent its coming into contact with McGowin was for appellant to fall with it to the ground below. Appellant did this,

and by holding to the block and falling with it to the ground below, he diverted the course of its fall in such way that McGowin was not injured. In thus preventing the injuries to McGowin appellant himself received serious bodily injuries, resulting in his right leg being broken, the heel of his right foot torn off and his right arm broken. He was badly crippled for life and rendered unable to do physical or mental labor.

On September 1, 1925, in consideration of appellant having prevented him from sustaining death or serious bodily harm and in consideration of the injuries appellant had received, McGowin agreed with him to care for and maintain him for the remainder of appellant's life at the rate of \$15 every two weeks from the time he sustained his injuries to and during the remainder of appellant's life; it being agreed that McGowin would pay this sum to appellant for his maintenance. Under the agreement McGowin paid or caused to be paid to appellant the sum so agreed on up until McGowin's death on January 1, 1934. After his death the payments were continued to and including January 27, 1934, at which time they were discontinued. Thereupon plaintiff brought suit to recover the unpaid installments accruing up to the time of the bringing of the suit.

The material averments of the different counts of the original complaint and the amended complaint are predicated upon the foregoing statement of facts."

In other words, the complaint as amended averred in substance: (1) That on August 3, 1925, appellant saved J. Greeley McGowin, appellee's testator, from death or grievous bodily harm; (2) that in doing so appellant sustained bodily injury crippling him for life; (3) that in consideration of the services rendered and the injuries received by appellant, McGowin agreed to care for him the remainder of appellant's life, the amount to be paid being \$15 every two weeks; (4) that McGowin complied with this agreement until he died on January 1, 1934, and the payments were kept up to January 27, 1934, after which they were discontinued.

The action was for the unpaid installments accruing after January 27, 1934, to the time of the suit.

The principal grounds of demurrer to the original and amended complaint are: (1) It states no cause of action; (2) its averments show the contract was without consideration; (3) it fails to allege that McGowin had, at or before the services were rendered, agreed to pay appellant for them; (4) the contract declared on is void under the statute of frauds.

1. The averments of the complaint show that appellant saved McGowin from death or grievous bodily harm. This was a material benefit to him of infinitely more value than any financial aid he could have received. Receiving this benefit, McGowin became morally bound to compensate appellant for the services rendered. Recognizing his moral obligation, he expressly agreed to pay appellant as alleged in the complaint and complied with this agreement up to the time of his death; a period of more than 8 years.

Had McGowin been accidentally poisoned and a physician, without his knowledge or request, had administered an antidote, thus saving his life, a subsequent promise

by McGowin to pay the physician would have been valid. Likewise, McGowin's agreement as disclosed by the complaint to compensate appellant for saving him from death or grievous bodily injury is valid and enforceable.

Where the promisee cares for, improves, and preserves the property of the promisor, though done without his request, it is sufficient consideration for the promisor's subsequent agreement to pay for the service, because of the material benefit received.

In *Boothe v. Fitzpatrick*, the court held that a promise by defendant to pay for the past keeping of a bull which had escaped from defendant's premises and been cared for by plaintiff was valid, although there was no previous request, because the subsequent promise obviated that objection; it being equivalent to a previous request. On the same principle, had the promisee saved the promisor's life or his body from grievous harm, his subsequent promise to pay for the services rendered would have been valid. Such service would have been far more material than caring for his bull. Any holding that saving a man from death or grievous bodily harm is not a material benefit sufficient to uphold a subsequent promise to pay for the service, necessarily rests on the assumption that saving life and preservation of the body from harm have only a sentimental value. The converse of this is true. Life and preservation of the body have material, pecuniary values, measurable in dollars and cents. Because of this, physicians practice their profession charging for services rendered in saving life and curing the body of its ills, and surgeons perform operations. The same is true as to the law of negligence, authorizing the assessment of damages in personal injury cases based upon the extent of the injuries, earnings, and life expectancies of those injured.

In the business of life insurance, the value of a man's life is measured in dollars and cents according to his expectancy, the soundness of his body, and his ability to pay premiums. The same is true as to health and accident insurance.

It follows that if, as alleged in the complaint, appellant saved J. Greeley McGowin from death or grievous bodily harm, and McGowin subsequently agreed to pay him for the service rendered, it became a valid and enforceable contract.

2. It is well settled that a moral obligation is a sufficient consideration to support a subsequent promise to pay where the promisor has received a material benefit, although there was no original duty or liability resting on the promisor.

In the *State ex rel. Bayer v. Funk*, the court held that a moral obligation is a sufficient consideration to support an executory promise where the promisor has received an actual pecuniary or material benefit for which he subsequently expressly promised to pay.

The case at bar is clearly distinguishable from that class of cases where the consideration is a mere moral obligation or conscientious duty unconnected with receipt by promisor of benefits of a material or pecuniary nature. Here the promisor received a material benefit constituting a valid consideration for his promise.

3. Some authorities hold that, for a moral obligation to support a subsequent promise to pay, there must have existed a prior legal or equitable obligation, which for

some reason had become unenforceable, but for which the promisor was still morally bound. This rule, however, is subject to qualification in those cases where the promisor, having received a material benefit from the promisee, is morally bound to compensate him for the services rendered and in consideration of this obligation promises to pay. In such cases the subsequent promise to pay is an affirmance or ratification of the services rendered carrying with it the presumption that a previous request for the service was made.

Under the decisions above cited, McGowin's express promise to pay appellant for the services rendered was an affirmance or ratification of what appellant had done raising the presumption that the services had been rendered at McGowin's request.

4. The averments of the complaint show that in saving McGowin from death or grievous bodily harm, appellant was crippled for life. This was part of the consideration of the contract declared on. McGowin was benefited. Appellant was injured. Benefit to the promisor or injury to the promisee is a sufficient legal consideration for the promisor's agreement to pay.

5. Under the averments of the complaint the services rendered by appellant were not gratuitous. The agreement of McGowin to pay and the acceptance of payment by appellant conclusively shows the contrary.

6. [Discussion regarding the statute of frauds omitted.]

The cases of *Shaw v. Boyd* and *Duncan v. Hall* are not in conflict with the principles here announced. In those cases the lands were owned by the United States at the time the alleged improvements were made, for which subsequent purchasers from the government agreed to pay. These subsequent purchasers were not the owners of the lands at the time the improvements were made. Consequently, they could not have been made for their benefit.

From what has been said, we are of the opinion that the court below erred in the ruling complained of; that is to say, in sustaining the demurrer, and for this error the case is reversed and remanded.

Reversed and remanded.

Reflection

Webb illustrates that, sometimes, a material benefit received in the past can be consideration if there was a subsequent promise for it and it was for emergency services or necessities. Moral obligation alone cannot be sufficient consideration unless there was a prior legal or equitable obligation. In this case, a moral obligation did not stand alone; McGowin received a material benefit from the promisee.

Webb had saved McGowin's life without any inducement. McGowin subsequently promised to pay Webb for saving his life. Thus, there is no consideration, and the court must look toward alternatives. Here, unlike *Mills*, the case did not rest upon only a moral obligation to carry out the promise. McGowin materially benefited because he

was saved from death or serious bodily injury. Therefore, because McGowin made a subsequent promise to compensate for a material benefit, the promise between McGowin's estate and Webb is binding.

Discussion

1. The *Webb* court distinguishes this case from ones where “the consideration is a mere moral obligation.” What consideration does the court here find? Does it find it under the benefit/detriment test or the bargained-for exchange test?
 2. Would a modern court applying the R2d approach find consideration in this case? Why or why not?
 3. If it were possible to freeze time at the very moment when Webb had the choice to injure himself to save McGowin's life, what do you think the parties would have bargained to do? Would McGowin have traded his life in exchange for lifetime payments to Webb? Does your answer to the question tend to support or refute the holding in *Webb*?
 4. McGowin was extremely wealthy and, in fact, owned the mill in which Webb worked. Should this impact the court's reasoning in any way?
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Reading Haynes Chemical Corp. v. Staples & Staples. A gift is defined as the voluntary transfer of property to another without compensation. By definition, one does not expect something in return for a gift. One does not give a gift in order to get some sort of consideration in exchange. True gifts are, therefore, gratuitous, that is, they are given without any expectation of exchange.

But this usage of gift as *donum gratuitum* is not necessarily how the term is used in commercial circumstances. Consider a situation where you get a “free \$10 Amazon gift card” for answering a “brief, 73-question marketing survey.” Is the marketing firm truly looking to give away Amazon gift cards, and the survey is simply the means by which one acquires that gift? Or is something else going on beyond what is nominally being said? The situation appears to be closer to a bargain than to a gift because the marketing company wants (and is willing to “pay”) for your information, and you are only completing the survey to get the gift card. This represents an exchange, distinguishable from gifts between friends. In fact, the presumption that parties are giving each other gifts generally does not apply to such commercial relationships.

In the *Haynes Chemical* case, two commercial parties entered into a relationship where an advertising firm agreed to produce a trial advertising campaign

for another company. If the company was not pleased with the campaign, it could have simply dismissed the advertising firm without incurring liability. But, instead, the company expressed a great deal of pleasure with the advertising product. The company even insisted on paying the advertising firm for the work. But, following some changes in management, the company ended up refusing to pay.

On the one hand, the trial advertising campaign was given without the support of consideration. There was no express agreement that the company would pay for the campaign. In this sense, the campaign was a gift. On the other hand, businesses like this do not usually give purely gratuitous gifts to each other. The commercial context implies that there were some strings attached, or at least some hope that this work would generate future business. But even that hope is not enough to make the company pay for the advertisement. After all, how much would a court charge? It is too uncertain. But then, when the recipient of such a “gift” promises to pay a specific amount for it, that promise may function as a substitute for consideration.

Haynes Chemical Corp. v. Staples & Staples

133 Va. 82 (1922)

WEST, J., delivered the opinion of the court.

The defendant in error, Staples & Staples, Incorporated, hereinafter called the plaintiff, recovered a judgment against the plaintiff in error, Haynes Chemical Corporation, hereinafter called the defendant, in the law and equity court of the city of Richmond for the sum of \$707.09, with interest from February 28, 1921, till paid. The case is here upon a writ of error to that judgment.

The plaintiff and defendant are both corporations duly chartered under the laws of the state of Virginia.

The defendant is engaged in the manufacture and sale of an insecticide product known as “Preventol.”

The plaintiffs are engaged in the advertising business, styling themselves as, “Advertising Counsellors,” who advise the manufacturers of the country as to how to market their products; there being over 100 of these advertising agencies in this country. A manufacturer desiring to put a product upon the market, selects an agent, and directs him to map out plans for marketing his product. The agent’s remuneration for handling the advertising campaign usually consists of a commission of 15 percent on the space which the manufacturer buys and is paid by the publishers. The cost of drawings, displays, and matters of that kind is invariably paid for by the manufacturer of the goods.

In August, 1919, C.P. Hasbrook, treasurer and a director of the defendant corporation, had an interview with H.L. Staples, president, and J.W. Fawcett, vice president, of

the plaintiff corporation, and commissioned them to prepare an advertising plan for the defendant, showing them how to put "Preventol" on the market, promising them their plans would receive the heartiest consideration on the part of his people, and, if satisfactory, the advertising under such plan would go to them. The plaintiff does not submit plans in competition, and no notice of competition was given it until its plans had been perfected and submitted.

Acting under instructions of Director Hasbrook, the plaintiff proceeded to make the plans without expectation of payment therefor, if satisfactory, as in that event the plaintiff would be selected to handle the campaign and make his commission out of the publishers; and if unsatisfactory, it would be entitled to nothing, provided, in either event, a decision in good faith was made on the merits of the plan. Later, Hasbrook requested the plaintiff to speed up the plan, and on October 12, 1919, Staples and Fawcett presented the plan to C.P. Hasbrook treasurer and director, L.G. Larus, director, and Roger Topp, vice president and general manager of the defendant corporation, all three of whom expressed themselves as satisfied with the campaign plan in all respects.

Hasbrook and Larus left the room stating that Topp, as general manager, was the man to sell, and would have the last say; and at their suggestion the plans were left at defendant's office for their study. Later Hasbrook attended a meeting of the board of directors of his company in New York, taking with him the proxy of Larus. Having no notice of the meeting, no representative of the plaintiff was present to explain the plan, nor was the plan itself, the sketches, statistics, merchandise data, or results of trade investigations there. At the close of the meeting, Hasbrook telegraphed Topp:

Our president deems it necessary to have a New York agent. Advise Staples.

The plaintiff, on condition of a fair decision, on its merits, had spent a large sum of money to produce a satisfactory plan, and there is nothing in the telegram to indicate that the plan was not satisfactory. Later Topp said to Staples and Fawcett, in discussing what happened at the New York meeting:

It looks like you got the rough end of the poker; however, you did a good job; your work was fine; and we feel you ought to be recompensed, and we would like for you to send us a bill for your expenses.

The bill was sent, but not paid, and this suit was brought to collect it.

The defendant's assignments of error are to the action of the court:

- (1) In refusing certain instructions asked for by the defendant;
- (2) In granting certain instructions;
- (3) In overruling defendant's motion to set aside the verdict of the jury;
- (4) In entering judgment upon the verdict.

The instructions granted by the court were as follows:

Instruction No. 1:

“The court instructs the jury that if they believe from all the evidence that the defendant requested the plaintiff to devise and submit a plan of advertising to them, and it was known to the defendant that the costs and expenses were connected with the work to be done by the plaintiff, and no express agreement was made between the parties with reference to payment for the services of the plaintiff, then the jury may infer from the evidence an implied contract on the part of the defendant to reimburse the plaintiff for such expenses in connection with getting up the advertising plan as were reasonably within the contemplation of the parties.”

Instruction No. 2:

“The court instructs the jury that if they believe from the evidence that the plaintiff performed certain work at the instance and request of the defendant, and thereafter the defendant acknowledged liability to the plaintiff for the expenses incident thereto and promised to pay the same, they shall find for the plaintiff in whatever amount they deem reasonable under all the circumstances of the case for such expenses.”

Instruction No. 3:

“The court instructs the jury that if they believe from the evidence that the defendant did no more than to agree that the plaintiff should devise and submit to it for its acceptance a plan for an advertising campaign, then the defendant is not liable to the plaintiff for any expenses incurred in and about getting up the plan to submit to the defendant.”

Instruction No. 4:

“The court instructs the jury that if they believe from the evidence that it was understood between the parties the plaintiff was merely to offer plans or specifications or a plan for advertising the product of the defendant for sale, and whether such specifications or plan were offered in competition with others or not, then the defendant is not liable for the expense of getting up such a plan unless accepted by it.”

Instruction No. 5:

“The court instructs the jury that where one party requests of another an opportunity of submitting an offer, then unless it be in the minds of both parties and understood and agreed at that time that the party making the offer is to be reimbursed for his expenses in submitting the same, then the law does not raise an implied contract for such reimbursement unless the jury shall further believe that there is a custom and usage equally within the knowledge of both parties and with reference to which they can be necessarily presumed to have contracted, calling for such reimbursement.”

Instructions numbered 1 and 2 were given by the court at the request of the plaintiff; instruction numbered 3 was given by the court of its own motion, after refusing instructions offered by the defendant; instruction numbered 4 was given by the court in lieu of instruction “B,” as requested by the defendant; and instruction numbered 5 was given at the request of the defendant.

Where one renders services for another at the latter’s request, the law, in the absence of an express agreement, implies a promise to pay what those services are reasonably worth, unless it can be inferred from the circumstances that those services were to be rendered without compensation.

It plainly appears from the evidence that the primary consideration which moved the plaintiff to prepare the advertising plan was the assurance of the representative of the defendant corporation that his people would give the plan heartiest consideration, which meant nothing less than a full and fair consideration of the plans and specifications upon their merits, by the proper authorities of that corporation.

The record shows that the board of directors, which, according to the present contention of the defendant, was alone authorized to pass upon them, never gave the plaintiff an opportunity to present its plans, and, without seeing them, and without regard to their merits, gave the contract to another agency, because the president of the company felt they should have a New York agent. In view of such conduct on the part of the defendant, it cannot be “inferred from the circumstances” that the services of the plaintiff, so far as concerns the expenses incurred by it, were to be rendered without compensation, and we are of opinion that the law implies a promise to pay any reasonable amounts expended by the plaintiff in complying with the request of the defendant to prepare the plans.

A person cannot request another to pay out money, or perform services for him, upon his agreement to render certain services for that person, and then, after the money is paid, or the services performed, refuse to keep his agreement and escape liability for the amount of money or labor so expended at his request.

It is said by the Supreme Court of Massachusetts in *Williams v. Bemis*:

The defendant having refused to perform [the contract], the party paying the money or rendering the services in pursuance thereof, may treat it as a nullity, and recover the money or value of the services under the common counts

There is evidence that the vice president and general manager of the defendant corporation, after the contract was awarded the New York agent, said to the vice president of the plaintiff company that they had considered the matter, and felt that the plaintiff should be compensated, and asked him to send bill for expenses.

The defendant contends that a subsequent express promise does not create any new cause of action, and is without consideration, except in those cases where the circumstances are such that an implied promise to pay arises under the law, and relies with confidence on a line of cases of which the following is representative: *Stout v. Humphrey*, where it is said:

An express promise, therefore, as it should seem, can only revive a precedent good consideration, which might have been enforced at law through the medium of an implied promise, had it not been suspended by some positive rule of law, but can give no original right of action if the obligation on which it is founded never could have been enforced at law, though not barred by any legal maxim or statute provision.

In the case of *Beaumont v. Reeve*, the rule is thus stated, and it is quoted by Mr. Chitty in the text of his work on contracts (volume 1, p. 54):

An express promise cannot be supported by a consideration from which the law would not imply a promise, except where the express promise does away with a legal suspension or bar of a right of action which, but for such suspension or bar, would be valid.

In our view, there is nothing in this line of cases which should deprive the plaintiff of its right to a recovery, as there was an implied promise to pay the amount expended at the defendant's request.

The defendant questions the authority of Hasbrook to bind the corporation by a contract of this nature.

It appears from the evidence that Hasbrook was treasurer and director, Larus, director, and Roger Topp, vice president and general manager of the defendant corporation, all of whom resided in Richmond, and that they constituted three of the five stockholders of the corporation, the remaining two, including the president, being residents of New York.

The general manager had full authority and was in active charge of the business of the company and was made vice president to increase his authority.

Hasbrook requested the work to be done, and promised that the plans would have the heartiest consideration of his people, and that, if approved, the defendant would be given the contract.

The plans were in preparation for several months, during which time it is presumed that he informed the proper officials of his company as to the agreement he had made with the defendant, as he sent defendants a request to speed up the plans. When completed, the plans and specifications were submitted to these three gentlemen, all of whom received and inspected them, without any suggestion from the vice president that Hasbrook had exceeded his authority in the premises. All three declared the plans satisfactory. Hasbrook and Larus, upon leaving, informed Staples that Topp, vice president and general manager, was the man they would have to sell; that he would have the last say. There is nothing in the record to show that any member of the board of directors at the New York meeting questioned Hasbrook's authority. On the contrary, his telegram intimates that the board had no objection to the plans, but the president felt the contract ought to go to a New York agent.

In *Winston v. Gordon*, this court held:

An act of an agent from which he derives no personal benefit, but which is done in good faith for the benefit of his principal, and which was apparently necessary and would redound to his benefit, will be held to have been ratified and acquiesced in, and be thereby rendered valid upon slight evidence.

And it is said:

This doctrine . . . is as applicable to corporations as to other principals.

The contract under consideration, entered by one director, was within the charter powers of the corporation, and was made, the circumstances tend to show, with the knowledge and consent of the vice president and general manager and another director of the company.

In *Am. B.H.O.S. Mach. Co. v. Burlack*, the court said:

There are so-called corporations which for all practical purposes, when they do business, cannot be reached at all, if we are not permitted to treat the only known or accessible embodiment in any other way than according to the character the manager may see fit for the occasion to assume. He is possessed of full authority to talk and act where there is anything to be gained, but he is not the proper man to talk or act when there is anything to be lost; and yet the principal, for all practical purposes, if not often in reality, is represented in no other way except by a name, so that a species of legerdemain is carried on—"now you see it, and now you don't." The ordinary business world is becoming tired with, if not vexed at, this sort of jugglery, and thinks that the true principles of evidence and of agency are not so narrow or so rigid that they may not be made to reach such cases.

Admitting that the making of the contract was irregular in its inception, those who governed the corporation will be held, by their conduct, to have waived such irregularity, and the corporation is estopped to rely on it as a defense to this action.

We find no error in the instructions granted of which the defendant can complain; and are of the opinion that the jury were fully and fairly instructed, and that there is no error in the court's refusal to grant instructions.

Upon the record we are unable to say that the verdict of the jury is plainly wrong, or without evidence to support it.

For the foregoing reasons the judgment complained of will be affirmed.

Affirmed.

Reflection

In *Haynes Chemical*, the plaintiff made plans to advertise the defendant's product without expectation of payment. If the plaintiff were chosen to run the campaign, then it would receive payment. However, the plaintiff's advertising plan was not selected.

The telegraph informing the plaintiff that the director wished to hire a New York agent made no mention of the plan's being unsatisfactory. After the plaintiff was informed that it was not selected to run the campaign, the chemical company reached out to the plaintiff, letting it know that they realized the amount of money spent on the campaign and wished to reimburse it for the cost. The plaintiff submitted its bills but was not reimbursed.

In this case, the intention that moved the plaintiff to create the advertising plan was not to receive immediate payment but for the company to honestly consider their plan. However, after the plaintiff was not selected to run the campaign, the defendant made the promise to reimburse the plaintiff.

A person cannot request another to pay out money, or perform services for him, upon his agreement to render certain services for that person, and then, after the money is paid, or the services performed, refuse to keep his agreement and escape liability for the amount of money or labor so expended at his request.

The chemical company requested that the advertising firm create an advertising plan in exchange for the chemical company's consideration. However, the chemical company did not consider the plaintiff's plan because the director decided that the company must use an advisor from New York instead. For this reason, the chemical company cannot escape liability for the money and labor that had been expended, since the company did not full-heartedly consider the plaintiff's campaign.

Discussion

1. What did Haynes Chemical promise to Staples & Staples? Did this promise contemplate receiving anything in exchange in the future, or was the promise given in recognition of something done in the past?
 2. The court finds that Haynes Chemical made a contract with Staples & Staples. Would a modern court applying R2d reach the same result? If so, cite the R2d provision that mirrors the rule in *Haynes Chemical*. If not, cite the correlated R2d provision and analyze how it would come out differently under the R2d.
 3. Do business corporations typically give gifts to each other? How does the answer to this question impact the court's interpretation of Haynes's promise to Staples?
 4. Would this case have been decided differently if the companies were small, family-run businesses, where the owners were longtime friends, or if the promises were between family relations who have a long history of giving freely to each other?
 5. What are jury instructions? How can jury instructions impact the disposition of a case? Why might jury instructions be litigated upon appeal?
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Reading Edson v. Poppe. The entire doctrine of promissory restitution requires some of the same elements that are required for a contract-at-law. In both cases, there must be a promise to do something, and a promise to do something in return. But that is where the similarities begin to break down. When promises mutually induce each other, we call the return promise “consideration.” But what happens where the promise and the return promise are separated by time, such that it is logically and chronologically impossible for the return promise to induce the performance of the original promise? For example, if I serve you a hamburger and you eat it, any promise to pay me for that hamburger is not motivated by your desire to incentivize me to cook a hamburger for you. The hamburger has already been cooked, served, and eaten! In truth, all you have done in this scenario is to make a gratuitous promise to me. You may feel morally obligated to follow through on this promise, but absent other circumstances, you are probably not legally required to do so.

One of the other circumstances that can transform a moral obligation into a legal liability is where the original promise was completed pursuant to some other contract. Where a contract formed the basis of a party’s actions, we may feel more confident that the performing party was not simply trying to impose some benefit upon another person. Rather, the contract shows that the completion of that promise was done for good reason, as part of a voluntary exchange.

Unfortunately, contracts do not always work out. The promisee may prove unable to pay the consideration. The promisee may dispute whether the performance meets the criteria required by the agreement. Or the promisee may claim that it no longer wants or needs to pay for the performance because of changed circumstances.

In some of these instances, where one party to a contract already performed but the other side was not ready to perform, a third party who was not part of the original contract but who benefited from it may feel a moral obligation to pay for the performance. A moral obligation is not enough to make for an enforceable agreement, but when the beneficiary manifests a desire to pay for that benefit, that manifestation may constitute a promise that can be binding upon the promisor.

The *Edson* case is a famous example of this situation. A tenant ordered a valuable well to be built. The well was built, but the tenant refused to pay. The landlord, brother of the tenant, seeing how the well improved the value of his land, then agreed to pay for the well. Just like the person who has already eaten the hamburger, the landlord has already received the well, and in both those cases, any promise to pay is gratuitous. But the difference between the scenarios is that the well was constructed pursuant to a valid contract. That may give courts confidence that the well-digger was not simply trying to impose unwanted benefits on landowners.

Edson v. Poppe

124 N.W. 441 (S.D. 1910)

McCOY, J.

The plaintiff recovered judgment upon the verdict of a jury in the circuit court. The case was tried upon the following complaint: That the defendant at all the times hereinafter named was the owner of the following described premises situated in Turner county, S.D., to wit (describing the land). That at all the times herein named George Poppe was in possession of said premises as the tenant of defendant. During the year 1904 this plaintiff, at the instance and request of said George Poppe, drilled and dug upon said premises a well 250 feet deep, and obtained water in said well, and placed casing therein. The reasonable value of the digging and casing of said well was and is the sum of \$250 and said well was and is a valuable improvement upon the said premises, and greatly adds to the value thereof. It has been used by the occupants of said premises since the said digging thereof.

Accordingly, with the knowledge and consent of defendant; that on or about the 5th day of August, 1905, the defendant, at the said premises, after having examined the said well, and in consideration of the said well to him, and of the improvement it made upon said premises, expressly ratified the acts of his said tenant in having said well drilled. He then and there promised and agreed to pay plaintiff the reasonable value of the digging and casing of the said well as aforesaid.; Defendant has since refused, and still refuses, to pay plaintiff anything for said well. Wherefore, etc.

To the said complaint, defendant made the following answer: Denies generally and specifically each and every allegation in said complaint, except such as is hereinafter specifically admitted. Defendant admits that he is the owner of the said premises as stated in the complaint. At the opening of the trial, and upon the offer of testimony on the part of plaintiff, defendant objected to the introduction of any evidence. For the reason that the complaint did not state a cause of action, in that the consideration alleged in the contract is a past consideration, and no consideration for any promise, if any was made, and no consideration for the promise alleged. The objection was overruled, and defendant excepted. This ruling of the trial court is assigned and now urged as error, but we are of the opinion that the ruling of the learned trial court was correct.

It seems to be the general rule that past services are not a sufficient consideration for a promise to pay therefor, made at a subsequent time, and after such services have been fully rendered and completed; but in some courts a modified doctrine of moral obligation is adopted, and it is held that a moral obligation, founded on previous benefits received by the promisor at the hands of the promisee, will support a promise by him. The authorities are not so clear as to the sufficiency of past services, rendered without previous request, to support an express promise; but, when proper distinctions are made, the cases as a whole seem to warrant the statement that such a promise is supported by a sufficient consideration if the services were beneficial, and were not intended to be gratuitous.

In *Drake v. Bell*, a mechanic, under contract to repair a vacant house, by mistake repaired the house next door, which belonged to the defendant. The repairing was a benefit to the latter, and he agreed to pay a certain amount therefor. It was held that the promise rested upon sufficient consideration. Gaynor, J., says: "The rule seems to be that a subsequent promise, founded on a former enforceable obligation, or on value previously had from the promisee, is binding."

In *Glenn v. Savage*, it was held that an act done for the benefit of another without his request is deemed a voluntary act of courtesy, for which no action can be sustained, unless after knowing of the service the person benefited thereby promises to pay for it.

In *Boothe v. Fitzpatrick*, it is held that if the consideration, even without request, moves directly from the plaintiff to the defendant, and inures directly to the defendant's benefit, the promise is binding though made upon a past consideration. In this case the court held that a promise by defendant to pay for the past keeping of a bull, which had escaped from defendant's premises and been cared for by plaintiff, was valid, although there was no previous request, but that the subsequent promise obviated that objection; it being equivalent to a previous request.

The allegation of the complaint here is that the digging and casing of the well in question inured directly to the defendant's benefit, and that, after he had seen and examined the same, he expressly promised and agreed to pay plaintiff the reasonable value thereof. It also appears that said well was made under such circumstances as could not be deemed gratuitous on the part of plaintiff, or an act of voluntary courtesy to defendant. We are therefore of the opinion that, under the circumstances alleged, the subsequent promise of defendant to pay plaintiff the reasonable value for digging and casing said well was binding, and supported by sufficient consideration. We are also of the opinion that the instructions based on this complaint, and in particular as to the validity of the subsequent promise of defendant, properly submitted the issues to the jury.

At the close of plaintiff's evidence, and again at the close of all the evidence on both sides, defendant moved for a directed verdict. Both motions were overruled. Defendant excepted, and now assigns such rulings as error; but, as the evidence is not contained in the abstract on which these motions were based, the assignment cannot be considered. Neither can we consider assignments of error based on evidence or objections to evidence not shown by the abstract.

Finding no error in the record, the judgment of the circuit court is affirmed.

Reflection

Edson demonstrates that when a third person subsequently promises to pay for the benefit received under another's contract, that promise can be binding. Here, William Poppe received a material benefit that was not intended to be gratuitous. He then subsequently promised to compensate Edson for the benefit. Therefore, the subsequent promise is binding.

Discussion

1. The *Edson* court references the *Drake* (the accidental home repair) and *Boothe* (the errant bull) cases. Does it use these cases as authority for rules, as factual analogies, as distinctions, or something else?
2. The defense is based on the claim “that the complaint did not state a cause of action, in that the consideration alleged in the contract is a past consideration.” Explain what this means.
3. In *Mills*, the court found there was no enforceable promise; in *Edson*, the court found there was. Can you distinguish the key facts of these cases such that the same rule applies to both, even though it produces different results?

Reading Muir v. Kane. There are many reasons why a promise turns out to be unenforceable. Parties who intended to contract may have failed to include enough definition in the terms of the agreement for a court to enforce it. The contract may be of a sort which requires a signed writing to be enforceable, but it lacks such a writing. The contract may have emerged from a mistake about the nature of the subject matter. Even changed circumstances after a valid formation can excuse an obligation and make it unenforceable.

In the *Muir* case, a man owed a debt. But the collection of this debt was unenforceable because the debt agreement was not in writing and a state statute required such contracts to be in writing. Perhaps in recognition of the unfairness of this situation, the debtor—an attorney—renewed his promise to pay the debt. Note that the renewed promise was not supported by consideration. When he made the renewed promise, the debtor already had received the services. He did not make this promise in order to get a loan but rather in recognition of his moral obligation to repay it.

Muir v. Kane

55 Wash. 131 (1909)

FULLERTON, J.

The respondent brought this action to recover of the appellants the sum of \$200, alleged to be due pursuant to a written agreement executed and delivered to him by the appellants, whereby they agreed to pay him the sum of \$200 for his services in selling for appellants a certain tract of real property.

Issue was taken on the complaint, and a trial had thereon which resulted in a judgment in his favor for the amount claimed to be due. The case was tried by the court

sitting without a jury. No question is raised as to the correctness of the facts found, but the case is here on the question whether these facts justify the judgment of the court.

The court's findings of fact are as follows:

"(1) That now and at all times herein referred to the plaintiff is and was doing a general real estate business in Seattle, Wash., under the firm name and style of B.L. Muir & Co., being the sole owner thereof.

"(2) That now and at all times concerned herein the defendants are and were husband and wife.

"(3) That on or about the 21st day of November, 1906, the defendants made, executed, and delivered to the plaintiff their written agreement, agreeing to pay said plaintiff \$200 for his services in selling for them a certain parcel of real estate; said agreement being in words and figures, to wit:

M. Francis Kane and Ida Kane, his wife, agree to sell and Paul Bush agrees to buy the following described real estate situated in the county of King, state of Washington, to wit: South 40 feet of lot 1, block 17, J.H. Nagle's addition to the city of Seattle, for the sum of nine thousand six hundred dollars (\$9,600) the purchaser having paid the sum of five hundred dollars (\$500) the receipt of which is hereby acknowledged, as earnest money and part payment for said land, the same to be held in trust by B.L. Muir & Co. until the sale is closed or canceled and the balance of said purchase price shall be paid as follows, or as soon after said dates respectively as the title to said real estate is shown to be marketable, to wit: Three thousand dollars (\$3,000) on or before the 22nd day of Nov., 1906, at 1 p. m.; nineteen hundred dollars (\$1,900) on or before the 22nd day of Nov., 1907, at 1 p. m.; four thousand dollars (\$4,000) according to certain mortgage to be executed due in three years from date. The purchaser agrees to pay interest at the rate of six percent, payable semiannually on all deferred payments. The vendor agrees to furnish an abstract of title made by a reliable abstract company for said real estate, showing a marketable title of record in the vendor free from encumbrances to date of conveyance, except the street assessments amount to about two hundred dollars (\$200) and if over \$200 the surplus to be deducted from the nineteen hundred payment which the purchaser assumes and agrees to pay as a part of the above named purchase price, and the vendor further agrees to transfer said property to the purchaser by a good and sufficient warranty deed to the said vendee or his assigns and pay two hundred dollars (\$200) of the purchase price to B.L. Muir & Co., for services rendered. The purchaser shall have one day's time after the delivery of said abstract for examination of same, and in case the abstract shall show a marketable title in the vendor, this sale shall be completed, and if the said title is not marketable and cannot be made so, then B.L. Muir & Co. shall refund to the said vendee the above named earnest money, and the sale shall be canceled, the deposit of \$500 to be paid to Mrs. Ida Kane in the event of the purchaser failing to comply with this agreement.

Witness our hands this 21st day of November 1906. Signed and delivered in the presence of B.L. Muir. M. Francis Kane. [Seal.] Ida Kane. [Seal.] Paul Bush. [Seal.]'

“(4) That the plaintiff did make the sale referred to in said written contract and which sale was accepted by the defendants, but they have since failed, neglected, and refused to pay the aforesaid two hundred dollars (\$200) commission allowed, although the same is long past due and still the property of the plaintiff.”

The statute governing contracts for commissions for buying or selling real estate provides that any agreement authorizing an employee, as an agent, or broker, to sell or purchase real estate for compensation or a commission, shall be void unless the agreement, contract, or promise or some note or memorandum thereof be in writing.

The appellants contend that the writing relied upon by the respondent is insufficient under the statute; that it is not an agreement authorizing the respondent to sell the real property described for compensation or commission, nor does it authorize or employ the respondent to sell real estate at all. Manifestly, if the writing sued upon was intended as an agreement authorizing the respondent to sell real estate of the appellants, it is faulty in the particulars mentioned, and so far, deficient as not to warrant a recovery even if a sale had been made thereunder. But we do not understand that this is the question presented by the record. This writing was not intended as an agreement authorizing the respondent to sell the real property mentioned. In fact, it was executed after that service had been performed, and is an agreement in writing to pay a fixed sum for a past service, not a service to be performed in the future.

The question for determination is its validity as a promise to pay for a past service. Looking to the instrument itself, there is nothing on its face that in any manner impugns its validity. It is a direct promise to pay a fixed sum of money for services rendered. Prima facie, therefore, it is legal and valid; and, if it is illegal at all, it is because the actual consideration for the promise, which was alleged and proven, rendered the promise illegal. This consideration was the sale of real property for the appellants by the respondent acting as a broker without a written agreement authorizing the service, and it is thought that, because the statute declares an agreement for such a service void unless in writing, the service furnishes no consideration for the subsequent promise, since the service must either have been founded upon an invalid agreement or was voluntary.

There are cases which maintain this doctrine. In *Bagnole v. Madden*, the precise question was presented. There the plaintiff had been orally authorized by the defendant to sell a parcel of real estate owned by the defendant. A purchaser was found, and a contract of sale entered. The defendant thereupon executed a written agreement, and delivered the same to the plaintiff, wherein she promises to pay him \$50 for his services. In an action brought upon the writing, the court held that she could not recover because of the invalidity of the original oral contract authorizing the services; it being in violation of the statute declaring such agreement void unless in writing.

The case was rested on a decision of the Court of Errors and Appeals, which announced the same doctrine, but upon a state of facts not quite the same; the subsequent promise to pay being oral instead of in writing. During its opinion in the latter case the court said: "It is clear that if a contract between two parties be void, and not merely voidable, no subsequent express promise will operate to charge the party promising, even though he has derived the benefit of the contract. Yet, according to the commonly received motion respecting moral obligations, and the force attributed to a subsequent express promise, such a person ought to pay. An express promise, therefore, as it should seem, can only revive a precedent good consideration which might have been enforced at law through the medium of an implied promise had it not been suspended by some positive rule of law, but can give no original right of action if the obligation on which it is founded never could have been enforced at law, though not barred by any legal maxim or statute provision."

The court, it will be observed, makes a distinction between contracts formerly good, but on which the right of recovery has been barred by the statute, and those contracts which are barred in the first instance because of some legal defect in their execution, holding that the former will furnish a consideration for a subsequent promise to perform, while the latter will not. It has seemed to us that this distinction is not sound. The moral obligation to pay for services rendered as a broker in selling real estate under an oral contract where the statute requires such contract to be in writing is just as binding as is the moral obligation to pay a debt that has become barred by the statute of limitations; and there is no reason for holding that the latter will support a new promise to pay while the former will not.

There is no moral delinquency that attaches to an oral contract to sell real property as a broker. This service cannot be recovered for because the statute says the promise must be in writing, not because it is illegal in itself. It was not intended by the statute to impute moral turpitude to such contracts. The statute was intended to prevent frauds and perjuries, and, to accomplish that purpose, it is required that the evidence of the contract be in writing; but it is not conducive to either fraud or perjury to say that the services rendered under the void contract or voluntarily will support a subsequent written promise to pay for such service. Nor is it a valid objection to say there was no antecedent legal consideration.

The validity of a promise to pay a debt barred by the statute of limitations is not founded on its antecedent legal obligation. There is no legal obligation to pay such a debt, if there were there would be no need for the new promise. The obligation is moral solely, and, since there can be no difference in character between one moral obligation and another, there can be no reason for holding that one moral obligation will support a promise while another will not.

Our attention has been called to no case, other than the New Jersey case above cited, where the facts of the case at bar are presented. A case in point on the principle involved, however, is *Ferguson v. Harris*. Certain persons without authority from

the defendant had ordered lumber and used it in the erection of a building on the defendant's separate property; she being a married woman. Subsequently she gave her promissory note therefor, and, when an action was brought upon the note, she sought to defend on the ground of want of consideration. It was conceded that there was never any legal obligation on the part of the defendant to pay for the lumber, but that her obligation was wholly moral. It was thereupon urged that such an obligation was insufficient to support the promise.

Speaking upon this question, the court said: "All of the authorities admit that where an action to recover a debt is barred by the statute of limitations, or by a discharge in bankruptcy, a subsequent promise to pay the same can be supported by the moral obligation to pay the same, although the legal obligation is gone forever; and I am unable to perceive any just distinction between such a case and one in which there never was a legal, but only a moral, obligation to pay. In the one case the legal obligation is gone as effectually as if it had never existed, and I am at a loss to perceive any sound distinction in principle between the two cases. In both cases, at the time the promise sought to be enforced is made there is nothing whatever to support it except the moral obligation, and why the fact that, because in the one case there was once a legal obligation, which, having utterly disappeared, is as if it had never existed, should affect the question, I am at a loss to conceive. If in the one case the moral obligation, which alone remains is sufficient to afford a valid consideration for the promise, I cannot see why the same obligation should not have the same effect in the other."

The remark made by Lord Denman in *Eastwood v. Kenyon*, that the doctrine for which I am contending "would annihilate the necessity for any consideration at all, inasmuch as the mere fact of giving a promise creates a moral obligation to perform it," is more specious than sound, for it entirely ignores the distinction between a promise to pay money which the promisor is under a moral obligation to pay, and a promise to pay money which the promisor, is under no obligation, either legal or moral, to pay. It seems to me that the cases relied upon to establish the modern doctrine, so far as my examination of them has gone, ignore the distinction pointed out in the note to *Comstock v. Smith*, above cited, between an express and an implied promise resting merely on a moral obligation, for, while such obligation does not seem to be sufficient to support an implied promise, yet it is sufficient to support an express promise.

To the same effect is *Anderson v. Best*, wherein it was said: "The distinction sought to be made between considerations formerly good but now barred by statute, and those barred by statute in the first instance, is not substantial, and is not sustained by the cases."

Believing, as we do, that the better rule is with the cases holding the moral obligation alone sufficient to sustain the promise, it follows that the judgment appealed from should be affirmed. It is so ordered.

RUDKIN, C. J., and GOSE, CHADWICK, and MORRIS, JJ., concur.

Reflection

The issue for determination in the *Muir* case regards the validity of a promise to pay for a past service. *Muir* states the rule that where an action to recover a debt is barred by the statute of frauds, a subsequent promise to pay the same can be supported by the moral obligations to pay the same. However, the legal obligation is gone forever.

In the *Muir* case, the consideration was the sale of real property for the appellants by the respondent acting as a broker. However, there was no written agreement authorizing such service, and the statute of frauds declares an agreement for such a service void unless in writing. For this reason, the service furnished no consideration for the subsequent promise.

The validity of a promise to pay a debt barred by the statute of frauds is not founded on its antecedent legal obligation. There is no legal obligation to pay such a debt; if there were, there would be no need for the new promise. The obligation is solely moral, and, since there can be no difference in character between one moral obligation and another, there can be no reason for holding that one moral obligation will support a promise while another will not.

The main takeaway from *Muir* is that where an action to recover a debt is barred by the statute of frauds, a subsequent promise to pay the same can be supported by moral obligation—and promissory restitution—to pay the same, but the legal obligation is gone forever.

Discussion

1. What does the *Muir* court mean when it states that moral obligation alone may be sufficient to sustain a promise?
 2. The statute at issue, which requires contracts promising real estate commission to be evidenced by a signed writing, is a type of statute of frauds. What purpose does the statute serve here? In other words, why should courts require real estate commissions to be evidenced by signed writings?
 3. The *Muir* opinion cites long provisions from cases that distinguish consideration formerly good but now barred from “consideration” that was never good. Can you apply this distinction to *Mills* and to the other cases in this chapter?
 4. Is there any doubt that the seller agreed to pay the real estate commission? Does the clear and substantial nature of the promise seem to have any impact on the court’s willingness to enforce it? Should that be a factor? What about the seller’s profession as attorney? Should attorneys be held to higher moral standards than laypersons?
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Problems

Problem 9.1. IRAC *Edson*

Under R2d, promises without consideration are generally unenforceable; however, the doctrine of promissory restitution makes promises to pay for a past benefit received enforceable where some plus factor applies. *Edson* is a classic case where the court found that justice required promissory restitution—but why? And, noting that *Edson* was decided even before the first Restatement of Contracts, would it still be so decided under the R2d? In other words, what was the plus factor in *Edson*, and does this factor “count” under the R2d? Answer this question using the IRAC writing paradigm; that is, first write the issue regarding this particular element of promissory estoppel: “Whether *Edson* merits enforcement of Poppe’s promise based on promissory restitution, where . . . ?” Include key material facts after the where clause. Second, write and cite the key rules from the R2d needed to answer this question (including the rule for promissory restitution) before analyzing the facts of this case under those rules. Finally, conclude whether *Edson* merits promissory restitution.

Problem 9.2. Annihilation of Consideration

The opinion in *Muir* defends its holding against the claim by Lord Denman in *Eastwood* that the doctrine espoused in *Muir* “would annihilate the necessity for any consideration at all, inasmuch as the mere fact of giving a promise creates a moral obligation to perform it.” The *Muir* court retorts that Denman’s remark “is more specious than sound, for it entirely ignores the distinction between a promise to pay money which the promisor is under a moral obligation to pay, and a promise to pay money which the promisor, is under no obligation, either legal or moral, to pay.” What do you make of these competing rationales for two competing doctrines? First, discuss whether it is easy and readily possible to distinguish between promises made pursuant to a moral obligation and promises made pursuant to no obligation. Second, discuss whether the doctrine should be as *Muir* argues it should, that is, whether promises made pursuant to moral obligations should be enforceable? Does the *Muir* doctrine “annihilate” the consideration doctrine?

MODULE III

Defenses

Contract law developed out of the idea that promises deserve legal protection. But this protection is not without limits. Previously, you learned that the consideration requirement limits courts' scope of enforcement to promises involving a bargained-for exchange. You also saw how equitable doctrines such as promissory estoppel expand this scope.

Now we will learn the defenses to contract formation, which narrow the scope of protection again by giving the defendant in a contract dispute a way to argue that a contract is unenforceable or should be voided or rescinded by the court.

These limitations on contract enforceability are considered defenses because they must generally be raised by the party seeking to get out of the contract—the defendant. They are, in this sense, affirmative defenses, which can be waived if they are not brought, and which the defendant has the burden to plead and prove.

After the plaintiff proves there is a valid contract supported by mutual assent and consideration (or an alternative to consideration), the defendant can avoid this otherwise-valid contract by raising a defense. As a matter of civil procedure, defendants usually have to raise defenses in the answer or a motion to dismiss. If defenses are not timely raised, they may be waived.

The first defense is the statute of frauds, which bars enforcement of certain oral contracts unless they are in writing.

The second category is mistake. Courts may rescind (unwind) a contract if one or both parties had a mistaken belief about an important fact relating to the agreement.

The third category consists of improper bargaining defenses: misrepresentation, duress, and undue influence. These doctrines focus on often-intentional wrongdoing that undermines voluntary consent.

The fourth category is public policy defenses, which address situations where enforcing a contract would harm the public interest. This category includes unconscionability, which prohibits grossly one-sided deals or deals based on unequal bargaining power, and defenses like illegality, which permit courts to find contracts void when they violate a law.

The fifth category is incapacity, which is effectively a codified extension of the more general public policy defenses. Certain categories of persons are deemed incapable of contracting as a matter of public policy. For example, minors can disaffirm contracts made while underage, and persons under guardianship cannot make binding agreements. Similar defenses exist for mental incapacity and, to a lesser extent, intoxication.

In the chapters that follow, you will see how each defense applies in concrete situations. Keep in mind that these black-letter rules reflect deeper questions about fairness, freedom, and the role of courts in shaping private agreements. These defenses help balance the costs of enforcing the wrong promises with the costs of failing to enforce the right ones. By exploring these doctrines, you will better understand how courts determine which promises deserve protection and which do not.

Chapter 10

The Statute of Frauds

A “statute of frauds” is, literally, a statute. It is a law governing the enforceability of certain contracts, passed by a legislative body. A statute of frauds creates an affirmative defense where a party can avoid certain types of contracts where the contract is not evidenced by a signed writing.

The British Parliament passed the original statute of frauds, titled the English Act for Prevention of Frauds and Perjuries, in 1677. It required courts to see some writing signed by the party to be charged (which generally means the party against whom enforcement of the contract is sought) that evidenced a contract—although not necessarily the contract itself—prior to courts’ granting judgment for breach of agreement regarding certain matters.

Statutes of frauds caught on in America, and most states have some version of the original on the books. In fact, many states have not only one but many statutes of frauds. Any statute that requires an enforceable contract to be in writing can be deemed a statute of frauds. Such statutes can appear in different places within one state’s legal code. For example, Pennsylvania’s statute of frauds requiring real estate leases to be in writing is codified in the Pennsylvania Landlord-Tenant Act at 68 P.S. § 250.202; and Pennsylvania’s statute of frauds requiring sales of goods for more than \$500 to be in writing is codified in the Pennsylvania Uniform Commercial Code at 13 P.S. § 2201(a). Most states do not put all writing requirements into a single statute but rather simply add writing requirements to the statutes covering the transactions in question.

Requiring a signed writing serves three functions. First, it creates evidence of contracting, which makes lawsuits easier to adjudicate or dismiss. Second, it cautions contract parties, who should realize that signing or sealing a formal writing is likely to bind them as to the terms therein. Third, it promotes the use of forms of agreement, which are standardized signed writings reflecting common issues that arise in specific types of transactions.

Typically, a statute of frauds issue comes up when one party does not want to be subject to a contract and that contract is either entirely oral or has some potential defect in its writing. When you spot an issue like this, ask three analytical questions to determine whether the statute of frauds prevents enforcement of that contract:

- (1) Does the statute of frauds in this jurisdiction require a signed writing for this general class of contract?

- (2) Is there a signed writing that satisfies the statute?
- (3) If there is no memorandum, do the specific facts suggest an equitable exception to the statute of frauds?

Importantly: Each state must enact its own version of the statute of frauds. This means there is significant variety across the various states. In practice, you should always look up the statute of frauds that applies in your jurisdiction and pay attention to the specific language.

Despite these variations in statutory language, the interpretation and enforcement of the statutes is quite similar across the states. In general, all statutes of frauds have the same effect: *a statute of frauds forbids enforcement of a contract unless it is evidenced by a memorandum signed by the party against whom the contract is being enforced.*

Understanding this effect makes analyzing statute of frauds problems easy. There is a straightforward, three-step process for analyzing every statute of frauds situation.

Rules

A. Classes of Contracts Requiring Signed Writing (MYLEGS)

According to the R2d, most American states have adopted a statute of frauds which covers six classes of contracts. The acronym “MYLEGS” is often used to represent these six classes:

- (1) Marriage
- (2) Year-long (or longer)
- (3) Land
- (4) Executorship
- (5) Goods for \$500 or more
- (6) Suretyship

Many states require additional categories of transactions to be evidenced by a writing to be enforceable. For example, Texas requires a signed writing for an agreement to pay a commission on the sale of mineral rights in the land. *See* TEX. BUS. & COM. CODE § 26.01(b)(7)(D) (2001). On the other hand, many states do not require the traditional categories to be in writing. For example, Louisiana does not require a signed writing for sales of goods. *See* LA. REV. STAT. § 10:8-113 (2016). Check the state legal codes to determine whether a certain type of contract requires evidence of its existence in the form of a signed writing. This book will not cover idiosyncratic state statutes.

Effectively, the statute of frauds requires additional written proof for contracts that fall into one of these six MYLEGS classes.

These categories have remained remarkably stable over time. R2d § 110 lists the same classes of contracts that were included in the English statute of frauds in 1677. Although the English statute was repealed in 1954, except for the suretyship and land contract provisions, many American states still require a signed writing to evidence five classes of contracts that were subject to the original statute of frauds:

- (a) *a contract of an executor or administrator to answer for a duty of his decedent (the Executor-administrator provision);*
- (b) *a contract to answer for the duty of another (the Suretyship provision);*
- (c) *a contract made upon consideration of marriage (the Marriage provision);*
- (d) *a contract for the sale of an interest in land (the Land contract provision);*
- (e) *a contract that is not to be performed within one year from the making thereof (the one-year provision).*

See R2d § 110(1).

The sixth class—sale of goods contracts priced at \$500 or more—was added when the R2d was revised in 1981 to include reference to the Uniform Commercial Code, Article 2. Accordingly, the R2d includes the UCC’s requirement for evidence of a signed writing where there is

- (a) *a contract for the sale of Goods for the price of \$500 or more (UCC § 2-201).*
R2d § 110(2).

These classes may overlap. In other words, a contract may be subject to a statute of frauds for multiple reasons. For example, if a landowner agrees to sell a tract of land, with closing to occur in 366 days, then that contract is subject to two provisions of the traditional statute of frauds: the land provision and the year-long provision.

We will quickly go through each of the six classes. But keep your focus on the most common types of contracts that trigger the statute of frauds: over one year, land, and sale of goods \$500 or more.

1. *Executor/Administrator*

Executors and administrators manage the estate of a decedent (someone who died). The primary difference between them is that an executor is named in the decedent’s will, whereas an administrator is appointed by a court, typically when the decedent didn’t name a valid executor. Many jurisdictions now refer to both as the decedent’s “personal representative.”

A decedent’s personal representative may have the power to enter into contracts on behalf of the decedent’s estate, such as by obligating the estate to make payment to creditors or provide awards to inheritors. These ordinary-course transactions, where

the executor is only obligating the estate and not the executor personally, are not subject to the statute of frauds executor provision. The statute of frauds is only triggered when a personal representative agrees to “answer personally” for the estate:

A contract of an executor or administrator to answer personally for a duty of his decedent is within the Statute of Frauds if a similar contract to answer for the duty of a living person would be within the Statute as a contract to answer for the duty of another. R2d § 111.

In other words, the executor provision only comes up in unusual circumstances where the executor agrees to be personally liable. For example, Sam is appointed executor of Dan’s estate, as Dan recently died. When Dan died, he owed Carl \$10,000. Sam strikes a bargain with Carl by promising to personally guarantee that the estate will pay Carl \$5,000 if Carl agrees to write off the rest of the debt. Sam’s promise is within the executor provision because Sam is personally liable for the remainder of the debt. Sam would likely agree to take on the debt because Sam is the main beneficiary of the estate and would have assumed the estate’s debt anyway. This is also a way to speed up probate.

On the other hand, if Sam simply promises Carl that the estate will pay \$5,000 now instead of Carl waiting for the estate to go through probate, then the agreement is not within the executor provision because Sam is not personally liable for that obligation.

2. Suretyship

Suretyship involves a promise to guarantee that the obligation of another will be performed. This ancient concept has existed for millennia. One of the earliest recorded suretyship agreements, inscribed on a Mesopotamian clay tablet around 2750 BCE, remains illustrative of the principles of suretyship.

In that agreement, a farmer was drafted into the king’s army and had to leave his farm. A second farmer agreed to manage the first farmer’s land in exchange for half the profits. A local merchant promised to ensure that the second farmer fulfilled this obligation. If the second farmer failed, the merchant guaranteed to pay the first farmer his share of the profits. This arrangement involved three roles central to suretyship: an obligor (the second farmer), an obligee (the first farmer), and a surety (the merchant).

The basic structure of suretyship has remained remarkably consistent over nearly 5,000 years. Today, a similar arrangement occurs when a parent co-signs a child’s lease. A landlord might be unwilling to rent to a young person without a credit history. To address this concern, the parent promises to pay the landlord if the child fails to pay rent. This promise ensures that the landlord will receive the rent.

Under the statute of frauds, a suretyship promise is unenforceable unless evidenced by a writing signed by the surety. The Restatement (Second) of Contracts frames this requirement negatively:

A contract is not within the Statute of Frauds as a contract to answer for the duty of another unless the promisee is an obligee of the other's duty, the promisor is a surety for the other, and the promisee knows or has reason to know of the suretyship relation. R2d § 112.

This writing requirement serves two purposes. First, it provides a cautionary function by ensuring that the surety carefully considers the obligations they are undertaking before formalizing their promise. Second, it serves an evidentiary function by requiring a higher burden of proof to establish that a promise of suretyship was genuinely made. These safeguards are particularly important because suretyship is often a gratuitous promise, lacking the consideration present in most other contractual obligations.

3. Marriage

Marriage is a commonly misunderstood topic under the statute of frauds. While many cultures, such as those following Jewish law, use formal contracts like a ketubah to document a marriage, such agreements formalize the marriage itself. These are distinct from contracts upon consideration of marriage, which fall within the statute of frauds.

The marriage provision does not concern marriage contracts or mutual promises to marry. Instead, it applies to contracts where marriage or a promise to marry is exchanged for something else:

A promise for which all or part of the consideration is either marriage or a promise to marry is within the Statute of Frauds, except in the case of an agreement which consists only of mutual promises of two persons to marry each other. R2d § 124.

For example, suppose Joe proposes to Anita, but Anita hesitates because she is concerned about leaving her ailing father without care. Joe promises Anita that if she marries him, he will hire a live-in nurse for her father. In this case, Joe's promise is within the statute of frauds because marriage is being exchanged as consideration for his promise.

Similarly, prenuptial agreements (prenups), in which spouses agree to transfer property or structure their assets in a certain way in consideration of marriage, are typically within the statute of frauds and require a writing. Dowries, in which a parent gives another parent assets in consideration of their children's marriage, are typically within the statute of frauds and require a writing.

By contrast, if Joe and Anita simply promise to marry each other, this agreement is not within the statute of frauds. Although mutual promises to marry were included in the original English statute, American courts excluded them early on as inconsistent with the statutory purpose. Many modern statutes explicitly exclude such promises.



Figure 10.1. A stylized Jewish marriage contract, or ketubah. Note that such a marriage contract, which recognizes a union, is distinct from a contract made upon consideration of marriage, which creates a duty upon consummation of marriage.

4. Land

Land has always held a special place in society, historically serving as a primary source of wealth, power, and security. Its unique characteristics—immovability, irreplaceability, and often subjective value—have made land transactions particularly important and prone to disputes. The English statute of frauds, enacted in 1677, recognized this importance and sought to prevent fraud by requiring that contracts for the transfer of land be evidenced by a signed writing. This principle continues to guide modern statutes of frauds, reflecting the enduring significance of land and the need for careful legal safeguards in its transfer.

The land provision of the statute of frauds is a foundational element in most modern American jurisdictions as well. It requires that any contract involving the transfer

of an interest in land be evidenced by a writing signed by the party to be charged. R2d summarizes this requirement:

A promise to transfer to any person any interest in land is within the Statute of Frauds. R2d § 125(1).

This rule is straightforward in the context of real estate sales. However, it becomes more complex when applied to leases. Most states except short-term leases and contracts to lease from the statute of frauds's land and one-year provisions. R2d provides the general principle:

Statutes in most states except from the land contract and one-year provisions of the Statute of Frauds short-term leases and contracts to lease, usually for a term not longer than one year. R2d § 125(4).

While the Restatement suggests a general rule of exempting leases for one year or less, variations exist among jurisdictions. For example, Pennsylvania requires a writing only for leases exceeding three years. This means that oral leases for three years or less are enforceable in Pennsylvania, aligning with the original English statute of frauds, which also excluded leases "not exceeding the term of three years from the making thereof." Other states, however, strictly adhere to the one-year threshold proposed in the Restatement and require leases longer than one year to be evidenced by a signed writing.

Some jurisdictions also impose additional formalities beyond the basic statute of frauds requirements. For instance, states may mandate notarization or recording of leases above a certain duration to protect third parties or provide public notice. These requirements ensure that longer-term lease agreements are properly documented and reduce the likelihood of disputes over their terms.

Given these variations, it is important to check the specific language of the applicable jurisdiction's statute of frauds to determine what constitutes a short-term lease that is excepted from the writing requirement. Even if a lease does not fall within the land provision of the statute, it may still fall under the one-year provision if performance cannot be completed within a year. This interplay between provisions underscores the importance of understanding both the statutory language and its practical implications.

5. Year

The one-year provision of the statute of frauds applies only to contracts that cannot possibly be performed within one year of their formation:

Where any promise in a contract cannot be fully performed within a year from the time the contract is made, all promises in the contract are within the Statute of Frauds until one party to the contract completes his performance. R2d § 130(1).

For example, if Sally contracts with AT&T for 18 months of cellular service at \$40 per month, this agreement is within the one-year provision. Performance of the contract—providing 18 months of service—cannot possibly be completed within one year. Therefore, a signed writing is required to make the contract enforceable.

The one-year provision focuses on theoretical impossibility, not on what actually happens or what the parties expect. For instance, if Allstate promises to insure Brian's house against fire for five years in exchange for weekly premiums, the contract is not within the one-year provision. This is because the house could theoretically burn down at any time, even within the first year. If it burns down after a month and Allstate promptly pays the claim, the contract would be fully performed in less than a year. Since this outcome is possible, the contract is not subject to the statute of frauds.

Similarly, traditional doctrine holds that contracts for lifetime obligations—such as lifetime employment or free beer for life—are not subject to the one-year provision because the person could die within a year. However, some jurisdictions now treat these agreements differently, reasoning that they should be included within the one-year provision regardless of the possibility of death.

The key to the one-year provision is that contracts of uncertain duration are excluded unless their performance cannot possibly be completed within one year.

Another important exception to the one-year rule involves full performance by one party:

When one party to a contract has completed his performance, the one-year provision of the Statute does not prevent enforcement of the promises of other parties. R2d § 130(2).

For example, if Farmer Fred promises to deliver three shipments of peaches to Grocer Georgia in six months, one year, and eighteen months, the contract initially falls within the Statute of Frauds because Fred cannot perform all his obligations within a year. However, if Georgia pays Fred in full at the time the contract is made, her complete performance removes the contract from the one-year provision, thus making a signed writing unnecessary to enforce Fred's promises under the statute.

This exception ensures that fully performed agreements are not invalidated by technicalities, thereby preserving fairness and reducing the potential for unjust outcomes. Together, these principles illustrate how the one-year provision balances predictability with flexibility in contract enforcement.

6. Goods

The UCC governs contracts for the sale of goods and introduces a specialized statute of frauds. Unlike other statute of frauds provisions, UCC § 2-201 focuses on practical and commercial realities that reflect the unique nature of goods transactions. It establishes a few basic principles.

First, any contract for the sale of goods priced at \$500 or more must generally be evidenced by a signed writing. NH UCC § 2-201(1) mirrors the typical language:

Except as otherwise provided in this section, a contract for the sale of goods for the price of \$500 or more is not enforceable . . . unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker.

Second, merchants are subject to a unique exception to the signed writing requirement. Under the “merchant’s confirmatory memo exception,” if both parties are merchants, and one merchant sends a confirmation of a contract to another merchant, the confirmation satisfies the statute of frauds unless the receiving party objects within ten days. This exception reflects commercial practices where formal contracts are often absent at the outset of performance.

For example, diamond merchants frequently ship valuable stones to prospective buyers without a formal contract. If the buyer retains the stone, the seller follows up with a confirmation memorandum that outlines the terms of the sale. This memorandum satisfies the statute of frauds against the sender, as it demonstrates their intent to form a contract. As NH UCC § 2-201(2) explains:

Between merchants if . . . a writing in confirmation of the contract . . . is received and the party receiving it has reason to know its contents, it satisfies the requirements . . . unless written notice of objection . . . is given within 10 days.

Third, UCC § 2-201(3) identifies three additional exceptions that apply to both merchants and non-merchants:

1. **Special Manufacture Exception:** A contract is enforceable if the goods are specially manufactured for the buyer, cannot be resold in the seller’s ordinary course of business, and the seller has begun production or procurement before receiving notice of repudiation. This exception recognizes that the act of beginning to manufacture unique goods is strong evidence of a contractual relationship.
2. **Party Admission Exception:** A contract is enforceable if the party against whom enforcement is sought admits in court that a contract was formed, though enforcement is limited to the quantity admitted. This ensures that formalities do not override clear evidence of a contract’s existence.
3. **Goods Accepted Exception:** A contract is enforceable for goods that have been delivered and accepted or for which payment has been made and accepted. When parties have acted on their agreement, their conduct provides compelling evidence of the contract.

These exceptions reflect the UCC's pragmatic approach, prioritizing evidence of contract formation over strict adherence to formalities. They illustrate how the statute of frauds for goods accommodates the realities of modern commerce while maintaining safeguards against fraud. Here, when a party accepts and pays for goods, that is evidence that the party wanted the benefit of that bargain.

B. Satisfaction of the Statute of Frauds

Once it is determined that a contract falls within the statute of frauds, the next step is to assess whether there is a writing that satisfies the statute. If no such writing exists, the contract is generally unenforceable unless an exception applies in law or equity.

The analysis of statute of frauds issues can be approached in various ways. One effective method is to proceed in three steps: (1) determine whether the transaction falls within the statute of frauds, (2) assess whether there is a writing that satisfies the statute, and, if not, (3) consider whether any exceptions apply. This order ensures that both legal and equitable arguments are properly addressed. This method of analysis reflects the statute's dual focus on technical precision and justice.

Focusing on whether there is a sufficient writing before exploring whether any exceptions apply is advantageous for several reasons. The requirement for a written memorandum and its sufficiency is based on legal principles grounded in technical, logical reasoning. This contrasts with equitable exceptions, which courts apply to avoid injustice in specific circumstances. By analyzing sufficiency first, the argument remains anchored in clear legal standards, potentially resolving the issue without the need to invoke exceptions. This approach aligns with the statute's purpose of promoting certainty and reducing reliance on subjective equitable considerations.

Additionally, many real-world contracts are evidenced by writings, even if informal or incomplete. Determining sufficiency early can simplify the analysis, particularly in cases where jurisdictional differences complicate the threshold question of whether the statute of frauds applies. If a writing sufficient to satisfy the statute exists, no further inquiry is necessary. The contract is enforceable on its terms.

However, the facts of a case or exam-prompt may dictate a different approach. For instance, if the prompt explicitly states that no written agreement exists, it is likely a signal to focus on exceptions. Conversely, if the facts indicate that a writing exists but its signature is unclear, that issue should take precedence. This flexibility ensures the analysis is tailored to the specific scenario while preserving the rigor of legal reasoning.

It is also important to remember that satisfying the statute of frauds does not require a formal written contract. The statute requires only a memorandum that meets certain legal criteria. As the following sections will show, these criteria are less

demanding than one might expect. Understanding these requisites is key to analyzing whether a contract can be enforced under the statute of frauds.

1. Memorandum

Our earlier discussion established when a signed writing is required to enforce a contract. Generally, contracts in one of six categories—represented by the acronym MYLEGS—require a signed writing under the statute of frauds. The Restatement (Second) identifies two common law exceptions, one that applies generally and one specific to land sales. The UCC adds four exceptions applicable to the sale of goods.

Once it is determined that a contract requires a signed writing, the next question is whether a sufficient writing exists to satisfy the statute of frauds. The R2d explains the requirements of a memorandum—which it clearly distinguishes from the contract itself:

Unless additional requirements are prescribed by the particular statute, a contract within the Statute of Frauds is enforceable if it is evidenced by any writing, signed by or on behalf of the party to be charged, which (a) reasonably identifies the subject matter of the contract, (b) is sufficient to indicate that a contract with respect thereto has been made between the parties or offered by the signer to the other party, and (c) states with reasonable certainty the essential terms of the unperformed promises in the contract. R2d § 131.

In simpler terms, a sufficient memorandum must:

1. **Identify** the subject matter,
2. **Indicate** that a contract exists,
3. **Include** the essential terms, and
4. Be **signed** by the party denying the contract.

In addition to memorizing these elements, consider recalling them based on their purpose: ensuring reliable evidence of a contract's existence and terms.

The primary goal of the statute of frauds is to prevent enforcement of contracts through fraud or perjury. It achieves this by requiring evidence that makes fraudulent claims unlikely. A sufficient memorandum need not include all the terms of the agreement. Instead, it must provide enough information to establish that the parties intended to enter into a binding contract and what they agreed upon.

Notably, the memorandum does not have to be a formal contract. Courts have found that a wide range of writings can satisfy the statute of frauds, including informal letters, receipts, notations on checks, diary entries, and even pleadings filed in court cases. Delivery of the memorandum to the other party is not required, nor must it have been created with the intent of serving as evidence of the contract. For example, a private ledger entry by one party can suffice, as long as it meets the statutory requirements.

2. Several Writings

Contracts are often evidenced by multiple writings, even for simple transactions. For example, a buyer might make an offer to purchase an item in one document, and the seller might respond in a separate document, offering to sell the same item at a higher price. The seller's reply may not include all the details of the buyer's offer, but the writings together can provide a complete picture of the agreement. Complex agreements, such as corporate mergers, often involve multiple documents as a matter of course.

R2d § 132 explicitly allows separate writings to be combined to satisfy the statute of frauds, provided they clearly relate to the same transaction:

The memorandum may consist of several writings if one of the writings is signed and the writings in the circumstances clearly indicate that they relate to the same transaction. R2d § 132.

If multiple documents are signed by the party to be charged, they can be read together even if they make no explicit reference to one another. Courts determine whether these writings constitute a sufficient memorandum as though they were incorporated into a single document. A sufficient connection between the writings is established if they refer to the same subject matter or transaction.

Suppose Taylor, a prospective buyer, corresponds with Alex, a property owner, about purchasing Alex's property at 123 Main Street. Imagine that Taylor physically mails Alex a letter that reads, "I'm offering to buy your property at 123 Main Street for \$500,000. Closing to occur within 60 days." In the same envelope, Taylor includes a signed check, made out to Alex, with a memo line stating, "Earnest money deposit for purchase of 123 Main Street." Alex cashes the check and, one month later, asks Taylor to schedule the closing. Taylor refuses to honor the deal and demands his money back. Is there a memorandum sufficient for enforcement against Taylor?

Taylor's letter outlines key terms of the proposed contract. However, the letter is unsigned. Under the statute of frauds, a writing must be signed by the party to be charged—in this case, Taylor—to be enforceable. Without Taylor's signature, the letter alone does not meet the statute's requirements, even though it contains essential terms.

Taylor's check is signed and references the property, but it lacks other essential terms of the contract, such as the purchase price of \$500,000, the timing for the closing, and an explicit indication that a binding contract has been formed. While the check provides evidence of Taylor's intent to proceed with a transaction involving the property, it does not include enough detail to stand alone as a sufficient memorandum under the statute of frauds.

When read together, however, the letter and the check create a complete memorandum satisfying the statute of frauds. Collectively, they include the parties, subject matter, price, and other essential terms. Common law allows multiple writings to be combined to satisfy the statute of frauds if they clearly relate to the same transaction. In this case, the letter and the check were sent in the same envelope, which indicates

a strong connection between the two documents. Together, they form a sufficient memorandum, enforceable against Taylor.

The memorandum required by the statute of frauds may be assembled from separate writings—some signed and some unsigned—as long as they clearly refer to the same transaction. This flexibility reflects the practical realities of contract formation and ensures that technicalities do not invalidate agreements where sufficient evidence exists.

3. Signature

The statute of frauds requires a signed writing for certain classes of contracts, but what constitutes a signature? Many assume this means a traditional pen-and-ink signature—one’s “John Hancock.” However, according to R2d, the legal definition of a signature is far broader:

The signature to a memorandum may be any symbol made or adopted with an intention, actual or apparent, to authenticate the writing as that of the signer. R2d § 134.

For a writing to satisfy the statute of frauds, it must include a signature by the party to be charged. However, “signed” does not require a traditional handwritten name. Any mark or symbol intended to authenticate the document can suffice. This includes initials, thumbprints, or even arbitrary symbols. The signature may be made in ink, pencil, or even stamped or impressed into the paper. Copies made with carbon paper, photocopiers, or similar methods also qualify as signed writings as long as they reflect the intent of the signer.

The rise of electronic commerce has further expanded the concept of a signature. Most states have adopted the Uniform Electronic Transactions Act (UETA), which defines an electronic signature as “an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.” Similarly, the federal Electronic Signatures in Global and National Commerce Act (ESIGN), enacted in 2000, ensures the validity of electronic signatures in interstate commerce. Under ESIGN, a contract or signature “may not be denied legal effect, validity, or enforceability solely because it is in electronic form.”

In other words, electronic signatures are treated as equivalent to their paper counterparts. This means that clicking “I agree” on a digital contract, typing one’s name at the end of an email, or using an electronic signing tool like DocuSign can constitute a legally binding signature.

Both UETA and ESIGN act as overlay statutes, addressing gaps left by the common law and ensuring that modern methods of communication and agreement are legally recognized. These statutes replace traditional paper-based requirements with electronic records and signatures, allowing contracts to adapt to technological advancements while maintaining enforceability under the Statute of Frauds.

4. *Loss or Destruction of a Memorandum*

The statute of frauds requires the creation of a signed writing to make certain classes of contracts enforceable. However, it does not require that the original signed writing be preserved or presented to the court. This distinction arises from the statute's purpose: it is not a rule of evidence but a substantive rule of contract law designed to ensure that sufficient evidence of the agreement exists at the time of formation. Under common law:

The loss or destruction of a memorandum does not deprive it of effect under the Statute. R2d § 137.

This means that even if the original memorandum is lost or destroyed, the agreement may still be enforceable. Courts permit proof of the memorandum's existence and contents through alternative forms of evidence, such as:

- An unsigned copy of the memorandum.
- Testimony from witnesses who saw or were familiar with the memorandum.
- Other corroborative evidence indicating the agreement's existence and terms.

The rationale for this rule is rooted in the statute's primary purpose: to prevent fraud by requiring that certain agreements be documented. Once a memorandum has been created and satisfies the statute's requirements, its loss or destruction does not undermine the fact that evidence of the contract once existed. Denying enforcement in such cases would elevate form over substance, creating an unjust result for the party seeking enforcement.

This rule also reflects the balance courts strike between enforcing contracts and preventing fraud. By allowing oral or secondary evidence to establish the existence and terms of a lost or destroyed memorandum, courts ensure that the statute of frauds remains a safeguard against fraud rather than a tool to escape valid agreements.

Consider this practical scenario: Brad and Ursula enter into a written agreement for the sale of a painting for \$50,000. Ursula signs the agreement, but the original document is accidentally destroyed in a fire at Brad's office. Later, Ursula disputes the agreement, arguing that without the original signed writing, the contract cannot be enforced under the statute of frauds.

Brad, however, produces an unsigned photocopy of the agreement and offers testimony from his assistant, who witnessed Ursula signing the original document. Under R2d § 137, the photocopy and oral testimony can together serve as sufficient evidence of the memorandum's existence and terms, satisfying the statute of frauds even though the original signed writing is no longer available.

This example highlights the practical flexibility in how courts interpret the statute of frauds. While the statute requires the creation of evidence at the time of contract formation, it does not demand that the original document be preserved or presented at trial. Allowing alternative forms of proof—such as copies or oral testimony—ensures

that a legitimate contract is not invalidated simply because the evidence was destroyed by accident.

C. Exceptions to the Statute of Frauds

Scholars criticize the statute of frauds for creating as many problems as it solves. While it aims to prevent fraudulent claims by requiring certain contracts to be evidenced by a signed writing, it can also lead to unjust results by rendering genuine agreements unenforceable simply because they fail to meet formal requirements.

To address this tension, courts and legislatures have developed exceptions to the statute of frauds. These exceptions ensure that the statute does not undermine its fundamental purpose: achieving fairness and preventing fraud. While the statute creates formal barriers to enforcement, these exceptions allow courts to consider alternative evidence or equitable principles in certain situations where enforcement is necessary to avoid injustice.

At common law, courts have applied the doctrine of promissory estoppel as a general equitable exception to the statute of frauds. This doctrine allows courts to enforce certain promises, even without a signed writing, where one party reasonably relied on the promise to their detriment. Promissory estoppel can apply to any class of contracts subject to the statute of frauds under common law.

In addition, the common law developed a more specific exception for contracts involving the sale of land: the part performance exception. This exception permits enforcement of oral agreements for the transfer of land when one party has partially performed their obligations under the contract in a way that unequivocally points to the existence of the agreement. While part performance applies only to land contracts, it reflects a broader judicial effort to balance the statute's formal requirements with equitable considerations.

The Uniform Commercial Code (UCC) introduces its own set of exceptions to the statute of frauds, specific to contracts for the sale of goods priced at \$500 or more. These four exceptions recognize the unique realities of commercial transactions and aim to prevent technicalities from invalidating legitimate agreements.

Below we examine these exceptions in detail and consider how they preserve the statute's integrity while addressing its limitations.

1. *Promissory Estoppel*

The doctrine of promissory estoppel should be familiar from earlier discussions of alternatives to consideration. While consideration is a core requirement for contract formation, courts have recognized certain equitable exceptions where promises made without consideration are still enforceable. Promissory estoppel, or detrimental reliance, is one such exception. It arises when one party takes or refrains from action to their detriment in reasonable reliance on a promise.

Promissory estoppel also serves as an exception to the statute of frauds. In these cases, the detrimental reliance of the promisee becomes evidence of the promise itself, allowing enforcement even without a signed writing. As R2d explains:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce the action or forbearance is enforceable notwithstanding the Statute of Frauds if injustice can be avoided only by enforcement of the promise. The remedy granted for breach is to be limited as justice requires. R2d § 139(1).

If you compare this to R2d § 90, you will see R2d applies virtually the same standard to justify enforcement of contracts that would otherwise be unenforceable for want of consideration or want of a signed writing. To determine whether enforcement is necessary to avoid injustice, R2d would consider several factors, including:

1. The availability and adequacy of other remedies, such as cancellation or restitution.
2. The definite and substantial character of the reliance in relation to the remedy sought.
3. The extent to which the reliance corroborates the evidence of the promise.
4. The reasonableness of the reliance.
5. The foreseeability of the reliance by the promisor.

See R2d § 139(2).

R2d was a bit ambitious in drafting this rule, as it takes a minority position. Most states do not yet recognize a broad promissory estoppel exception to the writing requirement. Rather, most states still follow the narrower exception found in the Restatement (First) of Contracts. The first Restatement included a much more limited reliance-based exception to the statute of frauds, which applied only where the party detrimentally relied on a promise that a writing existed or would be created. While R2d § 139 takes an expansive view, many jurisdictions still follow the narrower position of the first Restatement. This narrower approach demonstrates ongoing caution against eroding the statute's formal requirements.

Nonetheless, it is important to learn the R2d's expansive approach. As you learned in Chapter 8 on promissory estoppel, application of this doctrine is highly fact-specific and reflects the equitable nature of the doctrine.

Two cases illustrate how courts diverge in applying this doctrine. In *McIntosh v. Murphy*, 52 Haw. 29, 469 P.2d 177 (1970), below, an employer in Hawaii allegedly promised a man in California a year of employment if he moved to Hawaii. The court found that the employee's significant reliance—moving states and incurring substantial costs—justified enforcing the promise despite the lack of a signed writing. However, a dissenting opinion warned that overusing promissory estoppel could undermine the statute of frauds entirely by making equitable exceptions indistinguishable from general contract enforcement.

By contrast, in *Stearns v. Emery-Waterhouse*, 596 A.2d 72 (1991), an employee alleged he had been promised long-term employment if he relocated from Boston to Portland, Maine. The court unanimously rejected the claim, finding that the employee's reliance—relatively minor costs associated with a short move—was insufficiently substantial to warrant enforcement. These contrasting cases show how courts weigh the factors in § 139(2) differently depending on the facts, particularly the extent and reasonableness of the reliance.

Promissory estoppel highlights the tension between the statute of frauds's formal requirements and the need to enforce genuine agreements to avoid injustice. While it provides a vital safety valve for unfair cases, courts remain cautious in applying this doctrine, to avoid eroding the statute's purpose. As you study these cases, focus on how courts balance these competing considerations and whether justice can truly be achieved without undermining the statute's broader goals.

2. Part Performance of Land Transactions

The promissory estoppel exception to the statute of frauds, discussed in the previous section, potentially applies to all classes of MYLEGS contracts. In contrast, the so-called “part-performance” exception to the statute of frauds is narrower in scope. It applies only to contracts involving the transfer of interests in land. The part-performance exception, despite its name, is another reliance-based exception through which courts may order specific performance of a land transaction to prevent injustice caused by detrimental reliance on an oral promise.

Land is a distinct type of property—real property—that is subject to special rules and doctrines not applicable to personal property or intellectual property. The part-performance exception acknowledges the importance and permanence of land transactions and provides a limited exception to the statute of frauds for cases where one party has acted in reliance on an oral agreement. According to R2d § 129:

A contract for the transfer of an interest in land may be specifically enforced notwithstanding failure to comply with the Statute of Frauds if it is established that the party seeking enforcement, in reasonable reliance on the contract and on the continuing assent of the party against whom enforcement is sought, has so changed his position that injustice can be avoided only by specific enforcement. R2d § 129.

The usual fact pattern goes like this: a party who orally agreed to purchase an interest in land takes significant actions in reliance on the oral agreement even though there was no writing evidencing the transaction. The seller raises the statute of frauds. The purchaser argues the part-performance exception applies, due to their actions in reliance on the promise to sell them the land.

Courts may enforce such oral agreements for the transfer of land, but only if the party seeking enforcement has taken actions in reliance that unequivocally point to the existence of the agreement. Courts generally hold that for the part-performance

exception to apply, this oral promise must be evidenced by two or more of the following: taking possession of land, making a full or partial payment, and making improvements to the land.

Thus, the doctrine of part performance is not a blanket exception. Courts exercise this equitable power cautiously to ensure that its application does not undermine the statute of frauds' purpose: preventing fraudulent claims and ensuring reliable evidence of agreements.

For example, consider the following scenario: Sarah orally agrees to sell Blackacre, a parcel of land, to Betty for \$200,000. With Sarah's consent, Betty moves onto the property, pays \$50,000 of the purchase price, and builds a house on the land. Two years later, a dispute arises over the remaining balance, and Sarah repudiates the agreement, refusing to transfer title. Betty seeks specific performance of the oral contract.

Here, Betty's actions—taking possession, making a partial payment, and building a house—constitute part performance. These actions unequivocally indicate reliance on the agreement and are inconsistent with any explanation other than the existence of a contract. A court would likely find that enforcing the contract through specific performance is necessary to avoid injustice. In contrast, if all Betty did was make a down payment, without more, a court would not enforce this contract absent a writing signed by the seller. The court would simply order the seller to give the down payment back.

3. *UCC Exceptions for Goods Transactions*

Article 2 of the Uniform Commercial Code contains a statute of frauds provision that applies to contracts for the sale of goods valued at \$500 or more—regardless of whether those sales contracts involve merchants. UCC § 2-201 contains the UCC's unique version of the statute of frauds and provides several exceptions tailored to the realities of commercial practice.

These exceptions reflect the UCC's focus on flexibility and efficiency in commercial transactions and are a significant departure from the common law. Under the common law, the statute of frauds applies rigidly, often without regard to the parties' sophistication or the nature of the transaction. In contrast, the UCC's exceptions reflect its goal of accommodating the practical realities of commerce.

a. “Merchant’s Confirmatory Memo” Exception

The UCC provides a special exception to the statute of frauds for transactions between merchants. This exception recognizes that merchants operate in a world of fast-paced transactions where formalities like signed writings are often impractical.

Under the “merchant’s confirmatory memo” exception, if one merchant sends another merchant a signed confirmation of their agreement, this confirmatory memo can satisfy the statute of frauds against the receiving merchant so long as the memo

satisfies the Statute of Frauds as against the sending merchant and so long as the receiving merchant does not object within ten days. Read this provision closely and apply the elements with precision.

Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received. NH UCC § 2-201(2).

This merchant-specific exception to the statute of frauds is an example a so-called “big-boy” clause that applies only to merchants. As you saw when you learned about merchants’ firm offers, the UCC defines “merchants” as individuals or entities who deal professionally in goods of the kind in question or who hold out as having relevant skill or knowledge. See UCC § 2-104. The UCC identifies this merchant class, to whom special rules apply, in recognition of the fact that there are varying levels of sophistication among contracting parties. The UCC assumes merchants can fend for themselves to a greater extent than ordinary people can.

What is a confirmatory memo? A simple email or letter acknowledging the agreement and outlining its key terms—such as the nature and quantity of goods and the agreed price—can suffice as a confirmation. As long as the recipient has reason to know the contents of the confirmation and does not object within ten days, the writing satisfies the statute of frauds even if the recipient did not sign or even acknowledge it.

In sum, if you see a situation where both parties are merchants and they have entered an oral contract for the sale of goods valued at \$500 or more, consider whether the merchant’s confirmatory memo exception applies. If both parties qualify as merchants, a confirmation sent by one merchant to the other can satisfy the statute of frauds even if the recipient has not signed anything. Unlike the firm-offer rule, both parties must be merchants.

b. “Special Manufacture” Exception

The statute of frauds, which aims to reduce disputes by requiring reliable evidence of agreements, generally requires a signed writing for the enforcement of certain contracts. However, the UCC recognizes that a signed writing is not the only possible evidence of a contract. In some cases, actions speak louder than words. Specifically, when a seller begins or completes the production of goods that are uniquely designed for a particular buyer, the court may infer that a contract exists based on the goods themselves.

A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller’s business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the

buyer, has made either a substantial beginning of their manufacture or commitments for their procurement. NH UCC § 2-201(3)(a).

This “special manufacture” exception reflects the rationale of *res ipsa loquitur*—the thing speaks for itself. When a seller produces goods with unusual or distinctive characteristics that make them unsuitable for sale to anyone but the intended buyer, those goods provide compelling evidence of the contract. The law recognizes that sellers are unlikely to invest in creating goods they cannot resell unless they have a firm order in place.

The key question in determining whether goods are specially manufactured is whether they can be sold in the ordinary course of the seller’s business to someone other than the original buyer. If minor alterations would make the goods marketable to others, they are not considered specially manufactured. If, however, substantial changes would be necessary to sell the goods, or if they are entirely unsuitable for resale, the exception applies.

For example, in *Company Image Knitware, Ltd. v. Mothers Work, Inc.*, 2006 PA Super 272 (2006), the court examined whether maternity garments produced by CIK were specially manufactured for Mothers Work. The garments were made to exacting specifications: the fabric had to meet strict standards of content, texture, and processing, the findings (trim, buttons, etc.) had to match the fabric colors precisely, and the sizes were tailored to fit American women. These characteristics rendered the garments unsuitable for resale in the ordinary course of CIK’s business. The court concluded that the goods were specially manufactured and therefore fell within the UCC exception.

The policy underlying this exception is straightforward: the cost of mistakenly producing specialty goods is higher than that of manufacturing standard goods. Specialty goods are harder to sell on the open market because they are tailored to meet the unique needs of a specific buyer. For instance, a monogrammed leather notebook with someone else’s initials is likely less valuable than a plain leather notebook, as most buyers would prefer the latter. Similarly, a specialty item made for a particular customer will typically have limited value to other buyers, increasing the seller’s error cost if the agreement is repudiated.

Importantly, the special manufacture exception does not depend on whether producing specialty goods is part of the seller’s usual business. Instead, the focus is on the unique characteristics of the goods in question and whether they are unsuitable for sale to others. Even a seller who occasionally produces specialty goods may invoke this exception if the goods in question are truly tailored to the buyer’s specifications.

Courts applying this exception emphasize the need for clear evidence that the goods were uniquely created for the buyer and that their production or procurement was substantially underway before repudiation. By recognizing the special manufacture exception, the UCC balances its goal of reducing fraud with the practical realities of commercial transactions and thus ensures that sellers who act in good faith are not left uncompensated for their efforts.

c. “Party-Admission” Exception

Under the UCC, a party who admits in court that a contract for the sale of goods exists is estopped from asserting that the contract is unenforceable due to the lack of a signed writing. This exception reflects the UCC’s emphasis on practicality and the goal of preventing parties from using the statute of frauds as a shield to avoid legitimate obligations.

A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable if the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted. NH UCC § 2-201(3)(b).

This provision ensures that when a party acknowledges the existence of a contract under oath, the evidentiary purpose of the statute of frauds is satisfied. Such an admission eliminates the risk of fraud or perjury regarding the existence of the agreement, as the party against whom enforcement is sought has effectively confirmed the contract’s validity. However, the enforceability of the contract is limited to the quantity of goods admitted, preserving some safeguards against potential overreach.

CONTENTIOUS ISSUE: INVOLUNTARY ADMISSIONS

While the party-admission exception to the statute of frauds might seem straightforward, it can be contentious when admissions are *involuntary*.

For example, imagine a seller is being grilled by an opposing lawyer during a deposition about whether the seller entered a multi-million dollar oral contract with a buyer for the sale of goods. After hours in the deposition room, the seller admits to agreeing on the price and terms of an oral sale.

Is this a party admission for purposes of UCC § 2-201? Can the buyer use this involuntary admission to get around the statute of frauds and enforce the contract against the seller? Courts are divided.

Under the majority view, involuntary admissions satisfy the statute of frauds. These courts prioritize evidentiary reliability and reason that party admissions, even when made under cross-examination, should prevent parties from backing out of legitimate obligations. Under the minority view, involuntary admissions do not satisfy the statute of frauds. These courts place a greater value on the need for formal compliance with the writing requirement, and they fear that undue pressure during court

proceedings can lead to “false positives,” undermining the statute’s purpose of validating contracts through formal writings.

This split highlights the UCC’s pragmatic focus on preventing fraud versus the traditional emphasis on formal agreements. It also serves as a reminder to always consider jurisdictional differences and look up the specific approach in your jurisdiction.

d. “Goods-or-Payment-Accepted” Exception

The statute of frauds intends to prevent fraud by requiring a signed writing to evidence agreements. In theory, this writing provides clear proof of what the parties agreed to do, reducing disputes about the existence or terms of a contract. However, the UCC recognizes that actions can sometimes serve as reliable evidence of an agreement, particularly in the context of goods transactions.

The “goods-or-payment-accepted” exception under the UCC allows enforcement of an oral contract for the sale of goods when one party performs their side of the agreement and the other side accepts the benefits. This tends to show the parties’ mutual assent to the agreement, even if they never put it into writing. Specifically:

A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606). NH UCC § 2-201(3)(c).

This exception is based on the principle that actions speak louder than words. If a seller accepts payment for goods, this acceptance evidences the seller’s intent to sell those goods for the agreed-upon price. Similarly, if a buyer accepts delivery of goods, this acceptance demonstrates the buyer’s intent to purchase those goods. In either case, the conduct of the party serves as evidence of the contract, thus making a signed writing unnecessary.

The goods-or-payment-accepted exception is limited to the goods that have been paid for or delivered. It does not apply to goods that remain undelivered or unpaid. For example, if a seller delivers one thousand reams of paper, and the buyer accepts and pays for those one thousand reams, the seller cannot later deliver nine thousand additional reams and claim there was a contract for the sale of ten thousand reams. The exception applies only to the specific goods for which performance has occurred.

Similarly, this exception is sufficient to enforce a contract only to the extent of the performance. If a buyer pays for half the goods in an alleged contract, the seller may enforce the contract for that half but cannot demand payment or delivery for the remaining goods based solely on the performance exception.

D. Reflections on the Statute of Frauds

The statute of frauds serves as a study in the balance between formalism and equity. By requiring certain contracts to be evidenced by a signed writing, it aims to prevent fraud and ensure reliable evidence of agreements. Yet, as this chapter has shown, the statute also provides numerous exceptions and flexible standards to address the realities of contractual relationships.

At its heart, the statute of frauds highlights a core tension in contract law: the need for formal safeguards versus the need to honor legitimate agreements. Common law and UCC exceptions reflect this balance. While equitable doctrines like promissory estoppel address fairness broadly, targeted exceptions such as part-performance for land and the UCC's tailored rules for goods transactions demonstrate the law's adaptability to specific contexts.

Understanding these doctrines enables practitioners to navigate disputes with both technical precision and a sense of justice. The statute of frauds is not just a technical hurdle but a reminder of contract law's dual role: to provide clarity while accommodating human and commercial realities. As commerce continues to evolve, the principles underlying this doctrine will remain a vital part of contract law's enduring relevance.

Cases

Reading McIntosh v. Murphy. The statute of frauds was established for three purposes: (1) cautioning parties against entering into serious agreements, (2) evidencing those agreements so they can be properly enforced by courts, and (3) channeling certain types of agreements into certain forms and modes that are easier to adjudicate. The statute of frauds is meant as a defensive shield or bulwark against people fraudulently claiming that there is a serious agreement where none actually exists.

However, the statute of frauds itself can create the opportunity for fraud. For example, where one party promises to put an agreement in writing, that party may fail to do so to ensure the contract is later unenforceable. The law has created an exception to this instance, such that where a party promises to memorialize a contract in writing, the other party can evidence reliance on that promise that justifies an exemption to the statute of frauds.

A more general exception to the statute of frauds comes from reliance on the promise. Even where a party does not rely specifically on the other's promise to memorialize a contract in writing, the aggrieved party can still attempt to enforce that contract on the basis of reasonable reliance. The *McIntosh* case illustrates a situation where one party relied on the oral promise of another. The

court must first establish whether a contract falls within the statute of frauds. If it finds that it does, the court must then go on to determine whether an equitable exception applies. Read on to learn how courts will apply R2d § 139 to determine whether equity requires enforcement of contracts that are not evidenced in writing.

McIntosh v. Murphy provides a useful review of the statute of frauds, including its purpose, before discussing the promissory estoppel exception to the statute of frauds. The dissent is included because it shows how such a fact-specific inquiry can come out differently. Moreover, the dissent reminds us that applying equitable exceptions can eviscerate the purpose of the statute of frauds, and so they must be applied carefully and infrequently.

McIntosh v. Murphy

52 Haw. 29, 469 P.2d 177 (1970)

LEVINSON, Justice.

This case involves an oral employment contract which allegedly violates the provision of the Statute of Frauds requiring “any agreement that is not to be performed within one year from the making thereof” to be in writing in order to be enforceable. In this action the plaintiff-employee Dick McIntosh seeks to recover damages from his employer, George Murphy and Murphy Motors, Ltd., for the breach of an alleged one-year oral employment contract.

While the facts are in sharp conflict, it appears that defendant George Murphy was in southern California during March, 1964 interviewing prospective management personnel for his Chevrolet-Oldsmobile dealerships in Hawaii. He interviewed the plaintiff twice during that time. The position of sales manager for one of the dealerships was fully discussed but no contract was entered into. In April, 1964 the plaintiff received a call from the general manager of Murphy Motors informing him of possible employment within thirty days if he was still available. The plaintiff indicated his continued interest and informed the manager that he would be available. Later in April, the plaintiff sent Murphy a telegram to the effect that he would arrive in Honolulu on Sunday, April 26, 1964. Murphy then telephoned McIntosh on Saturday, April 25, 1964 to notify him that the job of assistant sales manager was available and work would begin on the following Monday, April 27, 1964. At that time McIntosh expressed surprise at the change in job title from sales manager to assistant sales manager but reconfirmed the fact that he was arriving in Honolulu the next day, Sunday. McIntosh arrived on Sunday, April 26 1964 and began work on the following day, Monday, April 27, 1964.

As a consequence of his decision to work for Murphy, McIntosh moved some of his belongings from the mainland to Hawaii, sold possessions, leased an apartment in Honolulu and obviously forwent any other employment opportunities. In short, the

plaintiff did all those things which were incidental to changing one's residence permanently from Los Angeles to Honolulu, which is approximately 2200 miles. McIntosh continued working for Murphy until July 16, 1964, approximately two and one-half months, at which time he was discharged on the grounds that he was unable to close deals with prospective customers and could not train the salesmen.

At the conclusion of the trial, the defense moved for a directed verdict arguing that the oral employment agreement was in violation of the Statute of Frauds, there being no written memorandum or note thereof. The trial court ruled that as a matter of law the contract did not come within the Statute, reasoning that Murphy bargained for acceptance by the actual commencement of performance by McIntosh, so that McIntosh was not bound by a contract until he came to work on Monday, April 27, 1964. Therefore, assuming that the contract was for a year's employment, it was performable within a year exactly to the day and no writing was required for it to be enforceable. Alternatively, the court ruled that if the agreement was made final by the telephone call between the parties on Saturday, April 25, 1964, then that part of the weekend which remained would not be counted in calculating the year, thus taking the contract out of the Statute of Frauds. With commendable candor the trial judge gave as the motivating force for the decision his desire to avoid a mechanical and unjust application of the Statute.

The case went to the jury on the following questions: (1) whether the contract was for a year's duration or was performable on a trial basis, thus making it terminable at the will of either party; (2) whether the plaintiff was discharged for just cause; and (3) if he was not discharged for just cause, what damages were due the plaintiff. The jury returned a verdict for the plaintiff in the sum of \$12,103.40. The defendants appeal to this court on four principal grounds, three of which we find to be without merit. The remaining ground of appeal is whether the plaintiff can maintain an action on the alleged oral employment contract in light of the prohibition of the Statute of Frauds making unenforceable an oral contract that is not to be performed within one year.

I. Time of Acceptance of the Employment Agreement

The defendants contend that the trial court erred in refusing to give an instruction to the jury that if the employment agreement was made more than one day before the plaintiff began performance, there could be no recovery by the plaintiff. The reason given was that a contract not to be performed within one year from its making is unenforceable if not in writing.

The defendants are correct in their argument that the time of acceptance of an offer is a question of fact for the jury to decide. But the trial court alternatively decided that even if the offer was accepted on the Saturday prior to the commencement of performance, the intervening Sunday and part of Saturday would not be counted in computing the year for the purposes of the Statute of Frauds. The judge stated that Sunday was a non-working day and only a fraction of Saturday was left which he would not count. In any event, there is no need to discuss the relative merits of either ruling since we base our decision in this case on the doctrine of equitable estoppel

which was properly briefed and argued by both parties before this court, although not presented to the trial court.

II. Enforcement by Virtue of Action in Reliance on the Oral Contract

In determining whether a rule of law can be fashioned and applied to a situation where an oral contract admittedly violates a strict interpretation of the Statute of Frauds, it is necessary to review the Statute itself together with its historical and modern functions. The Statute of Frauds, which requires that certain contracts be in writing in order to be legally enforceable, had its inception in the days of Charles II of England. Hawaii's version of the Statute is found in HRS § 656-1 and is substantially the same as the original English Statute of Frauds.

The first English Statute was enacted almost 300 years ago to prevent "many fraudulent practices, which are commonly endeavored to be upheld by perjury and subornation of perjury". Certainly, there were compelling reasons in those days for such a law. At the time of enactment in England, the jury system was quite unreliable, rules of evidence were few, and the complaining party was disqualified as a witness so he could neither testify on direct-examination nor, more importantly, be cross-examined. The aforementioned structural and evidentiary limitations on our system of justice no longer exist.

Retention of the Statute today has nevertheless been justified on at least three grounds: (1) the Statute still serves an evidentiary function thereby lessening the danger of perjured testimony (the original rationale); (2) the requirement of a writing has a cautionary effect which causes reflection by the parties on the importance of the agreement; and (3) the writing is an easy way to distinguish enforceable contracts from those which are not, thus channeling certain transactions into written form.

In spite of whatever utility the Statute of Frauds may still have, its applicability has been drastically limited by judicial construction over the years in order to mitigate the harshness of a mechanical application. Furthermore, learned writers continue to disparage the Statute regarding it as "a statute for promoting fraud" and a "legal anachronism."

Another method of judicial circumvention of the Statute of Frauds has grown out of the exercise of the equity powers of the courts. Such judicially imposed limitations or exceptions involved the traditional dispensing power of the equity courts to mitigate the "harsh" rule of law. When courts have enforced an oral contract despite the Statute, they have utilized the legal labels of "part performance" or "equitable estoppel" in granting relief. Both doctrines are said to be based on the concept of estoppel, which operates to avoid unconscionable injury.

Part performance has long been recognized in Hawaii as an equitable doctrine justifying the enforcement of an oral agreement for the conveyance of an interest in land where there has been substantial reliance by the party seeking to enforce the contract. Other courts have enforced oral contracts (including employment contracts) which

failed to satisfy the section of the Statute making unenforceable an agreement not to be performed within a year of its making. This has occurred where the conduct of the parties gave rise to an estoppel to assert the Statute.

It is appropriate for modern courts to cast aside the raiments of conceptualism which cloak the true policies underlying the reasoning behind the many decisions enforcing contracts that violate the Statute of Frauds. There is certainly no need to resort to legal rubrics or meticulous legal formulas when better explanations are available. The policy behind enforcing an oral agreement which violated the Statute of Frauds, as a policy of avoiding unconscionable injury, was well set out by the California Supreme Court. In *Monarco v. Logreco*, a case which involved an action to enforce an oral contract for the conveyance of land on the grounds of 20 years performance by the promisee, the court said:

The doctrine of estoppel to assert the Statute of Frauds has been consistently applied by the courts of this state to prevent fraud that would result from refusal to enforce oral contracts in certain circumstances. Such fraud may inhere in the unconscionable injury that would result from denying enforcement of the contract after one party has been induced by the other seriously to change his position in reliance on the contract.

In seeking to frame a workable test which is flexible enough to cover diverse factual situations and provide some reviewable standards, we find very persuasive section 139 of the Second Restatement of Contracts. That section specifically covers those situations where there has been reliance on an oral contract which falls within the Statute of Frauds. Section 139 states:

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce the action or forbearance is enforceable notwithstanding the Statute of Frauds if injustice can be avoided only by enforcement of the promise. The remedy granted for breach is to be limited as justice requires.

(2) In determining whether injustice can be avoided only by enforcement of the promise, the following circumstances are significant: (a) the availability and adequacy of other remedies, particularly cancellation and restitution; (b) the definite and substantial character of the action or forbearance in relation to the remedy sought; (c) the extent to which the action or forbearance corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence; (d) the reasonableness of the action or forbearance; (e) the extent to which the action or forbearance was foreseeable by the promisor.

We think that the approach taken in the Restatement is the proper method of giving the trial court the necessary latitude to relieve a party of the hardships of the Statute of Frauds. Other courts have used similar approaches in dealing with oral employment contracts upon which an employee had seriously relied. This is to be

preferred over having the trial court bend over backwards to take the contract out of the Statute of Frauds. In the present case the trial court admitted just this inclination and forthrightly followed it.

There is no dispute that the action of the plaintiff in moving 2200 miles from Los Angeles to Hawaii was foreseeable by the defendant. In fact, it was required to perform his duties. Injustice can only be avoided by the enforcement of the contract and the granting of money damages. No other remedy is adequate. The plaintiff found himself residing in Hawaii without a job.

It is also clear that a contract of some kind did exist. The plaintiff performed the contract for two and one-half months receiving \$3,484.60 for his services. The exact length of the contract, whether terminable at will as urged by the defendant, or for a year from the time when the plaintiff started working, was up to the jury to decide.

In sum, the trial court might have found that enforcement of the contract was warranted by virtue of the plaintiff's reliance on the defendant's promise. Naturally, each case turns on its own facts. Certainly, there is considerable discretion for a court to implement the true policy behind the Statute of Frauds, which is to prevent fraud or any other type of unconscionable injury. We therefore affirm the judgment of the trial court on the ground that the plaintiff's reliance was such that injustice could only be avoided by enforcement of the contract.

Affirmed.

Dissent

ABE, J., dissenting

The majority of the court has affirmed the judgment of the trial court; however, I respectfully dissent.

I.

Whether alleged contract of employment came within the Statute of Frauds:

As acknowledged by this court, the trial judge erred when as a matter of law he ruled that the alleged employment contract did not come within the Statute of Frauds; however, I cannot agree that this error was not prejudicial as this court intimates.

On this issue, the date that the alleged contract was entered into was all important and the date of acceptance of an offer by the plaintiff was a question of fact for the jury to decide. In other words, it was for the jury to determine when the alleged one-year employment contract was entered into and if the jury had found that the plaintiff had accepted the offer more than one day before plaintiff was to report to work, the contract would have come within the Statute of Frauds and would have been unenforceable.

II.

This court holds that though the alleged one-year employment contract came within the Statute of Frauds, nevertheless the judgment of the trial court is affirmed

“on the ground that the plaintiff’s reliance was such that injustice could only be avoided by enforcement of the contract.”

I believe this court is begging the issue by its holding because to reach that conclusion, this court is ruling that the defendant agreed to hire the plaintiff under a one-year employment contract. The defendant has denied that the plaintiff was hired for a period of one year and has introduced into evidence testimony of witnesses that all hiring by the defendant in the past has been on a trial basis. The defendant also testified that he had hired the plaintiff on a trial basis.

Here on one hand the plaintiff claimed that he had a one-year employment contract; on the other hand, the defendant claimed that the plaintiff had not been hired for one year but on a trial basis for so long as his services were satisfactory. I believe the Statute of Frauds was enacted to avoid the consequences this court is forcing upon the defendant. In my opinion, the legislature enacted the Statute of Frauds to negate claims such as has been made by the plaintiff in this case. But this court holds that because the plaintiff in reliance of the one-year employment contract (alleged to have been entered into by the plaintiff but denied by the defendant) has changed his position, “injustice could only be avoided by enforcement of the contract.” Where is the sense of justice?

Now assuming that the defendant had agreed to hire the plaintiff under a one-year employment contract and the contract came within the Statute of Frauds, I cannot agree, as intimated by this court, that we should circumvent the Statute of Frauds by the exercise of the equity powers of courts. As to statutory law, the sole function of the judiciary is to interpret the statute and the judiciary should not usurp legislative power and enter into the legislative field. Thus, if the Statute of Frauds is too harsh as intimated by this court, and it brings about undue hardship, it is for the legislature to amend or repeal the statute and not for this court to legislate.

Reflection

McIntosh involved a man who moved from California to Hawaii to take a job. He sold many of his possessions to make this long-distance transition. The court seems to make much about the 2,200-mile move. This implies that the case could have come out differently if the move was only 200 or 20 miles. But this raises the question: how far a move is far enough to constitute substantial reliance?

The court also seems to gloss over the fact that most terms of employment are at will. Is it reasonable to expect that a sales job will last for a year, regardless of performance on the job? There is not much discussion about McIntosh’s job performance. Should his work quality matter?

Perhaps the answers to these questions are found by evaluating the procedural posture. The Supreme Court decision you read follows a jury verdict. Courts are reluctant to set aside jury verdicts, especially on matters of fact. Whether or not McIntosh substantially and reasonably relied on the promise of employment is very much a

fact-specific question. The court even says that “each case turns on its own facts.” Perhaps the Hawaii Supreme Court’s deference to the jury finding implies that the court presumed the jury found McIntosh’s reliance was substantial and that he was not fired for cause.

Although the *McIntosh* court suggests that employment agreements will be treated favorably toward the employee-plaintiff, there are cases where the employee does not merit the equitable exception to the statute of frauds. For example, in *Stearns v. Emery-Waterhouse*, which was also about an employment offer that resulted in a long-distance move, the court’s decision was precisely the opposite of *McIntosh*. In *Stearns*, the court held that the employer was not bound to the oral agreement for the term contract—even though the employee made a relatively long move to Portland, Maine, and suffered detrimental reliance costs. Echoing the reasoning of the dissent in *McIntosh*, the *Stearns* court unanimously rejected the employee’s claim, concluding that “to enforce a multi-year employment contract an employee must produce a writing that satisfies the Statute of Frauds[,]” or else provide some other reason to get around the writing requirement, such as “fraud on the part of the employer.”

Once again, these cases supply a reminder to look up the law in your jurisdiction when dealing with essentially any common law issue.

Discussion

1. What is the purpose of the statute of frauds? Discuss how the underlying purpose of the statute was implicated in *McIntosh* and whether its purpose would be served by allowing the defendant to avoid the contract.
 2. The promissory estoppel exception to the statute of frauds works similarly to the promissory estoppel exception to the requirement of consideration. Compare R2d §§ 90 and 139. How are they similar? How are they different?
 3. Was there any evidence of potential injustice in this case? Look particularly at the dissent. Why would the dissent refuse to grant the promissory estoppel exception in this case? What injustice is that dissent trying to avoid?
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Reading Sterling v. Taylor. The case below gives an example of an insufficient memorandum. As you read *Sterling*, think about why the memorandum was not sufficient. The case also provides a thorough review and discussion of the general requisites of a memorandum that will help you better understand how the rule stated above is applied by courts.

Sterling v. Taylor

40 Cal. 4th 757 (2007)

CORRIGAN, J.

The Statute of Frauds provides that certain contracts “are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged. . . .” In this case, the Court of Appeal held that a memorandum regarding the sale of several apartment buildings was sufficient to satisfy the Statute of Frauds. Defendants contend the court improperly considered extrinsic evidence to resolve uncertainties in the terms identifying the seller, the property, and the price.

We reverse, but not because the court consulted extrinsic evidence. Extrinsic evidence has long been held admissible to clarify the terms of a memorandum for purposes of the Statute of Frauds. Statements to the contrary appear in some cases, but we disapprove them. A memorandum serves only an evidentiary function under the statute. If the writing includes the essential terms of the parties’ agreement, there is no bar to the admission of relevant extrinsic evidence to explain or clarify those terms. The memorandum, viewed in light of the evidence, must be sufficient to demonstrate with reasonable certainty the terms to which the parties agreed to be bound. Here, plaintiffs attempt to enforce a price term that lacks the certainty required by the Statute of Frauds.

I. Factual and Procedural Background

In January 2000, defendant Lawrence Taylor and plaintiff Donald Sterling discussed the sale of three apartment buildings in Santa Monica owned by the Santa Monica Collection partnership (SMC). Defendant was a general partner in SMC. Plaintiff and defendant, both experienced real estate investors, met on March 13, 2000, and discussed a series of transactions including the purchase of the SMC properties. At this meeting, plaintiff drafted a handwritten memorandum entitled “Contract for Sale of Real Property.”

The memorandum encompasses the sale of five properties; only the SMC properties are involved here. They are identified in the memorandum as “808 4th St.,” “843 4th St.,” and “1251 14th St.,” with an aggregate price term of “approx. 10.468 × gross income[,] estimated income 1.600.000, Price \$16,750.00.” Although defendant had given plaintiff rent rolls showing the income from the properties, neither man brought these documents to the March 13 meeting. Plaintiff dated and initialed the memorandum as “Buyer,” but the line he provided for “Seller” was left blank. Plaintiff contends the omission was inadvertent. Defendant, however, asserts he did not sign the document because he needed approval from a majority of SMC’s limited partners.

On March 15, 2000, plaintiff wrote to defendant, referring to the properties by street address only, and stating “[t]his letter will confirm our contract of sale of the above buildings.” The letter discussed deposits plaintiff had given to defendant and noted “our agreement that the depreciation allocation and tax benefits will be given to me no later than April 1, 2000, since I now have equitable title [sic].” Price terms

were not mentioned. Both parties signed the letter, defendant beneath the handwritten notation “Agreed, Accepted, & Approved.”

Plaintiff claims the March 13 memorandum was attached to the March 15 letter, which defendant annotated and signed in his presence. Defendant insists nothing was attached to the March 15 letter, which he did not sign until March 30. According to defendant, his signature reflected only an accommodation to acknowledge the deposits he had received from plaintiff.

On April 4, 2000, defendant sent plaintiff three formal purchase agreements with escrow instructions, identifying the properties by their legal descriptions. SMC was named as the seller and the Sterling Family Trust as the buyer. The price terms totaled \$16,750,000. Defendant signed the agreements as a general partner of SMC. Plaintiff refused to sign. Defendant claims plaintiff telephoned on April 28, saying the purchase price was unacceptable.

Plaintiff asserts that after reviewing the rent rolls, he determined the actual rental income from the SMC buildings was \$1,375,404, not \$1,600,000 as estimated on the March 13 memorandum. Plaintiff claims he tried to have defendant correct the escrow instructions, but defendant did not return his calls. Plaintiff wanted to lower the price to \$14,404,841, based on the actual rental income figure and the 10.468 multiplier noted in the memorandum.

Plaintiff did not ask for the \$16,750.00 purchase price stated in the memorandum. He admits that he “accidentally left off one zero” when he wrote down that figure. Defendant also acknowledges that the price recorded on the memorandum was meant to be \$16,750,000.

Defendant returned plaintiff’s uncashed deposit checks on May 23. The parties conducted further negotiations in December 2000 and January 2001. Defendant provided additional rent rolls, but no agreement was reached.

In March 2001, the trustees of the Sterling Family Trust sued Taylor, SMC, and related entities, alleging breach of a written contract to sell the properties for a total price of \$14,404,841. The March 13 memorandum and the March 15 letter were attached to the complaint as the “Purchase Agreement.” The complaint included causes of action for breach of the implied covenant of good faith and fair dealing, specific performance, declaratory relief, an accounting, intentional misrepresentation, and imposition of a constructive trust.

Defendants sought summary judgment, claiming that no contract was formed, the alleged contract violated the Statute of Frauds, and plaintiffs could not prove fraud. Defendants contended the memorandum and letter did not satisfy the statute because they established no agreement on price, failed to sufficiently identify either the contracting parties or the properties, and were not signed by Taylor and Christina Development. The trial court granted summary judgment. It ruled that the price term was too uncertain to be enforced and the writings did not comply with the Statute of Frauds. The court also concluded that the undisputed facts disclosed neither a

fraudulent intent on defendant's part nor damages to plaintiff, thus foreclosing the misrepresentation claim.

The Court of Appeal reversed as to the contract causes of action but remanded for entry of summary adjudication in defendants' favor on the fraud claim. The court held that Taylor's name and signature on the writings submitted by plaintiffs satisfied the Statute of Frauds. It also deemed the identification of the properties by street address sufficient, in light of extrinsic evidence specifying the city and state. Likewise, the court held that the price terms in the March 13 memorandum, while ambiguous, could be clarified by examining extrinsic evidence. It concluded that defendants' evidence raised a triable issue as to whether the parties had agreed on a formula for determining the purchase price. The court further ruled that the fraud claim failed because plaintiffs could not prove damages. Only the contract claims are at issue in this appeal.

II. Discussion

Defendants contend the Court of Appeal improperly considered extrinsic evidence to establish essential contract terms. They insist the Statute of Frauds requires a memorandum that, standing alone, supplies all material elements of the contract. Plaintiffs, on the other hand, argue that extrinsic evidence is routinely admitted for the purpose of determining whether memoranda comply with the Statute of Frauds.

Both sides of this debate find support in California case law, sometimes in the same opinion. Part A of our discussion explains that plaintiffs' view is correct. The Statute of Frauds does not preclude the admission of evidence in any form; it imposes a writing requirement, but not a comprehensive one. In part B, however, we conclude that defendants are nevertheless entitled to judgment. The Court of Appeal properly considered the parties' extrinsic evidence, but erroneously deemed it legally sufficient under the Statute of Frauds to establish the price sought by plaintiffs.

A. The Memorandum Requirement of the Statute of Frauds

The Statute of Frauds does not require a written contract; a "note or memorandum . . . subscribed by the party to be charged" is adequate. We [in a prior case] observed that "[a] written memorandum is not identical with a written contract; it is merely evidence of it and usually does not contain all of the terms." Indeed, in most instances it is not even necessary that the parties intended the memorandum to serve a contractual purpose.

A memorandum satisfies the Statute of Frauds if it identifies the subject of the parties' agreement, shows that they made a contract, and states the essential contract terms with reasonable certainty. "Only the essential terms must be stated, 'details or particulars' need not [be]. What is essential depends on the agreement and its context and also on the subsequent conduct of the parties."

This court recently observed that the writing requirement of the Statute of Frauds "serves only to prevent the contract from being unenforceable"; it does not necessarily establish the terms of the parties' contract." Unlike the parol evidence rule,

which “determines the enforceable and incontrovertible terms of an integrated written agreement,” the Statute of Frauds “merely serve[s] an evidentiary purpose.”

As the drafters of the Second Restatement of Contracts explained: “The primary purpose of the Statute is evidentiary, to require reliable evidence of the existence and terms of the contract and to prevent enforcement through fraud or perjury of contracts never in fact made. The contents of the writing must be such as to make successful fraud unlikely, but the possibility need not be excluded that some other subject matter or person than those intended will also fall within the words of the writing. Where only an evidentiary purpose is served, the requirement of a memorandum is read in the light of the dispute which arises and the admissions of the party to be charged; there is no need for evidence on points not in dispute.”

Thus, when ambiguous terms in a memorandum are disputed, extrinsic evidence is admissible to resolve the uncertainty. Extrinsic evidence can also support reformation of a memorandum to correct a mistake.

Because the memorandum itself must include the essential contractual terms, it is clear that extrinsic evidence cannot supply those required terms. It can, however, be used to explain essential terms that were understood by the parties but would otherwise be unintelligible to others. Two early cases from this court demonstrate that a memorandum can satisfy the Statute of Frauds, even if its terms are too uncertain to be enforceable when considered by themselves.

In *Preble v. Abrahams*, a written agreement for the sale of land described the property to be sold as “forty acres of the eighty-acre tract at Biggs.” The court observed: “An agreement not in writing for the sale and purchase of real estate is void. And the description of the property in the written agreement is so entirely uncertain as to render the instrument inoperative and void, unless we can go beyond the face of it to ascertain its meaning.”

To give effect to the agreement, the *Preble* court relied on extrinsic evidence that another buyer had purchased one 40-acre tract and the defendant had agreed to purchase the remainder. “We think the evidence makes the subject-matter sufficiently certain, and that is all that is necessary.” Professor Pomeroy says: “It is not strictly accurate to say that the subject-matter must be absolutely certain from the writing itself, or by reference to some other writing. The true rule is, that the situation of the parties and the surrounding circumstances, when the contract was made, can be shown by parol evidence, so that the court may be placed in the position of the parties themselves; and if then the subject-matter is identified, and the terms appear reasonably certain, it is enough.”

In *Brewer v. Horst and Lachmund Co.*, a contract was memorialized by two telegrams employing a form of shorthand notation so arcane that “[i]f there were nothing to look to but the telegrams, the court might find it difficult, if not impossible, to determine the nature of the contract, or that any contract was entered into between the parties.” The defendant contended the telegrams were an insufficient “note or memorandum” to satisfy the Statute of Frauds.

The *Brewer* court disagreed, stating: “[T]he court is permitted to interpret the memorandum (consisting of the two telegrams) by the light of all the circumstances under which it was made; and if, when the court is put into possession of all the knowledge which the parties to the transaction had at the time, it can be plainly seen from the memorandum who the parties to the contract were, what the subject of the contract was, and what were its terms, then the court should not hesitate to hold the memorandum sufficient. Oral evidence may be received to show in what sense figures or abbreviations were used; and their meaning may be explained as it was understood between the parties.”

Reading the telegrams “by the light of the circumstances surrounding the parties,” the *Brewer* court concluded it was clear that they referred to a contract for the purchase of 296 bales of hops on terms understood by the parties. The facts of *Brewer* were adapted by the drafters of the Restatements as an illustration of a sufficient memorandum for purposes of the Statute of Frauds.

Despite this venerable authority, conflicting statements appear in other California cases: The sufficiency of a writing to satisfy the Statute of Frauds cannot be established by evidence which is extrinsic to the writing itself. The preeminent qualification of a memorandum under the Statute of Frauds is ‘that it must contain the essential terms of the contract, expressed with such a degree of certainty that it may be understood without recourse to parol evidence to show the intention of the parties. The whole object of the statute would be frustrated if any substantive portion of the agreement could be established by parol evidence. Unless the writing, considered alone, expresses the essential terms with sufficient certainty to constitute an enforceable contract, it fails to meet the demands of the statute.

Defendants rely on these and similar cases to argue that the Court of Appeal improperly considered extrinsic evidence to determine the meaning of essential but imperfectly stated terms in the memorandum drafted by plaintiff Sterling.

To clarify the law on this point, we disapprove the statements in California cases barring consideration of extrinsic evidence to determine the sufficiency of a memorandum under the Statute of Frauds. The purposes of the statute are not served by such a rigid rule, which has never been a consistent feature of the common law.

Corbin observes: “Judicial dicta abound to the effect that the writing must contain all of the “essential terms and conditions” of the contract, and it is often said that these must be so clear as to be understood “without any aid from parol testimony.” But the long course of judicial decision shows that “essential terms and conditions” is itself a term of considerable flexibility and that the courts do not in fact blind themselves by excluding parol testimony when it is a necessary aid to understanding.”

Some confusion is attributable to a failure to keep clearly in mind the purpose of the statute and the informal character of the evidence that the actual words of the statute require; some is no doubt due to differences in the attitude of the judges as to the beneficence of the statute and the wisdom of its existence. Further, there are differences in the strictness of judicial requirements as to the contents of the memorandum.

It is believed that sometimes these apparent differences can be explained by the degree of doubt existing in the court's mind as to the actual making and performance of the alleged contract. The better and the more disinterested is the oral testimony offered by the plaintiff, the more convincing the corroboration that is found in the surrounding circumstances, and the more limited the disputed issue because of admissions made by the defendant, the less that should be and is required of the written memorandum.

Williston offers similar counsel: "In determining the requisites and meaning of a 'note or memorandum in writing,' courts often look to the origin and fundamental purpose of the Statute of Frauds. In fact, a failure to do so will often result in a futile preoccupation with the numerous and conflicting precepts and decisions involving the clauses providing for a note or memorandum, and a corresponding failure to see the forest for the trees."

The Statute of Frauds was not enacted to afford persons a means of evading just obligations; nor was it intended to supply a cloak of immunity to hedging litigants lacking integrity; nor was it adopted to enable defendants to interpose the Statute as a bar to a contract fairly, and admittedly, made. In brief, the Statute "was intended to guard against the perils of perjury and error in the spoken word." Therefore, if after a consideration of the surrounding circumstances, the pertinent facts and all the evidence in a particular case, the court concludes that enforcement of the agreement will not subject the defendant to fraudulent claims, the purpose of the Statute will best be served by holding the note or memorandum sufficient even though it is ambiguous or incomplete.

The governing principle is: "That is certain which can be made certain." We hold that if a memorandum includes the essential terms of the parties' agreement, but the meaning of those terms is unclear, the memorandum is sufficient under the Statute of Frauds if extrinsic evidence clarifies the terms with reasonable certainty and the evidence as a whole demonstrates that the parties intended to be bound. Conflicts in the extrinsic evidence are for the trier of fact to resolve, but whether the evidence meets the standard of reasonable certainty is a question of law for the court.

We emphasize that a memorandum of the parties' agreement is controlling evidence under the Statute of Frauds. Thus, extrinsic evidence cannot be employed to prove an agreement at odds with the terms of the memorandum. This point was made in *Beazell v. Schrader*. There, the plaintiff sought to recover a 5 percent real estate broker's commission under an oral agreement. The escrow instructions, which specified a 1.25 percent commission, were the "memorandum" on which the plaintiff relied to comply with the statute.

However, he contended the instructions incorrectly reflected the parties' actual agreement, as shown by extrinsic evidence. The *Beazell* court rejected this argument, holding that under the Statute of Frauds, "the parol agreement of which the writing is a memorandum must be one whose terms are consistent with the terms of the memorandum." Thus, in determining whether extrinsic evidence provides the certainty required by the statute, courts must bear in mind that the evidence cannot contradict the terms of the writing.

B. The Sufficiency of This Memorandum

As noted above, it is a question of law whether a memorandum, considered in light of the circumstances surrounding its making, complies with the Statute of Frauds. Accordingly, the issue is generally amenable to resolution by summary judgment. We independently review the record to determine whether a triable issue of fact might defeat the Statute of Frauds defense in this case.

A memorandum of a contract for the sale of real property must identify the buyer, the seller, the price, and the property. Defendants contend the memorandum drafted by plaintiff Sterling fails to adequately specify the seller, the property, or the price.

The Court of Appeal correctly held that the seller and the properties were sufficiently identified. The parties themselves displayed no uncertainty as to those terms before their dispute over the price arose. It is a “cardinal rule of construction that when a contract is ambiguous or uncertain the practical construction placed upon it by the parties before any controversy arises as to its meaning affords one of the most reliable means of determining the intent of the parties.” The same rule governs the interpretation of a memorandum under the Statute of Frauds.

The memorandum referred to “Seller Larry Taylor, & Christina Development.” Defendants argue that the omission of the actual owner of the properties, SMC, is fatal. However, they do not dispute Taylor’s authorization to act as SMC’s agent, or his actual performance of that role. A contract made in the name of an agent may be enforced against an undisclosed principal, and extrinsic evidence is admissible to identify the principal. If a term is stated in a memorandum with sufficient certainty to be enforced, it satisfies the Statute of Frauds. Therefore, the reference to Taylor was adequate, regardless of the apparently mistaken inclusion of Christina Development.

Similarly, while the properties were identified in the memorandum only by street address, neither party displayed any confusion over their actual location. The purchase agreements Taylor prepared included full legal descriptions, and when Sterling received those agreements he did not object that he wanted to buy buildings on 4th and 14th Streets in Manhattan rather than Santa Monica. In any event, the better view has long been that extrinsic evidence may be consulted to locate property described in imprecise terms, even though a memorandum with a more complete description would be preferable.

As defendants forthrightly conceded in the trial court, “[t]he problem here is the price term.” The Court of Appeal concluded that the lines in the memorandum stating “approx. $10.468 \times$ gross income[,] estimated income 1.600.000, Price \$16,750.00” were ambiguous, given the use of the modifier “approx.” before the multiplier, the omitted zero in the price, and the uncertain meaning of “gross income.” The court then considered Sterling’s testimony that “approx.” was meant to modify the total price, not the multiplier; that the missing zero was merely an error; and that “gross income” was used by the parties to refer to actual gross annual income. It decided that this evidence, if accepted by the trier of fact, could establish an agreement to determine the price based on a formula, which would be binding under *Carver v.*

Teitsworth. In *Carver*, a bid for either a specified price or \$1,000 over any higher bid was deemed sufficiently certain.

In this court, plaintiffs also cite *Cal. Lettuce Growers v. Union Sugar Co.* to show that a price term may be calculated from a formula. There, a price formula was derived from industry custom and the parties' past practice. Plaintiffs contend the parties here negotiated a 10.468 multiplier to be applied to the actual gross rental income from the buildings in March 2000, as indicated by the fact that Taylor gave Sterling rent rolls before their March 13 meeting.

The Court of Appeal erred by deeming Sterling's testimony sufficient to establish his interpretation of the memorandum for purposes of the Statute of Frauds. Had Taylor testified that the parties meant to leave the price open to determination based on a rental income figure that was yet to be determined, this would be a different case. Then, the "admissions of the party to be charged" might have supported a reasonably certain price term derived from a negotiated formula. Here, however, Taylor insists the price was meant to be \$16,750,000, and Sterling agrees that was the number he intended to write down, underlined, as the "Price."

\$16,750,000 is clearly an approximate product of the formula specified in the memorandum, applied to the income figure stated there. On the other hand, Sterling's asserted price of \$14,404,841 cannot reasonably be considered an approximation of \$16,750,000. It is instead an approximate product of the formula applied to an actual income figure not found in the memorandum. The writing does not include the term "actual gross income," nor does it state that the price term will vary depending on proof or later agreement regarding the actual rental income from the buildings. In effect, Sterling would employ only the first part of the price term ("approx. $10.468 \times$ gross income") and ignore the last parts ("estimated income 1.600.000, Price \$16,750.00"). He would hold Taylor to a price that is 10.468 times the actual rental income figure gleaned from the rent rolls, but only "approximately" so because of Sterling's computational errors.

Thus, two competing interpretations of the memorandum were before the court. Taylor's is consistent with the figures provided in the memorandum, requiring only the correction of the price by reference to undisputed extrinsic evidence. Sterling's price is not stated in the memorandum, and depends on extrinsic evidence in the form of his own testimony, disputed by Taylor, that the parties intended to apply the formula to actual gross rental income instead of the estimated income noted in the memorandum. Even if the trier of fact were to accept Sterling's version of the parties' negotiations, the price he seeks is not reflected in the memorandum; indeed, it is inconsistent with the price term that appears in the memorandum. Under these circumstances, we conclude the evidence is insufficient to establish Sterling's price term with the reasonable certainty required by the Statute of Frauds.

The Statute of Frauds demands written evidence that reflects the parties' mutual understanding of the essential terms of their agreement, when viewed in light of the transaction at issue and the dispute before the court. The writing requirement is

intended to permit the enforcement of agreements actually reached, but “to prevent enforcement through fraud or perjury of contracts never in fact made.” The sufficiency of a memorandum to fulfill this purpose may depend on the quality of the extrinsic evidence offered to explain its terms. In *Preble*, the memorandum failed to describe the property to be sold with any certainty, but extrinsic evidence established that the parties could only have been referring to the portion of a tract that was not sold to another buyer. Similarly, in *Brewer*, telegrams that were otherwise inscrutable demonstrated an ascertainable agreement when the court considered the circumstances of the transaction and the parties’ understanding of the terms employed.

Here, unlike in the *Preble* and *Brewer* cases, the extrinsic evidence offered by plaintiffs is at odds with the writing, which states a specific price and does not indicate that the parties contemplated any change based on actual rental income. Therefore, the evidence is insufficient to show with reasonable certainty that the parties understood and agreed to the price alleged by plaintiffs. The price terms stated in the memorandum, considered together with the extrinsic evidence of the contemplated price, leave a degree of doubt that the Statute of Frauds does not tolerate. The trial court properly granted defendants summary judgment.

III. Disposition

The judgment of the Court of Appeal is reversed with directions to affirm the trial court judgment in its entirety.

KENNARD, J., Concurring and Dissenting.

I agree with the majority that extrinsic evidence is admissible to resolve the meaning of an ambiguity in a written memorandum required by the Statute of Frauds as evidence of an agreement, and that conflicts in the evidence are for the trier of fact to resolve. The majority, however, goes astray when it takes it upon itself to resolve an existing conflict in the evidence. In my view, the ambiguity in the language of the memorandum at issue should be resolved by the trier of fact.

I.

In January 2000, plaintiff Donald Sterling and defendant Lawrence N. Taylor, both of whom are experienced real estate investors, discussed the proposed sale of three apartment buildings in Santa Monica owned by a partnership in which defendant was the general partner. On March 13, 2000, they met again. At the meeting, plaintiff (the prospective buyer) prepared a brief handwritten memorandum entitled “Contract for the Sale of Real Property.” As relevant here, the memorandum identified properties at “808 4th St.,” “843 4th St.,” and “1251 14th St.” This is immediately followed by “approx 10.468 × gross income [¶] estimated income 1.600.000, Price \$ 16,750,000.” The memorandum was initialed by plaintiff, but was not signed by defendant. Two days later, on March 15, 2000, plaintiff sent defendant a letter that confirmed the contract of sale but did not mention the price. Defendant signed the letter below the handwritten notation, “Agreed, Accepted, & Approved.” The parties dispute whether the March 13 memorandum was attached to the March 15 letter.

The issue is whether the document entitled “Contract for the Sale of Real Property” is a memorandum sufficient to satisfy the Statute of Frauds. That statute provides that contracts for, among other things, the sale of real estate are invalid unless evidenced by a note or memorandum signed by the party to be charged. Plaintiff here claims that the memorandum meets the requirements of the Statute of Frauds because extrinsic evidence he offered clarifies that the agreed price was \$14,404,841—determined by applying the formula in the memorandum of multiplying the actual rent times 10.468. Plaintiff’s extrinsic evidence includes the “Contract for Sale of Real Property,” the letter dated March 15, 2000, confirming the buildings’ sale signed by defendant, and defendant’s having given plaintiff information showing the actual rent received. Defendant maintains that the price is the figure \$16,750,000 expressed in the memorandum.

The trial court granted defendant’s motion for summary judgment. The Court of Appeal, concluding there was a triable issue of material fact as to whether the parties had agreed to a formula for determining the purchase price, reversed.

II.

The parties’ dispute here centers on whether the price description in the memorandum is ambiguous so that extrinsic evidence is admissible to clarify its meaning and satisfy the Statute of Frauds. Regarding price the memorandum states: “approx. $10.468 \times$ gross income [¶] estimated income 1.600.000, Price \$16,750,000.” Plaintiff claims that the word “approx.” modified the entire statement, not just “ $10.468 \times$ gross income,” and that the parties understood the term “gross income” to mean actual annual gross rental income. In other words, plaintiff’s position is that the memorandum sets forth a formula for determining the actual price—10.468 multiplied by actual annual gross rental income, which results in a price of \$14,404,841—and that the reference to “Price \$16,750,000” is an estimate of the actual price, determined by application of the formula just mentioned, albeit using a somewhat inaccurate estimate of gross annual rental income. Defendant disagrees, contending that the memorandum’s mention of “Price \$16,750,000” reflects the actual purchase price agreed upon by the parties. Both have a point.

As the Court of Appeal observed, the language in the memorandum is ambiguous; that is, it can reasonably be read as each party proposes. To accept plaintiff’s argument would give meaning to the language in the disputed statement of “ $10.468 \times$ gross income [¶] estimated 1.600.000.” To accept defendant’s argument would give meaning to the term “Price \$16,750,000.” Which view should be accepted is a determination to be made by the trier of fact, based on its consideration of the extrinsic evidence presented. Either way, the trier of fact’s resolution would result in a specific purchase price: one arrived at through application of a formula expressed in the memorandum, the other through acceptance of the figure \$16,750,000 mentioned in the memorandum.

The majority, however, simply adopts defendant’s view instead of leaving it to the trier of fact to resolve the conflict in the evidence. In accepting defendant’s view, the

majority rejects plaintiff's view as attempting to alter rather than explain the terms of the memorandum. I disagree.

Apparently based on its own evaluation of the evidence, which as discussed above is conflicting, the majority takes it upon itself to decide that the agreed price was \$16,750,000 and then concludes that any extrinsic evidence presented by plaintiff would be inconsistent with that figure. The majority reasons that plaintiff is looking only to the first part of the memorandum's price description of "approx. 10.468 × gross income," while ignoring the last part stating "estimated income 1.600.000, Price \$16,750,000." This is both a misapprehension of plaintiff's view and a failure to appreciate that defendant's view too is not free from ambiguity.

Plaintiff's position that the memorandum sets forth a formula for determining the price does not ignore the memorandum's reference to "estimated income 1.600.000, Price \$16,750,000." According to plaintiff, the memorandum's stated price is itself an estimate, for it is the product of the estimated income of 1.600.000 times 10.468, while the actual price is to be determined by using the formula 10.468 multiplied by the actual gross income, resulting in a price of \$14,404,841. Defendant's view that the actual price is \$16,750,000 finds support in the memorandum's mention of "Price \$16,750,000" but it ignores the memorandum's formula that plaintiff relies on. Unlike the majority, I see no reason to reject plaintiff's position as a matter of law when the purchase terms in the memorandum are ambiguous and are as reasonably susceptible to plaintiff's position as to defendant's. I would leave it to the trier of fact to resolve the ambiguity.

Unlike the majority, I would affirm the judgment of the Court of Appeal.

WERDEGAR, J., concurred.

Appellants' petition for a rehearing is denied April 18, 2007. GEORGE, C.J., did not participate therein. KENNARD, J., and WERDEGAR, J., were of the opinion that the petition should be granted.

Reflection

In *Sterling*, the parties disputed the purchase price, and the court found that price to be ambiguous. Later, in the chapters on contract interpretation, you will learn that courts have tools known as the "canons of construction" to resolve ambiguities in a document. Courts may also take evidence such as parties' and experts' testimonies to determine how a contract should be interpreted. You will also learn about the so-called "policy canon," which instructs that an unresolvable ambiguity should be construed against the drafter. All of these legal tools can be employed by courts to disambiguate a contract and to resolve a dispute by assessing damages for breach.

But the *Sterling* court did not engage in this interpretive activity. Instead, the court focused on the preliminary question of whether there was any enforceable contract at all. This reflects a certain jurisprudential stance. Some courts would be more apt to construe the legal meaning of the writing and thus find the contract was enforceable

in this case. Yet this court chose not to imply an agreement where the parties did not expressly write out what price they would pay for a rental property. Although *Sterling* accords with principles in the R2d, a court with a different perspective could have resolved the case differently. Given a complex enough set of rules such as we find in contract law, courts have more freedom than might be initially apparent to uphold contracts—or not. Careless drafting puts parties at risk of judicial discretion.

Discussion

1. Although the statute of frauds does not require an entire contract to be written, it does require written evidence of material terms. What are “material” terms, in general?
 2. In *Academy Chicago Publishers v. Cheever*, 578 N.E.2d 981 (Ill. 1991), the trial court found that although the contract lacked essential terms, the court could discover and imply those terms, thus making the contract enforceable. Note that the *Cheever* decision was eventually reversed. Can you reason why the court in *Sterling* did not take it upon itself to determine what the price term should be?
 3. The *Sterling* concurrence and dissent argues that the majority overreached its judicial authority where it determined what the contract itself means. According to the dissent, who should resolve such matters of factual inquiry? Why should appellate courts not resolve such inquiries?
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Problems

Problem 10.1. Perpetuating Frauds

The equitable exception to the statute of frauds implicitly recognizes that the statute can sometimes create injustice. Can you think of some situations where requiring a signed writing might perpetuate fraud instead of preventing fraud? In other words, could someone use the requirement of a signed writing to defraud another? Discuss a hypothetical situation to illustrate your reasoning.

Problem 10.2. Frauds Policy

The *Stearns* court concludes simply: “to enforce a multi-year employment contract an employee must produce a writing that satisfies the Statute of Frauds or must prove fraud on the part of the employer.” This does not appear to be the same standard that *McIntosh* or the R2d employ, in that *Stearns* seems to add a new requirement for the promissory estoppel exception to the statute of frauds, such that fraud by one party

is required to prevent the statute of frauds from barring enforcement of the contract by the other. Do you agree with this addition? Explain your reasoning in terms of public policy.

Problem 10.3. UCC Frauds

The UCC makes it easier for merchants to satisfy the statute of frauds than the R2d does for ordinary people. What policy reasons might justify a rule that effectively makes it easier for merchants to enforce contracts among each other? Do you agree with this distinction for merchants? Make sure to cite the rules and describe their differences in your discussion of the policy reasons for such differences.

Problem 10.4. Misty Wedding

Misty G. O'Connor established a limited liability company named Misty Shores Events, LLC. She created this entity to operate a wedding venue. On September 10, 2017, Shannon Markham and Cameron Folga entered into a contract with Misty Shores Events, LLC, for the purchase of a "full wedding and reception package" that included a rental of the reception facility on June 16, 2018, at a total cost of \$17,500. Folga paid Misty Shores Events, LCC, a \$1,000 deposit.

Misty Shores Events, LLC, was ultimately unable to open for business and failed to return any of ten customer deposits. On March 4, 2018, O'Connor sent an email to Folga. In it, O'Connor wrote that she was "personally trying to pick up the pieces of my business not opening," and that she "agreed to pay each couple monthly payments until their full deposited amount is paid in full." After what in a traditional letter would have been called the complimentary closing, O'Connor typed "Misty" in a space immediately above the automated signature block in her email. Despite this promise, Folga received no reimbursement. Folga sued O'Connor. She defended on the basis that the statute of frauds prevents enforcement of her alleged promise.

Who should prevail, and why?

See In re O'Connor, 630 B.R. 384 (2021).

Chapter 11

Mistake

Contracts are the architecture of voluntary exchange. They transform uncertainty into mutual gain. When two parties shake hands—or sign on the dotted line—they create a framework of rights and obligations that allows each to plan, invest, and rely on the other’s promises. But what happens when that framework rests on a faulty assumption? When one or both parties misunderstand a crucial fact, should the law intervene, or should the mistake stand as part of the bargain?

The doctrine of mistake allows courts to address profound misunderstandings that undermine mutual assent. At its core, contract law prioritizes efficiency by allocating risks and rewards to maximize the benefits of exchange. Certainty plays a vital role in this process. Parties must trust that their agreements will be upheld as written, even when unforeseen circumstances arise, or they would not plan, invest, and rely on them.

Predictability enables commerce to thrive, but rigid enforcement can clash with fairness and justice. When contracts are formed under significant misunderstandings, strict adherence to their terms may lead to unfair outcomes and undermine confidence in the legal system. The doctrine of mistake navigates this tension, preserving stability while addressing cases where fairness demands intervention.

On the one hand, letting parties rescind their contracts too easily would discourage diligence and destabilize transactions. On the other hand, some mistakes are so fundamental that they disrupt mutual assent. In these rare cases, the law steps in to adjust or unwind the deal, striking a balance between stability and fairness.

This chapter examines how courts address these competing priorities, using cases to illustrate when a mistake justifies intervention. From the tale of a mysterious stone to disputes over a fertile heifer, these stories reveal how the law defines mistake, allocates risks, and determines the boundaries of contractual fairness.

As we explore the doctrine of mistake, consider its broader implications: How should the law encourage parties to act carefully without punishing honest errors? When does fairness require courts to intervene, and when should parties bear the risks of their own assumptions? These questions guide our study of the rules and policies that shape this complex and fascinating area of contract law.

Rules

A. Mutual Mistake

A mutual mistake occurs when both parties share the same mistake about a material fact relating to the transaction.

For example, the buyer and seller of a car both believe they are buying and selling a 2004 Dodge Ram Pickup 1500 vehicle, identified by vehicle identification number (VIN) 1D7HU18D54S747050. However, the seller's agent inadvertently transfers to the buyer a 2004 Chevrolet Tracker with VIN 2CNBJ134146900067. Unbeknownst to either party, the buyer goes home with the wrong car. These parties have made a mutual mistake. They entered a contract for the sale of the wrong vehicle.

The party who is harmed by a mutual mistake may attempt to raise the mistake defense in order to rescind (unwind) the contract. The result, if the defense is successful, would be to return the consideration paid by both parties as if the contract never occurred. In this hypothetical, assume the Dodge Ram has an estimated value of \$6,000, while the Chevy Tracker has an estimated value of \$5,000. This means the *buyer* is likely to be harmed by over-paying for the vehicle and can try to raise mutual mistake as a defense.

The rule governing the defense of mutual mistake is found in R2d § 152.

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. R2d § 152(1).

Mutual mistake under R2d § 152 requires proving four elements:

1. The parties have both made a mistake of fact;
2. about a basic assumption on which the contract is made;
3. the mistake has a material effect on the agreed exchange; and
4. neither party assumed the risk of mistake.

The first element clarifies that the mistake must be a factual error. A fact is an objectively verifiable statement that can be proven or disproven through evidence. An example of a fact is “the sky today is blue” or “the earth is round.” A fact is not an opinion, a prediction, or a judgment call. Thus, a mistake about the value of a thing, or a mistake about the future value of a thing, is not a mistake of fact at all. The principle to keep in mind is that a party cannot escape their bad judgment simply by arguing, “Mistake!”

The second element requires the mistake to relate to “a basic assumption on which the contract was made.” Traditionally, courts considered whether the mistake went to

the “nature of the thing”—to its identity or its fundamental character—as opposed to merely its “quality” or “value.” This is the test used in the older cases you will read: *Wood v. Boynton*, 64 Wis. 265 (1885), and *Sherwood v. Walker*, 66 Mich. 568 (1887).

Today, this element is more nuanced, asking whether the parties were operating on the assumption that the mistaken fact was true and formed their contract based on this assumption. Courts distinguish core issues (basic assumptions) from collateral side issues that did not really matter to the parties when making their contract.

For example, in the Dodge Ram example, the parties were mistaken about the type of car being sold, so this would almost certainly be deemed a basic assumption on which the contract was made. But what if their mistake was that the name of the founder of the car company was “Jack,” when it was “Jeff”? This would only be a basic assumption on which the contract was made *if* the parties explicitly addressed this issue and saw it as a core part of their deal—which is highly unlikely.

Third, the mistake must have had a “material effect on the agreed exchange.” “Material” in contract law means something that would affect a reasonable person’s decision to enter the contract or that would affect the price or value ascribed to the consideration. The outcome of this element will likely overlap with the outcome of the second element, but the focus is different. The “basic assumption” element asks whether the parties considered this issue when they entered the contract and saw it as a core part of the transaction; “materiality” assesses the impact of the mistake on the values exchanged. A mistake has a material effect on the exchange if the parties would not have entered the contract if they knew the truth, or at least they would not have entered it on these terms. One useful rule of thumb is to ask whether the mistake affects the *price* paid by one of the parties.

Finally, the party trying to get out of the contract cannot have borne the risk of the mistake. Even if the first three elements are met, modern courts will not grant a mistake defense if the aggrieved party bore the risk of the mistake. This doctrine, sometimes called “assumption of risk,” is explained in R2d § 154:

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.

The acronym for remembering when a party bears the risk of mistake is the “three Cs”—contract, conscious ignorance, and court.

First, assumption of risk occurs through contract when the parties expressly agree that one party shall bear the risk of the mistake. This is a question of contract interpretation, which is the subject of the module on Interpretation. For example, imagine a contract that provides that Seller will sell Blueacre to Buyer via a quitclaim deed. Unlike a general or special warranty deed, a quitclaim deed is a legal instrument that

provides no protections for the buyer as to whether the seller has a good title. The Buyer has assumed the risk that Seller's title to Blueacre is defective.

Second, assumption of risk occurs through conscious ignorance when one party enters a transaction knowing she has limited knowledge of material facts and yet agrees to enter the contract anyway. For example, imagine a contract in which Buyer and Seller agree to the sale of Greenacre, a parcel of land which the parties believe encompasses one hundred acres. During negotiations, Buyer asks Seller to obtain a surveyor's report verifying the acreage of the property. However, Seller refuses to pay for the report, and Buyer chooses to buy the land without verifying the acreage. Buyer has assumed the risk that their belief about the acreage is mistaken. Buyer cannot later raise the defense of mutual mistake, even if it turns out the property only contains seventy acres.

Finally, courts can decide that a party assumed the risk of a mistake based on concerns of reasonableness, efficiency, or fairness. For example, courts may find that a professional developer, who contracted to build an apartment complex on a parcel of land owned by an onion farmer, bore the risk that the subsoil conditions were abnormal. A professional developer has the resources and knowledge to efficiently determine the subsoil conditions, whereas the onion farmer does not. Courts may also pay attention to the comparative knowledge and sophistication of the parties. For example, if the buyer of a car is an ordinary person, while the seller is a sophisticated corporation that sells hundreds of cars a week, the court may determine, based on efficiency and fairness concerns, that the corporation bears the risk of pricing mistakes and refuse to grant a mistake defense to such a powerful counterparty.

Illustration of Mutual Mistake: *Sherwood v. Walker*. Mutual mistake is famously illustrated by the 1887 case of *Sherwood v. Walker*, which is also known as the case of the fertile cow. Hiram Walker & Sons agreed to sell a cow named Rose 2d of Aberlour (which the court mistranscribed as Aberlone) to Theodore C. Sherwood for five and a half cents per pound. Rose weighed in at 1,420 pounds, and Sherwood tendered \$80 for her. But Walker refused to deliver Rose to Sherwood, and Sherwood sued for the cow.

Walker defended on the ground that the parties assumed Rose was a barren cow and would not breed. But both parties were mistaken. Rose turned out to be with calf. A fertile cow is worth ten times more than a barren cow. Therefore, Walker argued, the parties made a mutual mistake. They thought they were buying and selling a barren cow but were transacting regarding a fertile cow.

Sherwood counter-argued that the parties made a contract for Rose 2d, and Rose 2d is indeed what the parties agreed to buy and sell. Whether Rose was barren or fertile was of no moment, argued Sherwood.

The *Sherwood* court thus had to answer the question of whether the contract was for a barren cow or for Rose 2d. The court determined that the

contract was for a *barren cow* and that the parties were in fact mistaken over whether the cow was barren.

The court then applied the traditional rule, which asked whether the mistake went to the nature of the thing or only to its quality or value. The court found the parties' mistake indeed went to the very "character of the animal," and so a mistake defense was warranted. The court allowed Walker to rescind the contract. Sherwood gained the right to the return of any price paid, and Walker gained the right to keep the cow.

Sherwood included a strenuous dissent. The dissent took the position that courts should be very reluctant to allow parties to unwind a contract due to a mistake.

It is not the duty of courts to destroy contracts when called upon to enforce them, after they have been legally made.

The dissent also agreed with Sherwood's position that the cow was in fact the very same cow that Walker agreed to sell, so there was no mistake at all. Moreover, the dissent disagreed with the majority's conclusion that the cow's barren state went to its inherent nature, as opposed to merely its quality or value.

This debate, between two reasonable jurists, highlights the weakness of the traditional rule. Rather than asking whether the aggrieved party assumed the risk of the mistake, which is the focus of the modern rule in R2d §§ 152 and 154, the court tried to resolve a metaphysical question over what makes a cow a cow.

B. Unilateral Mistake

A unilateral mistake occurs when only one party to a transaction is mistaken as to a material fact relating to the deal. One party makes a mistake that causes them to hold an erroneous belief, but the other party's belief remains accurate or simply unformed.

For example, imagine that Seller believes she is the legal owner of two acres of land, when in fact she owns three acres of land. Buyer approaches Seller to buy the land, either knowing there are three acres, or having no opinion on the matter at all. Seller then sells Buyer the land based on her erroneous belief that it is only two acres. Seller regrets her decision once she learns the truth. This mistake results in harm to Seller. Presumably, Seller would have sold three acres for more money than two acres. Seller may attempt to invoke the defense of unilateral mistake to avoid the contract.

The unilateral mistake defense is far more difficult to bring than the mutual mistake defense. The defense of unilateral mistake requires proving all the same elements of mutual mistake, including that the mistaken party did not bear the risk of the mistake, plus additional elements.

The elements of a unilateral mistake defense are delineated in R2d § 153:

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.

As you can see, the mistaken party must prove, along with the usual elements of mistake, either that the effect of the mistake would make enforcement of the contract unconscionable (meaning so grossly one-sided it would shock the conscience of the court) or that the other party had reason to know about the mistake or caused the mistake.

In the land-sale hypothetical above, it is unlikely Seller could get out of the contract based on her unilateral mistake about the acreage of her own land. Not only would it be challenging to show she did not assume the risk of mistake, but there are no facts suggesting Buyer knew about or caused the mistake or that the sale would be unconscionable due to Seller's error.

In sum, courts are far less likely to grant the defense of unilateral mistake. Contract law generally does not permit parties to escape unfavorable agreements simply due to their failure to investigate material facts. That said, as you will see in *DePrince v. Starboard Cruise Services, Inc.*, 271 So. 3d 11 (Fla. Dist. Ct. App. 2018), the defense can be successful in certain circumstances.

Illustration of Unilateral Mistake: DePrince v. Starboard Cruise Services, Inc. The recent case of *DePrince v. Starboard Cruise Services, Inc.*, illustrates a unilateral mistake. Thomas DePrince was traveling aboard a Starboard cruise ship when he visited the ship's jewelry boutique and indicated his interest in purchasing a large, loose diamond. The boutique manager called his corporate office, which, in turn, contacted the corporation's diamond broker in New York. The broker emailed the following prices to the corporate office, which forwarded the communication to the boutique, whose manager then presented this information to Mr. DePrince:

EC 20.64 D VVS2 GIA VG G NON selling price \$235,000

EC 20.73 E VVS2 GIA EX EX FNT selling price \$245,000

The manager, who was authorized to transact on behalf of Starboard, then agreed to sell the first stone to DePrince for \$235,000. DePrince paid with his

credit card, and the manager promised that Starboard would ship the stone to him. But this manager, who had never dealt with such a large diamond before, had made a critical mistake.

Unbeknownst to the boutique manager, diamond traders quote prices in per-carat terms. In this case, the first stone was 20.64 carats, and the per-carat price was \$235,000, so the total price should have been \$4,850,400. In other words, the manager made a \$4.5 million mistake.

When Starboard Corporation discovered the error, it immediately notified DePrince of the error and reversed the charge to his card. But DePrince did not want his money back; rather, he wanted Starboard to keep its promise and complete the transaction. DePrince sued Starboard to enforce the contract, and Starboard defended on the ground of unilateral mistake.

The court of appeals upheld the jury verdict that Starboard should be excused. The jury, the trial judge, and the court of appeals all agreed that the elements of unilateral mistake were met, as described in R2d § 153, quoted above.

The court did not need to focus on subparagraph (a) regarding unconscionability because Starboard presented sufficient evidence indicating that DePrince was aware of the mistake and chose to remain silent. Key facts supporting the court's decision to grant the defense of mistake included the fact that DePrince's partner, Mr. Crawford, who was with him at the time of the sale, was a certified gemologist. This tends to show that DePrince should have known that Starboard's manager was making a mistake.

Additionally, Crawford called DePrince's sister, who was a graduate gemologist, to discuss the price. The sister advised Crawford that something was wrong because a diamond of that size should cost millions of dollars. This provided further evidence that DePrince knew of Starboard's mistake.

As for the other elements, the mistake clearly had a material impact on the transaction since Starboard sold a diamond for one-twentieth of its value. There was nothing in the parties' contract showing that Starboard had the risk of this mistake, although a seller is typically responsible for pricing its goods correctly. But, here, a jury found that DePrince knowingly took advantage of Starboard's material mistake; therefore, granting the defense of mistake was appropriate.

C. Mistranscription

Mistranscription, sometimes called a scrivener's error, occurs when a written contract fails to reflect the actual agreement between the parties. Imagine Bartleby, a meticulous but occasionally distracted scrivener, mistakenly omits a zero or transposes a key term, leading to a contract that doesn't match what the parties intended.

These errors can have serious consequences depending on the significance of the mistake and its impact on the agreement.

Some mistranscriptions make a contract voidable. This happens when the mistake is so significant that it undermines mutual assent. If Bartleby drafts a sales agreement for an art gallery and writes \$75,000 instead of \$750,000, the written contract fails to reflect the true deal. The seller could argue there was no meeting of the minds and refuse to complete the sale. The mistake would affect a fundamental term and destroy the shared understanding necessary for a valid contract.

Reformation offers another way to resolve a mistranscription. Courts often correct the written terms to reflect the parties' actual agreement when there is clear and convincing evidence of their mutual intent. In the example above, if the buyer's administrative assistant testifies that the parties orally agreed to \$750,000, or if that was the price at which the art was publicly listed for sale, a court might reform the contract to align with the true terms. Reformation ensures the contract matches what the parties intended without voiding the entire agreement.

Sometimes, mistranscriptions are enforced as written. This happens when the error is minor or when a third party relies on the contract in good faith. For example, if Bartleby transcribes \$3,000 instead of \$30,000 in a sales contract for a car and the buyer assigns the agreement to an innocent third party, courts might enforce the document as written to protect the third party's reliance. Protecting innocent reliance often takes priority over correcting the original mistake.

Mistranscription cases highlight the balance between fairness and efficiency in contract law. Reformation preserves the integrity of the parties' true agreement, while enforcement as written ensures predictability and stability in contractual relationships. Bartleby's well-intentioned but flawed work reminds us that even small errors in transcription can lead to significant legal disputes. Courts must weigh these concerns carefully, balancing the principles of fairness, mutual assent, and reliance.

Whether a contract is voidable, reformed, or enforced as written depends on the nature of the error and its effect on the parties and others involved. Bartleby's mistakes are not just the source of headaches. They reveal the broader challenges of ensuring fairness while maintaining the reliability of written agreements. By addressing these disputes thoughtfully, courts strive to achieve justice while respecting the foundations of contract law.

D. Reflections on Mistake

Mistake occurs when one or both parties hold a belief that is not in accord with the facts. When only one party is mistaken and the other party holds a correct belief or no belief about the matter, this is known as a unilateral mistake. When both parties share the same mistaken belief, it is called a mutual mistake. Finally, when a mistake arises in the final written memorialization of an agreement, it is referred to as a mistranscription.

The mistake doctrine involves a careful balance between two key policies underlying contract law: fairness and efficiency. On the one hand, it seems fundamentally unfair to hold a party to a contractual obligation that was entered into under a mistaken belief about a material fact. On the other hand, permitting parties to escape their agreements too easily risks encouraging carelessness and undermines the stability of contracts, thus making the entire system inefficient. Unilateral mistakes present a particular challenge because our legal system generally expects capable individuals to bear the risks of their own errors. For this reason, courts rarely grant relief for unilateral mistakes.

Mutual mistakes, however, are treated somewhat differently. When both parties are mistaken about a fundamental fact underlying their agreement, questions naturally arise about whether there was ever mutual assent. Mutual assent is the foundation of enforceable contracts in a free society, and its absence strikes at the very core of contractual obligations. Where neither party is at fault for the mutual mistake, courts are often inclined to void the agreement entirely.

Mistranscriptions, when parties share a common understanding but do not write it down correctly, do not always justify voiding the contract. In cases of minor errors, such as typos, courts may reform the written agreement to reflect the true intent of the parties rather than invalidate the entire contract.

It is also important to distinguish mistake from misunderstanding, a related but distinct concept. While a mistake involves a belief not in accord with the facts, a misunderstanding arises when the parties have different but accurate beliefs about a material aspect of the transaction. For example, consider the famous *Peerless* case, where two ships with the same name led to confusion. I may intend for cotton to be shipped on the October *Peerless*, while you believe we are referring to the December *Peerless*. Neither of us holds a mistaken belief about the ships themselves; we are both correct about their existence and schedules. However, we do not share the same understanding. This situation reflects a failure of mutual assent, not a mistake, because there was no true agreement about the subject matter of the contract.

Similarly, misrepresentation is often mistakenly grouped with mistake. However, these doctrines address different concerns. A misrepresentation involves an assertion that is not in accord with the facts, typically made by one party to induce the other into a contract. While a misrepresentation may result in a party's holding a mistaken belief, the focus of the analysis shifts to the wrongful conduct of the party making the misrepresentation. This difference is critical: the mistake doctrine applies to situations where erroneous thinking arises without fault, whereas misrepresentation introduces an element of culpability. The next chapter, which focuses on how intentional or negligent misstatements can undermine the validity of a contract, will explore this distinction further.

By distinguishing mistake from related doctrines such as misunderstanding and misrepresentation, we see how contract law categorizes and addresses the challenges of erroneous thinking. The doctrine of mistake, though narrow in scope, underscores the importance of fairness and mutual understanding in the formation and enforcement of agreements.

Cases

Reading Wood v. Boynton. Imagine you have a Beanie Babies collection that you want to sell. You don't know how much they're worth, but you go to a shop anyway. The shop owner doesn't know how much they're worth either, but you decide to sell them for \$20. Later you find out they were actually worth \$20,000. Can you use the defense of mistake? What was your belief that was not in accord with the facts? The case below, *Wood v. Boynton*, discusses a similar situation. The seller, Ms. Wood, sold a stone to the buyer, Mr. Boynton, for \$1, believing the stone to be a rock of unknown value, perhaps a topaz. But the stone was actually an extraordinarily expensive diamond. This case provides an example of how courts used to tackle the issue of mistake. Rather than explicitly asking whether a party assumed the risk of a mistake—which is the modern approach under R2d § 154—courts used to focus on whether mistake regarded the very nature of the thing, or merely its quality or value. In *Wood*, the court found the parties made no mistake as to “the identity of the thing sold.” They thought they were transacting over a stone of unknown value, and indeed they were. Consider how you might respond to this point. Was there perhaps indeed a mistake as to the nature of the thing? Also consider how a modern court might have addressed this case under the framework provided in the R2d.

Wood v. Boynton

64 Wis. 265 (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 28th 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 learning 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 his store to get a little pin mended, and I had it in a small box—the pin—a small earring; . . . 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 28th 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. 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 that 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 knew 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 after-investigation 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.

Reflection

The *Wood* case is an introduction to what a mistake is not. In this case, the court found there was no mistake as to the identity of the thing being sold. It might be tempting to say that Wood and Boynton believed the stone to be a topaz when in fact it was an uncut diamond. In other words, their mutual mistake was that the stone was “not a diamond.” But the court reasoned that, in fact, there was no mistake of fact at all. As the court stated, “[b]oth were entirely ignorant at the time of the character of the stone and of its intrinsic value.” Wood intended to sell a stone of uncertain value for \$1, and that is what she indeed sold. Boynton intended to buy a stone of uncertain value for \$1, and that was what he indeed bought.

The law does provide limited grounds for rescinding a contract on the basis of a mutual mistake. But a seller cannot generally back out of a bargain simply because it turns out the thing she sold was more valuable than she had presumed. In holding for Boynton, the court focused primarily on the nature of Wood’s mistake, zeroing in on the fact that there was “no pretense of any mistake as to the identity of the thing sold.” The court applied the traditional rule, which you will see again in *Sherwood*, that there must be a mistake as to the character of the thing sold rather than merely its quality or value.

A modern court would instead likely have focused on Wood’s assumption of the risk. As the court noted, Wood had the stone in her possession for a long time, and

while she made some inquiry as to its nature, she apparently did not hire an expert or reach any definitive conclusion as to what the stone was. By choosing to sell the stone without a more complete investigation into the stone's true nature, Wood assumed the risk of her mistake. She acted in "conscious ignorance." She could not thereafter get out of the deal she made for herself.

Discussion

1. The court found that there was no mistake in this case, so that defense was unavailable as a definitional matter. What is the definition of mistake, and why do the circumstances in this case not reflect a mistake by either party?
 2. Defenses are granted to ensure that contract law does not create injustice. What injustice does the plaintiff seek to remedy by avoiding the contract? Why does the court determine that it is not unjust to enforce the contract?
 3. Neither of the parties in this case was an expert in gemology. Did this lack of expertise seem to impact the court's decision? Should courts consider whether a party is an expert or not in determining whether there has been a mistake?
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Reading Sherwood v. Walker. *Sherwood v. Walker*, the case of the barren cow, is perhaps the most famous case in the history of the mistake doctrine. The facts of *Sherwood* are actually similar to those of *Wood v. Boynton*. A seller sells an object (or, here, an animal) that they believe to have a certain value, and then they learn that the object of the sale is far more valuable than they thought. Mutual mistake provides a potential way out. In *Wood*, the seller lost. But in *Sherwood*, the seller wins. The seller (Walker) was in the business of importing and breeding polled Angus cattle (as well as distilling whiskey). The buyer (Sherwood) was a banker who wanted to purchase some of Walker's stock but could find none that suited him at Walker's Canadian farm. Walker told Sherwood that there were also cows at Walker's Michigan farm, but that those cows were probably barren. Sherwood visited Walker's farm in Michigan and chose one of the cows to purchase. Walker wrote a letter to Sherwood authorizing the purchase of that particular cow, the price, and explaining how Sherwood could obtain the cow. When the cow turned out to be fertile rather than barren, the economics of the deal turned out to be different than the parties believed. Walker refused to deliver the cow to Sherwood. Sherwood sued to enforce the contract, seeking replevin—return of the cow—and Walker defended on the ground of mutual mistake. The question became, can one party avoid the deal, given the (apparently) mutual mistake about the nature of the cow?

Sherwood v. Walker

66 Mich. 568 (1887)

MORSE, J.

Replevin [a procedure where seized goods can be returned to the owner dependent on the outcome of a lawsuit] 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. . . . 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 the 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. "The difficulty in every case is to determine whether the mistake or misapprehension is as to the substance of the whole contract, going, as it were, to the root of the matter, or only to some point, even though a material point, an error as to which does not affect the substance of the whole consideration." 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 its 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.

Reflection

Sherwood demonstrates a way to determine whether there is a mutual mistake between parties. This court expands on the rule for mistake that was established in *Wood*. Recall that in *Wood*, the parties were found not to be mistaken as to the nature of the thing sold, namely, a stone of uncertain value. In *Sherwood*, there is no mistake as to the identity of the creature: it is the same cow. Yet the *Sherwood* court looks to the nature of the cow. If mutual assent to a bargain was made upon the mutual mistake of a material fact (such as the subject matter of the sale or the price) that materially induced the agreement, then the contract is void. The mistake must go to the substance of the contract, and this is where the difficulty arises under the rule in *Sherwood*.

The court held that a barren cow was not just a 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.” The court also believed that the parties would not have contracted for the sale except on the understanding and belief that the cow was incapable of breeding. “The mistake affected the character of the animal for all time, and for its present and ultimate use.” The cow would have been sold for around \$750 if not barren, as opposed to the \$80, and this went to the substance of the whole agreement.

The court’s distinction between whether the mistake went to the substance of the contract or to its quality can be confusing since what affects its value also affects

its consideration. The R2d's rule on mutual mistake makes less of a distinction and instead states that the mistake must have been "as to a basic assumption on which the contract was made" and that it had a material effect.

Discussion

1. In *Wood*, the court found there was no mistake; in *Sherwood*, the court found there was. Can you distinguish the cases on their facts such that you can apply the same rule and arrive at different results?
 2. In a case regarding the purchase and sale of a farm animal, who should bear the risk of mistake that the animal is not as expected: the rancher or the purchaser?
 3. Orthodox Jews only eat meat from cows whose lungs do not have blemishes. Such blemishes are only observable after slaughtering the animal. If a rancher sells to a Jewish butcher a cow that both believe to be unblemished (*glatt*), but the cow turns out to have lesions in its lungs, is this a mistake? Is this a mistake that merits avoidance of the contract?
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Reading DePrince v. Starboard Cruise Services, Inc. As previously stated, a mistake is a belief that is not in accord with the facts. In this next case, the seller clearly made a mistake regarding the price of a valuable diamond. The mistake was adverse to the seller because the seller accidentally sold the diamond for about one-twentieth of its value. On the ground of this unilateral mistake, however, the seller can only avoid the contract if the seller does not bear the risk of this mistake. This next case focuses on who bears the risk of mistake.

DePrince v. Starboard Cruise Services, Inc.

271 So. 3d 11 (Fla. Dist. Ct. App. 2018)

LUCK, J.

On February 11, 2013, Thomas DePrince, a passenger aboard a cruise ship, visited the ship's jewelry boutique, operated by Starboard, where he indicated his interest in purchasing a fifteen to twenty carat loose diamond. DePrince specified he wanted an emerald cut, high quality, color D, E, or F diamond with a G.I.A. certificate. The ship-board jewelry store did not have such a diamond, so the store's manager, Mr. Rusan, e-mailed Starboard's corporate office.

The corporate office reached out to Starboard's diamond vendor in California. The vendor in California then called a diamond broker in New York for its available

inventory. The diamond broker then sent a list of diamonds available with the desired specifications. The list provided a per-carat price and net price for each diamond. The vendor in California then selected two diamonds from the inventory listing and electronically mailed the corporate office the following information:

These prices are ship sailing prices based on the lowest tier diamond margin we have. Let me know if you have any questions.

EC 20.64 D VVS2 GIA VG G NON selling price \$235,000

EC 20.73 E VVS2 GIA EX EX FNT selling price \$245,000

The corporate office forwarded this information back to the ship. Mr. Rusan presented the information to DePrince and his partner, Mr. Crawford.

Neither the contact nor the corporate office nor Mr. Rusan had ever sold a large loose diamond before and did not realize that the quoted price was per carat. Mr. Crawford, who was a certified gemologist, asked the opinion of DePrince's sister, a graduate gemologist. The sister warned that something was not right because the price for a diamond of that size should be in the millions and recommended not buying the diamond.

Disregarding his sister's advice, DePrince contracted with Starboard to purchase the 20.64 carat diamond for the quoted \$235,000 price, paying with his American Express credit card. Starboard discovered that the \$235,000 price was per carat and immediately notified DePrince of the error and reversed the charges to his credit card.

DePrince then filed a complaint seeking to enforce the parties' contract.

The trial court initially granted summary judgment in favor of Starboard on June 20, 2014, based on Starboard's defense of unilateral mistake. The trial court used a "four-prong test to establish unilateral mistake." The court held that in order to rescind an otherwise-valid contract based on a unilateral mistake, the party seeking to avoid the contract must show:

(1) The mistake was induced by the party seeking to benefit from the mistake, (2) there is no negligence or want of due care on the part of the party seeking to return to the status quo (3) denial of release from the agreement would be inequitable, and (4) the position of the opposing party has not so changed that granting the relief would be unjust.

The court concluded that there was a genuine issue of material fact on the inducement prong because "knowledge of an error is markedly different than inducement of that error." As an example of inducement, the court quoted the test for fraudulent inducement, and explained:

We do not hold that the burden to establish inducement for purposes of the first prong of a unilateral mistake defense is the same as proving the elements for a fraudulent inducement defense, but merely use fraudulent inducement by way of example to demonstrate that inducement requires some type of action, not mere knowledge.

In fact, the burden of proof cannot be the same because such a requirement would render the unilateral mistake of fact defense completely obsolete by requiring a party seeking to avoid a contract on that basis to prove fraudulent inducement, which is itself sufficient to render a contract voidable by the aggrieved party.

The court also concluded that there was a genuine issue of material fact on the negligence prong. “[W]hether Starboard made a reasonable and understandable mistake or acted negligently in its handling of the sale is a disputed issue of fact.” Based on this, the court reversed the summary judgment for Starboard and remanded for further proceedings because there remained genuine issues of material fact to be resolved.

The case went to trial on April 4, 2016, on DePrince’s claim for breach of contract and Starboard’s defense of unilateral mistake. The parties did not dispute that they entered into an agreement; the only issue was whether Starboard was excused from that agreement because it made a unilateral mistake.

The trial court instructed the jury on the elements of the unilateral mistake affirmative defense, including inducement: “To establish this defense Starboard must prove . . . the mistake was induced by the party, here Mr. DePrince, seeking to benefit from the mistake. Inducement may occur through misrepresentations, statements or omissions which cause the contracting party to enter into a transaction.”

The jury found that Starboard should be excused from performing under the contract because it committed a unilateral mistake. The trial court denied DePrince’s motion for directed verdict on the unilateral mistake affirmative defense and entered judgment for Starboard consistent with the jury’s verdict.

The case was remanded for a new trial because the trial court’s jury instruction on inducement prong of the unilateral mistake test was inconsistent. The trial court defined inducement to include DePrince’s omission of information about the price of the diamond, even though inducement had previously been defined as “some type of action, not mere knowledge.”

The District Court of Appeal held that inducement is not an element of a unilateral mistake defense to enforce a contract, that the jury was properly instructed on the element of unilateral mistake and that sufficient evidence supported the jury’s finding that all required elements for rescission of a contract on the basis of unilateral mistake had been met.

Reflection

A unilateral mistake occurs when 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.

In this case, Starboard made a mistake by not realizing that the quoted price of the diamond was per carat, not for the entire diamond. Starboard sold the diamond to DePrince for less than a twentieth of the actual cost of the diamond. The price of the diamond is fundamental to the contract and materially affects the agreed exchange of

performances. Had Starboard not made this mistake, it never would have agreed to sell the uncut diamond for that price. In this case, Starboard, the party who made the mistake, would have borne the brunt of its mistake but for the court's determination that Starboard's mistake had been induced by DePrince.

Starboard illustrates a unilateral mistake. DePrince, the buyer, caused Starboard, the seller, to make a mistake as to a basic assumption on which the contract was formed that materially affected the agreed exchange of performances and adversely affected Starboard.

Discussion

1. Generally, the party seeking to avoid a contract on the grounds of mistake is the party making the mistake. In *Starboard*, Starboard Cruise Services is looking to avoid the contract. What is Starboard's mistake? Evaluate this purported mistake based on the R2d's definition of mistake, and confirm whether this is a mistake for which the law can grant a remedy.
 2. Mistakes are only actionable where they relate to a material aspect of the transaction. Was the mistake in *Starboard* material? Explain.
 3. A party only merits the defense of mistake where it did not bear the risk of mistake. Did Starboard bear the risk of its mistake in this case? Why or why not?
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Problems

Problem 11.1. A Mistaken Dream

After landing her dream job, Lauren decided to buy herself a car to celebrate. Lauren did months of online research before she went to a used car lot to look at the cars in person.

Lauren had decided that she wanted to purchase a used Volkswagen Beetle listed for \$4,700 at Trevor's Used Car Dealership. Based on her research, Lauren knew that a used Volkswagen Beetle with approximately 50,000 miles should cost closer to \$10,000 than \$5,000.

Kierstin had just started working at Trevor's Used Car Dealership three days before Lauren arrived at the dealership to look at used cars. Kierstin's boss sent her an email that listed the prices of all the new cars on the lot that Kierstin needed to tag. Kierstin had misread the email and mislabeled the cars. The \$4,700 price tag was supposed to be placed on the Volkswagen Passat with almost 100,000 miles that was parked next to the Beetle.

Lauren moved forward with purchasing the Beetle from Trevor's Used Car Dealership even though she knew that the car should be sold for nearly \$5,000 more than it was listed for. Kierstin drew up all the paperwork, and she and Lauren entered a contract for the sale of the car.

Kierstin's boss, Shannon, arrived at the dealership later that afternoon and, while reviewing the paperwork, realized that Kierstin had listed the car at the wrong price and immediately called Lauren to rectify the error.

Is the contract for the sale of the Volkswagen Beetle voidable based on the theory of unilateral mistake?

Problem 11.2. A Foundational Mistake

In the summer of 1995, Jesse and Barbara Darnell expressed an interest in buying a home from Magdalene Myers, and all parties made preparations to sell and purchase the house. The Darnells received a copy of the Seller's Disclosure of Real Property Condition Report (Seller's Disclosure). In it, Myers answered that she was not aware of "any water leakage, accumulation, or dampness within the basement or crawl space." She also answered that there were not "any repairs or other attempts to control any water or dampness problem in the basement or crawl space."

The Darnells and Myers met to negotiate the price, and Myers brought, unsolicited, a handwritten list of amenities. The list included a "[n]ew pump in crawl space to remove whatever water comes in when we have a hard rain." The Darnells did not end negotiations because they believed that water only came in through the crawl space after a hard rain and that it normally wasn't a problem because the sump pump prevented accumulation. The parties agreed on a price.

The Darnells had the home inspected, and the inspector noticed a "moisture problem" in the crawl space that should be fixed. The Darnells put all of their money into the house and decided to forgo the repairs for another year, which the inspector thought would be fine. In the inspector's report, the "Structural" section indicated the moisture as a "major deficiency," but it did not indicate the intensity of the water problem or whether the moisture had caused any actual damage to the structure of the house. The crawl space was not readily accessible, and a pre-printed paragraph stated, "If there is an inaccessible basement or crawl space, there is a possibility that past or present . . . rot exists in this area. Since no visual inspection can be made, it is not possible to make a determination of this damage if it exists."

The Darnells read the contradictory report and signed an agreement of sale with no renegotiation because of the crawl space or moisture. The day after they moved in, the Darnells noticed water problems underneath a carpet on the first floor. They called someone to do another inspection and discovered that the structural framing in the crawl space was so severely deteriorated from water that three-quarters of the structural members were no longer capable of holding up the house. They were

advised to leave the house and have not been able to return since. The Darnells sued Myers for rescission of the agreement of sale and argued, among others, the defense of mistake.

Under the R2d, what is the mistake, and what type of mistake should the Darnells argue for in court? Under the R2d, do the Darnells have a viable defense of mistake?

See Darnell v. Myers, 1998 WL 294012 (Del. Ch. 1998).

Problem 11.3. A Policy Mistake

OneBeacon America Insurance Company and Pennsylvania General Insurance Company (collectively, OneBeacon) issued a car insurance policy to Leasing Associates, Inc., and LAI Trust (collectively, LAI), a vehicle leasing agency. LAI then leased a vehicle insured under this policy to Capform, Inc., which had its own insurance coverage from Travelers. Capform, Inc., drove the vehicle negligently and struck a pedestrian in an accident that resulted in a vehicle liability suit that Capform settled for \$1,000,000, which is the limit under the OneBeacon insurance policy. Citing the OneBeacon/LAI policy, Capform demanded that OneBeacon reimburse Travelers \$1,000,000, the policy's limit. The OneBeacon/LAI policy defines an "insured" to include:

- a. *You for any covered auto.*
- b. *Anyone else while using with your permission a covered auto you own.*

Although OneBeacon acknowledges that this language may be read to extend coverage to LAI's lessees, it says that neither it nor LAI intended that coverage. Accordingly, OneBeacon asked the district court to reform the policy in light of mutual mistake. OneBeacon asked the court to reform the insurance policy to match the parties' intent that it would cover only those lessees who had specifically applied for and been approved for coverage under the OneBeacon policy.

Is OneBeacon entitled to reform the insurance policy due to a scrivener's error (mistranscription mistake)?

See OneBeacon Am. Ins. Co. v. Travelers Indem. Co., 465 F.3d 38 (1st Cir. 2006).

Chapter 12

Improper Bargaining

Contract law is founded on the principle that agreements should reflect voluntary and informed consent. Yet not all agreements are the product of fair negotiation or equal footing. Improper bargaining refers to a set of doctrines—misrepresentation, duress, undue influence, unconscionability, and public policy defenses—that address situations where consent is tainted or fairness is undermined. These defenses serve as a check on private ordering by ensuring that contracts are not enforced when they are the result of deception, coercion, or exploitation, or when they contravene societal norms.

The unifying purpose of these doctrines is to safeguard the integrity of contractual consent while balancing autonomy, fairness, and efficiency. The misrepresentation doctrine ensures that agreements are not based on falsehoods. The duress and undue influence doctrines prevent the enforcement of contracts formed through improper pressure or the abuse of trust. The unconscionability doctrine examines both the terms and the process of contract formation to identify egregiously unfair agreements. Finally, public policy defenses reflect the law's commitment to broader societal interests by invalidating contracts that harm the public or promote injustice.

Together, these defenses form the boundaries of enforceable contracts. They highlight the law's dual role in respecting individual freedom to contract while stepping in to correct or prevent the exploitation of vulnerable parties. This chapter explores the principles, policies, and applications of these defenses to illustrate how courts navigate the complex interplay between autonomy and equity in the enforcement of contracts.

Rules

A. Misrepresentation

Misrepresentation can make a contract voidable when one party induces another to enter a contract by making an assertion that is not in accord with the facts. The analysis of this defense begins with identifying whether there is a misrepresentation, as defined by R2d:

A misrepresentation is an assertion that is not in accord with the facts. R2d § 159.

A misrepresentation is any assertion that is not true. To understand this, we first need to clarify what qualifies as an assertion. According to *Black's Law Dictionary*:

Assertion. A person's speaking, writing, acting, or failing to act with the intent of expressing a fact or opinion; the act or an instance of engaging in communicative behavior.

Assertions may take many forms, including spoken or written statements, actions intended to convey meaning, or omissions where there is a duty to disclose. The doctrine's broad scope reflects the law's recognition that communication in various forms influences contracting decisions.

Once you have identified that some assertion is a misrepresentation, then the next step in the analysis is determining the nature of the misrepresentation. Fraudulent misrepresentation occurs when a party makes a false statement with the intent to deceive. Non-fraudulent misrepresentation, by contrast, does not require intent but instead hinges on whether the false assertion is material—meaning that it would likely influence a reasonable person's decision to enter into the contract. R2d § 162. In either case, the misrepresentation must induce the other party's agreement, and their reliance must be justified.

At its core, the doctrine of misrepresentation protects the principle of informed consent. Contract law values autonomy and presumes that parties are best positioned to make decisions about their own interests. However, this autonomy is undermined when one party's ability to make informed choices is compromised by false or misleading information. Misrepresentation disrupts the fundamental premise that agreements arise from an honest and fair exchange of information. By making contracts voidable in such cases, the law deters deceptive practices and promotes fairness in the bargaining process.

The policy behind this doctrine reflects a balance between private ordering and public norms. On the one hand, the law respects individuals' ability to negotiate and assume risks in contracts. On the other, it recognizes that some risks—those arising from dishonesty or misinformation—undermine not only the individual contract but also the trust necessary for the broader functioning of markets. The misrepresentation doctrine ensures that contract law aligns with these broader societal interests by holding parties accountable for the integrity of their assertions.

This section explores the steps in analyzing misrepresentation and how courts evaluate assertions, reliance, and inducement to protect the legitimacy of contractual relationships.

1. *Fraudulent Misrepresentation*

Fraudulent misrepresentation arises when one party intentionally deceives another to induce them to enter into a contract. It is the most blameworthy form of misrepresentation and reflects a deliberate breach of the trust essential to contractual relationships. Under R2d § 162(1), a misrepresentation is fraudulent if the maker intends

their assertion to induce assent and if the maker either knows their assertion is false or acts with reckless disregard as to the assertion's falsity. We will explore the specific degree of knowledge that is required in detail below.

Fraudulent misrepresentation requires the following elements:

a. False Assertion

A fraudulent misrepresentation begins with a false assertion. The statement must be objectively untrue and may take the form of spoken or written words, conduct, or silence where there is a duty to disclose. R2d § 159. For example, turning back an odometer on a car being sold constitutes a fraudulent misrepresentation because it implies a false fact about the car's mileage.

b. Scierter (Knowledge of Wrongdoing)

The asserting party must have acted with the appropriate state of mind, called "scierter." The term derives from the Latin verb *sciō*, meaning "to know." In modern legal usage, scierter signifies knowledge of wrongdoing. For a misrepresentation to be fraudulent, the asserting party must have knowingly made a false statement or at least acted with reckless disregard as to whether the assertion was false.

A misrepresentation is fraudulent if the maker intends his assertion to induce a party to manifest his assent and the maker

(a) knows or believes that the assertion is not in accord with the facts, or

(b) does not have the confidence that he states or implies in the truth of the assertion, or

(c) knows that he does not have the basis that he states or implies for the assertion. R2d § 162(1).

This tells us that the knowledge requirement can be satisfied in one of three ways:

- actual knowledge the assertion is false; or
- lack of confidence that the assertion is true, despite an expression of such confidence; or
- lack of a basis for believing the assertion is true.

The second two states of knowledge can be referred to as reckless disregard for the truth. Reckless disregard is more than mere carelessness (negligence) but less than actual knowledge. For purposes of proving a misrepresentation is fraudulent, reckless disregard is typically sufficient.

c. Intent to Induce Reliance

The asserting party must have made the misrepresentation with the specific purpose of inducing the recipient to manifest assent. This requirement focuses on the maker's intent at the time the assertion was made.

d. Actual Inducement

The misrepresentation must have induced the recipient to assent to the contract. Under R2d § 167, inducement requires a causal connection: the false assertion must have substantially contributed to the decision to contract. However, fraudulent misrepresentation does not require the misrepresentation to be material to the agreement; it is enough that the assertion influenced the recipient's decision in any meaningful way.

e. Justifiable Reliance

Finally, the recipient's reliance on the misrepresentation must be justified. Courts generally consider whether a reasonable person in the recipient's position would have relied on the assertion under the circumstances. However, the standard is laxer than a fully objective standard would be. While the law expects a degree of diligence, it does not excuse intentional deception simply because the recipient could have discovered the truth with extraordinary effort or expertise.

The R2d takes the position that failing to investigate whether an assertion is true does not make a person's reliance unjustified, even if a reasonable person might have investigated further.

A recipient's fault in not knowing or discovering the facts before making the contract does not make his reliance unjustified unless it amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing. R2d § 172

This standard for justified reliance is much lower than in other areas of contract law, such as in mistake doctrine, where the law considers whether the mistaken party assumed the risk of their mistake by failing to take steps to learn the truth. The reason the standard is lower in this context is that fraudulent misrepresentation represents an egregious breach of trust in contract law. By making such agreements more easily voidable, the law upholds the principles of fairness and honesty while also deterring deceptive practices in the marketplace.

2. Material Misrepresentation

Material misrepresentation occurs when one party makes a false assertion that significantly affects the other party's decision to enter a contract. Unlike fraudulent misrepresentation, material misrepresentation does not require intent to deceive. Instead, the focus is on the importance of the misrepresentation and its actual impact on the recipient's decision.

Material misrepresentation requires essentially the same elements as a fraudulent misrepresentation except for two key differences.

First, the state of mind of the maker of the statement need not be fraudulent. The misrepresentation can be entirely innocent, and yet the law may still allow the aggrieved party to rescind the contract based on their false belief.

Second, the misrepresentation must have been material. A misrepresentation is material if it is significant enough to influence the decision to contract. Under R2d § 162(2),

[a] misrepresentation is material if it would be likely to induce a reasonable person to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so.

In other words, a misrepresentation can be material in one of two ways—either under an objective standard, meaning a reasonable person in the same situation would likely be induced to assent by the assertion, or under a subjective standard, if the maker knows the assertion is uniquely important to the specific recipient.

For example, a seller's claim about the structural soundness of a building is objectively material because it impacts the property's value. Conversely, a statement about a building's historical significance might be subjectively material if the seller knows the buyer is particularly interested in historical preservation.

3. Concealment as Misrepresentation

Concealment occurs when one party actively prevents the other from discovering a material fact, effectively making an assertion that the fact does not exist. Concealment is defined as follows:

Action intended or known to be likely to prevent another from learning a fact is equivalent to an assertion that the fact does not exist. R2d § 160.

Concealment is a form of misrepresentation because it involves behavior designed to mislead. The analysis of concealment focuses on four key elements: an act of concealment, knowledge or intent, materiality, and inducement of consent.

a. An Act of Concealment

Concealment requires affirmative conduct intended to hide a fact or mislead the other party. This may include physical actions, such as painting over water damage in a house to obscure the defect, or verbal interference, such as instructing others to withhold material information. Unlike mere silence, which is addressed below, concealment involves deliberate action to obscure or distort the truth.

b. Knowledge or Intent

The party engaging in concealment must either know that their actions are likely to mislead the other party or act with the intent to prevent discovery of the fact. Courts focus on whether the concealing party's behavior demonstrates an awareness that the concealed information is material and would influence the other party's decision to contract. For example, a seller of a car rolls back the odometer to conceal the vehicle's true mileage. This conduct clearly demonstrates knowledge that the fact being hidden is significant.

c. Materiality

For concealment to amount to actionable misrepresentation, the concealed fact must be material. A fact is material if it would likely influence a reasonable person's decision to enter into the contract or if the party concealing the fact knows that it is particularly important to the other party.

If a seller of a house paints over a cracked foundation to hide structural damage, this concealed defect would be material because it significantly affects the value and safety of the property. Even if the buyer does not explicitly ask about the foundation, the seller's deliberate action to obscure this fact tends to demonstrate its materiality in the transaction.

However, if a seller puts a welcome mat by the front door, this is probably not a material concealment even if this covers up a small coffee stain on the carpet by the door. Not only could the buyer easily check under the mat to see whether the carpet is perfect, but also a small cosmetic defect in this part of the carpet does not significantly impact the value of the home and has zero impact on its property value. Even if the seller deliberately put the mat down because he wanted to obscure the coffee stain, this is not a material concealment.

Materiality is essential in the analysis because courts aim to ensure fairness and protect parties' reliance on good-faith dealings. If the fact concealed is trivial or would not affect the transaction, it may not rise to the level of actionable misrepresentation.

d. Inducement of Assent

The concealed fact must be material to the transaction, and the concealment must have induced the other party's assent. As with other forms of misrepresentation, courts require a causal connection between the concealment and the decision to contract. The recipient must also show that they relied on the absence of the concealed information in making their decision. For example, if a buyer purchases a home believing it has no prior flood damage and the seller painted over water stains to hide evidence of flooding, the concealment likely induced the buyer's assent.

Concealment as misrepresentation protects parties from active deceit that undermines the fairness of the bargaining process. The doctrine emphasizes that contractual consent must be based on truthful and complete information, which is not possible when one party takes affirmative steps to hide material facts. By treating concealment as equivalent to an assertion, the law ensures that parties engaging in deceptive conduct cannot avoid liability simply because they did not speak falsely.

4. Silence as Misrepresentation

Silence, or non-disclosure, may constitute misrepresentation when one party fails to disclose a material fact under circumstances where disclosure is required. Unlike concealment, which involves affirmative acts to hide a fact, silence becomes

misrepresentation when it violates duties of honesty, good faith, or fair dealing. Non-disclosure is equivalent to an assertion that a fact does not exist in the following situations:

- (1) The party knows that disclosure is necessary to prevent a prior assertion from being a misrepresentation or from being fraudulent or material.
- (2) The party knows that disclosure would correct a mistake of the other party as to a basic assumption on which that party is making the contract, and failure to disclose would violate standards of good faith and fair dealing.
- (3) The party knows that disclosure would correct a mistake of the other party as to the contents or effect of a writing evidencing or embodying an agreement.
- (4) The other person is entitled to know the fact because of a relationship of trust and confidence.

The analysis of silence as misrepresentation requires the following elements: duty to disclose, knowledge of the fact and its materiality, and reliance and inducement.

a. Duty to Disclose

Non-disclosure is generally not actionable unless the party withholding the information has a duty to disclose. Such duties arise in specific circumstances outlined in R2d § 161. For example, a duty to disclose exists when one party's silence would cause a prior statement to become misleading, or when failing to disclose would violate good faith and fair dealing by leaving the other party mistaken about a basic fact central to the agreement. For example, a seller of a home tells a buyer that the foundation has been inspected but fails to disclose that the inspection revealed serious cracks. The seller has a duty to disclose the defect to prevent the prior statement from becoming misleading.

b. Knowledge of the Fact and Its Materiality

The party remaining silent must know both the fact in question and its materiality. Courts assess whether the fact relates to a basic assumption underlying the agreement or is likely to influence the recipient's decision to contract. For example, a car dealer knows that a vehicle has been in a serious accident and fails to disclose this information to a buyer who reasonably assumes the car is in good condition. The accident history is a material fact that the dealer has a duty to disclose.

c. Reliance and Inducement

The non-disclosure must have induced the other party to enter the contract. The misled party must demonstrate that they relied on the absence of the withheld information when deciding to agree and that this reliance was justified. For example, a buyer relies on a seller's silence about a property's flood history when deciding to purchase. If the buyer would not have agreed had they known the truth, the non-disclosure has induced their assent.

Silence as misrepresentation reflects contract law's commitment to fairness and informed consent. While parties are generally not required to volunteer all information, the law imposes disclosure duties in situations where silence would perpetuate mistakes or unfairly exploit disparities in knowledge or trust. By treating silence as equivalent to an assertion in these limited contexts, the doctrine balances the principle of freedom to contract with the need to ensure honesty and equity in bargaining.

5. Solving Misrepresentation Problems

The doctrine of misrepresentation addresses the balance between protecting contractual consent and preserving good faith in negotiations. By rendering contracts voidable in cases of fraudulent or material misrepresentation, the law upholds fairness and deters deceptive practices, thus ensuring that agreements reflect informed and voluntary assent.

There are fifteen sections in R2d dedicated to explaining the defense of misrepresentation. This book has reproduced and explicated the key rules. But, given the broad scope and technical nature of this doctrine, it is recommended that students read all these rules and comments for themselves.

To analyze a misrepresentation scenario, follow these steps:

1. **State the ISSUE:** For example,

The ISSUE is whether [Buyer] can avoid the contract regarding [Term] because [Seller] misrepresented, where [Seller] asserted [Assertion] but [Fact] is true.

2. **Cite the RULES:** Start with R2d's definition of misrepresentation:

A misrepresentation is an assertion that is not in accord with the facts. R2d § 159.

Additionally, reference key provisions such as:

- *R2d § 164*, explaining that only fraudulent or material misrepresentations render contracts voidable.
- *R2d § 159 cmt. c*, which clarifies that facts include past events or present circumstances but exclude future events.

3. **Analyze the APPLICATION:**

- Determine whether the fact meets the legal definition of a fact (not an opinion, prediction, or puffery).
- Distinguish the assertion from the fact; the discordance between the two is the misrepresentation.
- Classify the misrepresentation as fraudulent (intentional) or material. A misrepresentation that is neither fraudulent nor material cannot void a contract.
- Explain how the misrepresentation induced Buyer to contract with Seller.

4. **Conclude:** Decide whether Buyer merits the defense of misrepresentation. Consider whether Seller acted in good faith and whether Buyer can avoid the contract as a result.

B. Duress

The legal concept of duress refers to the improper use of strength or pressure to compel another to act against their will. The term itself traces back to Proto-Indo-European roots, where *deru* or *dreu* referred to firmness, hardness, or unyielding strength, as seen in words like the Sanskrit *dru* (tree) and the Greek *doru* (spear shaft). In Latin, this evolved into *durus*, meaning “hard,” and later into Old French *duresse*, signifying harshness or severity. This evolution captures the core of duress in modern law: the wrongful application of unrelenting force to overpower another’s autonomy.

The concept of duress in law can be traced to Roman legal traditions, where *vis compulsiva* referred to coercion through fear, contrasting with *vis absoluta*, which involved overt physical compulsion. Over centuries, the doctrine expanded from addressing only physical threats to encompassing subtler forms of coercion, such as economic pressure. Today, the duress doctrine protects the integrity of contractual relationships by ensuring that agreements are based on genuine consent rather than submission to improper pressure.

In modern law, duress occurs when one party improperly pressures another to enter a contract by making threats that leave the victim with no reasonable alternative but to agree. The duress doctrine ensures that contractual consent is voluntary and free from coercion. Duress can take one of two forms:

1. **Physical duress**, which involves threats of violence or the use of physical force. If a party’s manifestation of assent is physically compelled, the contract is void because the act is not voluntary.
2. **Economic duress**, which involves the improper use of financial or economic pressure to coerce assent. A contract is voidable if one party’s assent is induced by an improper threat that leaves them with no reasonable alternative. For example, threatening to breach an existing contract unless the other party agrees to new, unfair terms can constitute economic duress if the victim has no viable alternatives to mitigate the harm.

The evolution of the word “duress” from concepts of firmness and unyielding force mirrors the doctrine’s focus on the misuse of power to override free will. Just as the term suggests unrelenting pressure, the legal doctrine addresses situations where a party’s consent is coerced by the improper application of strength—whether physical or economic.

By addressing duress, contract law reinforces the foundational principle of voluntary agreement and ensures that contracts reflect mutual assent rather than submission to coercion.

1. Physical Duress

Physical duress addresses situations where coercion eliminates a party's ability to provide genuine assent. It encompasses both physical compulsion and threats of harm, with the law distinguishing between these forms based on the degree of control exercised over the victim's will.

Physical compulsion involves direct physical force, reducing the victim to a "mere mechanical instrument." In such cases, no intent to assent exists, and the resulting contract is void under R2d § 174. For example, if one party physically grasps another's hand and forces them to sign a document, the signature reflects nothing more than the act of the coercer. No legal agreement is formed because the fundamental requirement of mutual assent is absent.

Torture also falls within the realm of physical compulsion, albeit in a slightly less direct manner. Historically, devices like the thumbscrew were used to extract confessions by inflicting excruciating physical pain. While the victim retained some control over their actions, the overwhelming coercion rendered their choices involuntary. Modern contract law rejects any agreement obtained through such means, treating it as equally invalid because the coercion destroys the possibility of free will. The metaphorical "turning of the screws" aptly captures the essence of physical compulsion: unbearable force that eliminates volition entirely.

Threats of harm, by contrast, operate through psychological intimidation rather than direct physical control. Under R2d § 175, threats of violence leave the victim in



Figure 12.1. Thumbscrew used in France to make prisoners confess to crimes or to otherwise reveal information. Credit: Wellcome Trust, Science Museum A67686, CC-A 4.0.

a state of fear that compels assent. In such cases, the contract is voidable, allowing the victim to affirm or rescind the agreement once the coercive circumstances have passed. For example, if one party threatens to break the other's legs unless they sign a contract, the victim may agree out of fear. The law recognizes that the resulting assent is coerced but preserves the victim's ability to void the agreement later. Courts evaluate threats based on their severity, credibility, and whether the victim had any reasonable alternatives to agreeing.

Parmentier v. Pater, 13 Ore. 121 (1885), illustrates the devastating effects of psychological intimidation and the nuanced application of the doctrine of duress. Louis Parmentier entered into a financial agreement with Claude Pater that he later sought to cancel. On September 25, 1884, Parmentier surrendered a \$6,000 promissory note secured by a mortgage on Pater's property and recorded the note's cancellation. Five days later, he died by suicide. His widow, Elizabeth Parmentier, contested the validity of the debt cancellation, alleging that his consent to this financial agreement was procured through duress.

The facts presented at trial revealed that Parmentier had been in a state of extreme emotional distress leading up to the cancellation of the note. Elizabeth testified that her husband had not eaten or slept for ten days before his death, repeatedly expressing fear of Pater and the potential consequences of his threats. She tried to reassure him that Pater could not harm him, but Parmentier remained nervous and anxious. Specific threats made by Pater included statements such as "Before I get through with you, I will send you to Salem," implying imprisonment or institutionalization. These statements, though vague, exacerbated Parmentier's already fragile mental state, leaving him unable to think or act rationally.

The court emphasized that duress does not require the threats to be explicit or immediate, nor does it require that the threats be of the type that would intimidate a person of ordinary firmness. Instead, the focus is on the subjective experience of the victim and takes into consideration factors such as their state of health, temperament, and vulnerabilities. In this case, the evidence demonstrated that Pater knowingly exploited Parmentier's weakened condition by applying psychological pressure severe enough to compel him to act against his will. The court noted that Pater's threats, though indirect, were "as effective as a double-barreled shotgun leveled at the party's head," highlighting their potency in coercing Parmentier's actions.

Ultimately, the court ruled in favor of Elizabeth Parmentier, finding that the cancellation of the debt was not a voluntary act but the result of duress. It concluded that "any course calculated to excite alarm, which is resorted to by one party in order to coerce another to do an act detrimental to his rights, and advantageous to the former, is unlawful." By leveraging Parmentier's mental distress and creating a pervasive sense of fear, Pater invalidated the agreement.

This case demonstrates how the doctrine of duress accounts for both the victim's subjective experience and the coercer's intent to exploit that vulnerability. It reinforces the principle that threats need not involve physical harm to undermine voluntary

consent. By recognizing the impact of psychological intimidation, the court expanded the application of duress to protect parties who are particularly vulnerable to exploitation. The ruling reflects the broader purpose of the doctrine: to ensure that contracts arise from genuine and informed assent, free from improper coercion.

In summary, physical duress occurs when one party improperly compels another to manifest assent through either direct physical compulsion or threats of violence. Physical compulsion, which renders a contract void, involves the use of force to physically control the victim's actions, leaving no room for intent or volition. Threats of violence, by contrast, operate through fear, leaving the victim with no reasonable alternative but to agree; such contracts are voidable at the victim's option. Both forms of duress undermine the principle of voluntary consent and demonstrate the law's commitment to protecting parties from agreements formed through coercion. The nuanced distinctions between these forms of duress serve to ensure fairness and uphold the integrity of contractual relationships.

2. *Economic Duress*

Economic coercion, also known as economic duress, arises when one party improperly compels another to enter into a contract through wrongful threats or actions that cause severe financial distress. The doctrine recognizes that consent obtained under such circumstances is not voluntary and undermines the fundamental principle of mutual assent. However, it is a limited defense, applicable only when the coercing party's threats or actions are deemed improper.

The cornerstone of the doctrine is the concept of an improper threat, as defined by R2d § 176. A threat is improper if it involves criminal or tortious conduct, the bad-faith use of legal process, or a breach of good faith and fair dealing. For instance, threatening to breach an essential contract unless the victim agrees to unrelated and unfavorable terms is considered improper.

In *Acquaire v. Canada Dry Bottling*, 906 F. Supp. 819 (E.D.N.Y. 1995), distributors of Canada Dry products successfully alleged economic duress after being forced to sign contracts under extreme conditions. Canada Dry threatened to terminate their distributorships unless the distributors accepted new contracts on a "take-it-or-leave-it" basis. The distributors claimed they were coerced into signing while loading their trucks, without time to consult counsel, under the wrongful threat of losing their livelihoods. The court recognized that such threats, if proven, could constitute economic duress under R2d § 176. Although the parties agreed to private arbitration before the case went to trial, this case illustrates how leveraging essential goods or services can be considered an improper threat if it coerces the victim into assenting to an unfair contract.

But not all economic threats are improper. The doctrine recognizes that market dynamics often create situations of financial pressure, but such pressure does not automatically equate to coercion. R2d § 176(2) explains that a threat is only improper if it results in unfair terms or is made for illegitimate ends.

For example, a business raising prices in response to increased production costs may impose significant financial stress on a buyer, but this reflects lawful market behavior rather than coercion. Courts carefully distinguish between hard bargaining, which is legitimate, and conduct that crosses the line into coercion by exploiting vulnerabilities or undermining fairness.

This distinction was illustrated in *Martinez-Gonzalez v. Elkhorn Packing Co. LLC*, 25 F.4th 613 (9th Cir. 2022). There, the court rejected a claim of economic duress after a farmworker signed an arbitration agreement during a late-night onboarding session conducted in a parking lot. Although the conditions were less than ideal and Martinez-Gonzalez claimed he felt pressured, the court found no evidence of a wrongful act or improper threat. The agreements were presented as part of a routine business process, and no one explicitly told Martinez-Gonzalez that his job depended on signing. Moreover, the court noted that the onboarding session served a legitimate business purpose: facilitating mass employment agreements for a large workforce. Without evidence of bad faith or coercive intent, the economic pressure inherent in the situation did not rise to the level of duress.

The *Martinez-Gonzalez* case demonstrates how courts carefully evaluate whether the pressure applied stems from legitimate business practices or crosses into improper threats. Even in situations of financial stress, economic duress requires a clear showing of wrongful conduct that exploits vulnerabilities or leaves the victim without reasonable alternatives. This distinction ensures that the doctrine protects against genuine coercion without interfering with lawful negotiations or practical business operations.

For a claim of economic coercion to succeed, three key elements must be established:

- (1) There must be a wrongful act or improper threat;
- (2) The victim must show that the threat caused significant financial distress, leaving them unable to make a free and voluntary decision; and
- (3) The victim must demonstrate that they had no reasonable alternative but to agree to the terms.

This final element ensures that the doctrine is not overextended. If the victim could have sought legal remedies, alternative suppliers, or other solutions without undue harm, the defense may fail.

Economic coercion renders a contract voidable, allowing the victim to affirm or rescind the agreement. However, the victim must act promptly to repudiate the contract; failure to do so may result in ratification. In *VKK Corp. v. NFL*, 244 F.3d 114 (2d Cir. 2001), the court held that a two-year delay in challenging a release agreement, signed under alleged economic duress, constituted ratification. The victim's failure to act swiftly undermined their claim, as prompt repudiation is essential to preserving the defense of duress.

The doctrine balances the need to protect parties from wrongful economic threats with the enforceability of contracts negotiated under legitimate commercial conditions. By addressing improper threats that undermine consent, it safeguards fairness while preserving the integrity of contractual relationships. The economic coercion defense ensures that agreements reflect genuine mutual assent, even in the face of financial pressure, without interfering in lawful business negotiations. Cases like *Acquaire* demonstrate the boundaries of the doctrine, showing how courts assess the nature of the threat, the victim's financial distress, and the availability of alternatives to determine whether economic coercion invalidates a contract.

C. Undue Influence

Undue influence occurs when a party's will is overborne by excessive persuasion. Unlike duress, undue influence does not require a wrongful act or threat. Instead, it focuses on whether the victim was unduly susceptible to persuasion and whether the persuading party exploited a relationship of trust or dominance. Under R2d § 177(1), undue influence arises when a party is unfairly persuaded by someone who dominates them or shares a special relationship of trust.

The doctrine requires two key elements: undue susceptibility in the victim and excessive persuasion by the dominant party. These elements work together. If one element is strongly present, the other may be less critical. Undue susceptibility often arises from age, illness, or emotional distress. Excessive persuasion involves conduct such as isolating the victim, excluding independent advisers, or creating urgency to act. Courts also consider the fairness of the resulting agreement.

A special relationship is central to undue influence. Fiduciary, familial, or caregiving relationships often involve the trust or reliance necessary to establish undue influence. However, not all relationships involving power imbalances qualify.

In *Martinez-Gonzalez*, migrant farmworkers claimed undue influence after signing arbitration agreements during onboarding sessions held late at night in a parking lot. The workers argued that the circumstances, including logistical pressure, economic dependence, and limited English proficiency, created undue influence. Many workers relied on their jobs for survival, and the agreements were presented without prior notice or independent advice. *Martinez-Gonzalez* specifically claimed that the employer's authority and the workers' vulnerable position left them with no meaningful choice.

The court rejected the claim. While the workers faced significant logistical and financial pressure, these factors alone did not establish undue influence. The court emphasized that the employer-employee relationship, even in the context of economically dependent migrant workers, does not automatically create the special relationship of trust or dominance required for undue influence. The employer was not in a fiduciary or advisory role, and there was no evidence that the employer exploited a relationship of trust to compel the workers' assent. The agreements were presented as

routine onboarding documents, and there was no indication of excessive persuasion, such as threats or insistence on immediate compliance.

This case illustrates that factors like economic dependence, limited English proficiency, and vulnerability due to employment are not enough to establish undue influence without a special relationship of trust. To succeed on the defense of undue influence, courts require evidence of domination or reliance that allows one party to supplant the other's independent judgment. The decision in *Martinez-Gonzalez* demonstrates that undue influence demands more than power imbalances or logistical challenges, which ensures that the doctrine remains focused on genuine relational exploitation rather than routine workplace dynamics.

By contrast, *Goldman v. Bequai*, 19 F.3d 666 (D.C. Ct. App. 1994), demonstrates a situation where undue influence was found. Florence Goldman, an elderly widow, transferred property interests to her attorney, August Bequai, shortly after her husband's death. Goldman was emotionally distressed and reliant on Bequai as a trusted advisor. The court found sufficient evidence that Bequai exploited this trust to secure unfair property transfers without adequate consideration. Goldman's vulnerability combined with Bequai's position of influence supplanted her independent judgment. (This case also raised issues of incapacity, as her emotional state and reliance on medication heightened her susceptibility to undue influence.)

As these illustrations show, undue influence overlaps with other defenses like duress and incapacity. Duress focuses on threats or wrongful acts, while undue influence examines relationships and persuasion. Incapacity addresses cognitive ability, while undue influence focuses on relational dynamics. Together, these doctrines protect individuals from agreements that lack true consent. The cases of *Martinez-Gonzalez* and *Goldman* show how courts analyze undue influence in different contexts and balance the need for fairness with the importance of upholding genuine agreements.

D. Unconscionability

Unconscionability prevents the enforcement of contracts or terms that are grossly unfair or oppressive. The doctrine ensures fairness and protects parties from exploitation. Under R2d § 208 and UCC § 2-302, courts may refuse to enforce a contract or its terms if they find unconscionability.

Unconscionability has two elements: procedural and substantive. Procedural unconscionability focuses on the fairness of the bargaining process. It considers factors like surprise, unequal bargaining power, or lack of meaningful choice. Substantive unconscionability examines the fairness of the terms. Courts look for terms that are overly harsh, one-sided, or oppressive. A sliding scale often applies. A strong showing of one element may offset a weaker showing of the other.

The contractual context matters. In *Ronderos v. USF Reddaway, Inc.*, 114 F.4th 1080 (9th Cir. 2024), Ronderos applied for a job. As part of the hiring process, USF Reddaway required him to sign an arbitration agreement. The agreement was in the form

of a contract of adhesion: it was preprinted, non-negotiable, and required immediate signing on site. Ronderos had no chance to consult a lawyer or negotiate terms. This created procedural unconscionability. Substantive unconscionability was also present. The terms disproportionately benefited the employer by limiting Ronderos's ability to seek redress. Together, these flaws rendered the agreement unenforceable.

In contrast, in *Fagerstrom v. Amazon.com, Inc.*, 141 F. Supp. 3d 1051 (S.D. Cal. 2015), a court upheld an Amazon.com arbitration clause in a sales agreement that Amazon's customers entered into over the internet. Customers agreed to Amazon's "Conditions of Use" during checkout in Amazon's online store. The arbitration clause was included in those terms. Even though this was a contract of adhesion, because it was non-negotiated and drafted only by one side, the court found minimal procedural unconscionability.

Customers created the sales agreement by clicking a button on the checkout page that said "Place your order," constituting an affirmative act of consent. While the customer did not have to specifically click "I accept" on a pop-up window that included the full contract terms, those terms, including the arbitration clause, were reasonably accessible via hyperlinks on the checkout page. Consumers faced no immediate pressure to agree and could choose not to use Amazon's services. Substantive unconscionability was also absent. The terms were reasonable. Amazon's ability to modify the agreement was limited by the implied duty of good faith. The court upheld the agreement, finding no significant unfairness.

These cases show the importance of context but also highlight challenges in assessing procedural unconscionability. In *Ronderos*, the employer-employee dynamic created immediate pressure and emphasized the unequal bargaining power, with significant consequences for refusing to sign. In *Fagerstrom*, the consumer setting arguably reduced procedural concerns, as customers could review the terms and theoretically decline the service without immediate repercussions. However, the heavy reliance on adhesion contracts in online transactions raises questions about whether consumers genuinely have meaningful choices, as refusal often means exclusion from widely used services. Courts must balance these contextual differences while critically assessing whether apparent freedom to decline masks a lack of practical alternatives.

Unconscionability balances fairness and freedom of contract. It protects against exploitation while allowing legitimate agreements to stand. Courts carefully evaluate the process and terms to ensure that contracts reflect mutual consent. The cases show that courts consider both the relationship between the parties and the context of the agreement.

E. Contracts Violating Public Policy

Contracts that violate public policy are unenforceable, even if both parties willingly agree to them. Public policy limits the freedom of contract to ensure that agreements do not conflict with laws or harm societal interests. Contract law exists within

a system of justice and cannot be used as a tool to promote illegality or undermine ethical norms.

R2d § 178 provides the framework for determining when a contract violates public policy. A promise is unenforceable if legislation explicitly prohibits it or if the public interest in voiding the contract outweighs the interest in enforcing it. Courts balance the harm caused by enforcement against the benefits of upholding the agreement.

Contracts that promote illegal activities are void. For example, a contract to smuggle goods or evade taxes directly conflicts with public policy and is unenforceable. Similarly, an agreement to commit perjury or falsify evidence undermines the judicial system and cannot be enforced. These contracts conflict with the core principles of legality and justice.

Certain contracts restrict legal rights in ways that violate public policy. For instance, a contract waiving liability for intentional harm or gross negligence is void. Such agreements remove accountability for serious wrongdoing, which harms the public good. An agreement that prevents someone from reporting illegal conduct to authorities would also be unenforceable. These contracts interfere with societal interests in accountability and public safety.

Contracts that violate statutes are similarly unenforceable. For example, an agreement to charge an interest rate exceeding a statutory usury cap is void. These contracts conflict with legislative protections and harm the individuals the law seeks to protect. Courts refuse to uphold agreements that undermine legislative intent.

Some contracts harm social relationships. For example, an agreement to pay someone to divorce their spouse violates public policy because it disrupts family unity. Similarly, contracts promoting illegal discrimination are void because they conflict with fundamental principles of fairness and equality. These agreements are not only harmful to individuals but also detrimental to societal values.

R2d § 178 also distinguishes between contracts that are inherently illegal and those that are only incidentally connected to illegality. For instance, a seller's contract to provide goods is not void simply because the buyer intends to use them unlawfully, unless the seller knew of and supported the illegal purpose. This distinction ensures that the doctrine targets only agreements that directly conflict with public policy.

By balancing private rights with societal interests, R2d § 178 ensures that contracts align with justice and public welfare. The doctrine preserves the integrity of the legal system while protecting individual freedoms. It reflects the broader principle that contracts, while powerful tools for private ordering, cannot be used to undermine public trust or harm the public good.

F. Reflections on Improper Bargaining

The improper bargaining doctrines reveal the limits of freedom in contract law. These doctrines ensure that agreements reflect genuine consent and fundamental fairness. By applying the doctrines of misrepresentation, duress, undue influence,

unconscionability, and public policy violations, courts can intervene when agreements are tainted by deception, coercion, or exploitation.

These doctrines serve not only to protect individual parties but also to maintain trust in the contractual system. By deterring unfair practices and enforcing societal norms, they support the integrity of private agreements while upholding broader principles of justice. However, such interventions are calibrated carefully to avoid undue interference with autonomy, preserving the core freedom to shape agreements according to individual needs.

The study of improper bargaining underscores the dual role of contract law: facilitating voluntary transactions while safeguarding against abuse. Understanding these boundaries equips practitioners to navigate the complex interplay among autonomy, fairness, and enforceability in private agreements.

Cases

Reading Barrer v. Women's National Bank. Under R2d § 159, a misrepresentation is an assertion not in accord with the facts. A deliberate lie will always be such an assertion, while concealment and non-disclosure may be in certain circumstances outlined in R2d §§ 160 and 161. Once a misrepresentation has been identified, it needs to be material or fraudulent under R2d § 162.

Barrer is about an innocent material misrepresentation, which is when a person fails to disclose something unintentionally. As you read the case, pay attention to how the court organizes its rules and analysis for determining whether there is an innocent material misrepresentation.

Barrer v. Women's National Bank

761 F.2d 752 (D.C. Cir. 1985)

HARRY T. EDWARDS, Circuit Judge.

The appellant, Lester A. Barrer, brought this action against Women's National Bank ("the Bank" or "WNB") for damages he allegedly sustained as the result of the Bank's eleventh-hour decision to rescind a loan agreement. WNB defended and moved for summary judgment on the ground that Barrer had made innocent material misrepresentations in his loan application that justified the Bank's avoidance of the contract. The magistrate found that Barrer had made five material representations to the Bank that were not in accord with the facts and, on that basis, granted WNB's motion for summary judgment. We find that the magistrate failed to apply the correct legal test for determining when an innocent material misrepresentation permits the rescission of a contract, and that there are material issues of fact that make summary judgment

inappropriate. Accordingly, we reverse and remand for further proceedings consistent with this opinion.

I. Background

A. Factual Background

On June 24, 1981, Lester Barrer's personal home was sold at a tax sale by the Internal Revenue Service ("IRS") because of his inability to pay certain employment taxes. The taxes were owed by Barrer's closely-held corporation, Today News Service, Inc., and had been asserted against him personally as a 100 percent penalty pursuant to 26 U.S.C. § 6672 (1982). At the tax sale, Barrer's home was purchased by Edward L. Curtis, Jr., for \$16,326, subject to the underlying mortgage. The Internal Revenue Code provides for the redemption of real property within 120 days of a tax sale upon payment to the purchaser of the purchase price plus interest. Barrer accordingly was advised by the IRS that he could redeem his home by delivering \$17,400, in cash or its equivalent, to the IRS or to Curtis on or before October 22, 1981.

On October 20, 1981, Barrer went to WNB to discuss a personal loan for the redemption amount. Apparently, on the previous day, Barrer had approached one other bank about the possibility of a loan; however, he had been advised by the President of that bank that it would not be possible to process an application for a loan in the amount sought by Barrer in such a short period of time. Barrer indicated in his deposition statement that he waited until the last minute to seek a bank loan because he had been involved in serious negotiations over the sale of his business and had expected to close on the sale before October 20, 1981, and that he had intended to use the proceeds from that sale to redeem his house.

At WNB, Barrer spoke with Emily Womack, the President of the Bank, with whom he had a professional acquaintance. Barrer's corporation published the Women Today Newsletter, a periodical to which the Bank subscribed and which, according to Barrer's deposition statement, had published an article on the Bank. Barrer's corporation also maintained an account with the Bank. Womack gave Barrer a loan application form, which he completed and returned to her the next day, October 21, along with certain supporting documents, including those concerning the tax sale and his efforts to sell the business.

Barrer evidently explained to Womack that he had experienced severe financial difficulties since his wife and long-time professional collaborator died of cancer in 1978. At his deposition, Barrer testified that he told Womack that, for a period after his wife died, he lost his motivation to work and that the business they had jointly owned and managed suffered serious economic reverses as a consequence. Those reverses led to Today News Service, Inc.'s inability to pay its employment taxes and ultimately to the tax sale of Barrer's home. Womack sympathized with Barrer's plight and expressed to one of her bank officers the hope that they could help him.

On October 21, Barrer and Womack reviewed his loan application line by line. With reference to his home mortgage, Barrer told her that his house was worth approximately

\$130,000 and that Columbia First Federal Savings and Loan Association (“Columbia”) held a \$65,000 mortgage on it. When asked whether his mortgage payments were up-to-date, Barrer recalls replying that he “thought” he was two months behind. By contrast, Womack testified that Barrer said he was current. In fact, Barrer was six months behind. Barrer explained that he thought his obligation to pay his mortgage ceased at the time of the tax sale and that he did not realize that he was responsible for more than the two months’ mortgage payments that had been due before the sale.

Because Barrer’s mortgage payments were in arrears, Columbia had begun foreclosure proceedings—also a fact that Barrer did not disclose to Womack. In his deposition statement, Barrer accounted for this failure by stating that on October 21, 1981, he did not know that Columbia had initiated foreclosure proceedings.

On the liability side of the loan application, Barrer revealed that he had borrowed \$40,000 from friends and relatives. Barrer testified that he explained to Womack that he had borrowed this sum to ease the financial difficulties he had encountered since his wife’s death.

Barrer also disclosed the \$38,000 tax liability which was the cause of the tax sale. He did not indicate, however, a contingent liability for an additional \$11,000 in employment taxes owed by his corporation which had not, at that time, been asserted against him personally under 26 U.S.C. § 6672. Barrer seems to argue both that this \$11,000 was included in the \$38,000 figure, and that because the \$11,000 tax liability had not been assessed against him personally it was not a contingent liability that he was obligated to reveal.

Nor did Barrer list as a contingent liability a \$5,300 debt owed by his wife’s estate to IBM. The Bank argues that this debt should have been revealed because Barrer had demonstrated, by requesting the probate court to charge the obligation to him, that he thought himself responsible for the debt. Barrer contends that because the probate court ultimately ruled that the obligation belonged to the estate, his failure to list the amount on the loan application was not a misrepresentation.

Finally, Barrer did not indicate on the loan application that he had approximately \$1,500 in unsatisfied judgments pending against him. However, he answered in the affirmative to a specific question on the application form which inquired whether he was “a defendant in any suits or legal actions.” Barrer also stated at his deposition that he told Womack that he owed small amounts arising out of these lawsuits. He said that he explained to her that these debts involved disputes over medical bills and that he expected his major medical insurance to cover most of them.

After Barrer and Womack finished discussing the content of the completed loan application form and Barrer’s financial situation, Womack indicated that, in order for the Bank to grant the loan, the IRS would have to agree to subordinate its claim with respect to Barrer’s house to that of WNB. On October 22, 1981, the last redemption day, Barrer obtained the subordination agreement from the IRS and delivered it to the Bank. Barrer then executed a collateral note for \$17,400, payable in 90 days at 15 percent interest, which gave the Bank the right to a security interest

in his house. The Bank's Vice President, Emma Carrera, gave Barrer a cashier's check, payable to him, for the loan amount. Prior to granting the loan, neither Womack nor Carrera obtained a credit report on Barrer and neither officer phoned Columbia about the status of his mortgage.

That afternoon, Barrer delivered the endorsed check to the IRS in accordance with the required redemption procedure and returned home, believing that his home had been saved.

In the meantime, the tax sale purchaser, Curtis, phoned WNB and spoke with Carrera. According to her deposition, their conversation was as follows:

He stated that he had some information that he thought would be of interest to me on the loan that the bank had made to Mr. Barrer. I told him at that time that I could not discuss any loan with him in regards to who it was or what it was for. He said he didn't want me to do any discussing, but he just wanted to tell me some facts.

He then told me he was the purchaser of the property at the tax sale. He couldn't believe that a bank would make a loan to a man who was in the credit position that he was in; that there were liens and judgments and so forth against him and at that time, I signaled for my secretary to bring me the file on Mr. Barrer.

I quickly looked through the file and found there wasn't a credit report in the file. At that time I told her to pull a credit report on him, which she did, and brought it to me within just a couple of minutes.

In the meantime, Mr. Curtis was continuing to talk. He had mentioned something about some kind of code that says that a person who buys a property at a tax sale cannot interfere with the owner's right to redeem, but that he didn't feel he was doing that just by informing the bank of Mr. Barrer's situation.

He put me on a conference call with a gentleman who identified himself as an official of the mortgage company [Columbia] that held the mortgage on Mr. Barrer's property. He [Mr. Ford] asked me at that time who, in his organization, had given us a credit report.

... I ... answer[ed] him ... that it was my understanding that all of the savings and loan associations required a written request for credit rating [sic] on any of the mortgages that they held and it had always been, to my knowledge, their policies not to give a reference by phone.

[Mr. Ford] said at that point he thought it was important that we know that Mr. Barrer's mortgage was six months in arrears and they were prepared to go to foreclosure on the property. He excused himself and Mr. Curtis stayed on the line.

[Mr. Curtis] said that he had knowledge that IRS had not made an agreement with Mr. Barrer to repay the balance of the taxes; that they were ready to go back to another tax sale as soon as this \$17,400 was paid.

Based on the information furnished by Curtis, Ford, and the credit report, the Bank decided to stop payment on the cashier's check. The Bank's counsel called Barrer later that day to inform him that the check would not be honored. When Curtis, to whom the IRS had turned over the check, presented it for payment the Bank refused to cash it. Barrer, therefore, did not effect the redemption of his home within the statutory period and Curtis became the owner.

B. Procedural History

Barrer filed suit against the Bank in District Court to recover damages to compensate him for the loss of \$94,000 equity in his home—the difference between the market value of the house and the balance due on the mortgage—that he allegedly suffered as a result of the Bank's rescission of the loan agreement. Barrer also claimed punitive damages for the embarrassment he endured and the rent he has been required to pay Curtis in order to remain in his home.

The case was referred to a magistrate for pretrial proceedings. On the Bank's motion for summary judgment, the magistrate found that Barrer did not disclose the following five material facts to the Bank: (1) that he was six months delinquent in mortgage payments, (2) that Columbia had begun foreclosure procedures, (3) that Barrer had at least an \$11,000 contingent liability to the IRS in addition to his \$38,000 actual liability, (4) that he had a contingent liability to IBM of approximately \$5,000, and (5) that he had approximately \$1,500 in unsatisfied judgments pending against him. The magistrate purported to rely on the law of innocent material misrepresentation to hold that these disclosure omissions justified WNB's rescission of the loan contract. On that basis, he granted summary judgment in favor of the Bank. This appeal followed.

II. Analysis

[A. Standards for Summary Judgment omitted.]

B. Elements of Innocent Material Misrepresentation

It is well established that misrepresentation of material facts may be the basis for the rescission of a contract, even where the misrepresentations are made innocently, without knowledge of their falsity and without fraudulent intent. The rationale supporting this rule, which has its origins in equity, is that, as between two innocent parties, the party making the representation should bear the loss. Stated another way, the rule is based on the view that "one who has made a false statement ought not to benefit at the expense of another who has been prejudiced by relying on the statement." This rule may be employed "actively," as in a suit at equity or law for rescission and restitution, or "passively," as a defense to a suit for breach of contract.

It is generally understood that four conditions must be met before a contract may be avoided for innocent misrepresentation. The recipient of the alleged misrepresentation must demonstrate that the maker made an assertion: (1) that was not in accord with the facts, (2) that was material, and (3) that was relied upon (4) justifiably by the recipient in manifesting his assent to the agreement. District of Columbia law adds a fifth condition, i.e., that the recipient relied to his detriment.

Unfortunately, the applicable precedent does not elaborate on the meaning of these conditions. In trying to give them content, we have found that the Restatement (Second) of Contracts (“Restatement (Second)”) provides helpful guidance concerning the first four conditions.

1. Misrepresentation

Section 159 of the Restatement (Second) defines a misrepresentation as “an assertion that is not in accord with the facts.” Comment c explains that an “assertion must relate to something that is a fact at the time the assertion is made in order to be a misrepresentation. Such facts include past events as well as present circumstances but do not include future events.” Comment d observes that a person’s state of mind is a fact and that an assertion of one’s opinion constitutes a misrepresentation if the state of mind is other than as asserted.

According to section 161, the only non-disclosures that may be considered assertions of fact for purposes of misrepresentation analysis are non-disclosures of facts known to the maker where the maker knows that disclosure: (a) is necessary to prevent a previous assertion from being a misrepresentation or from being fraudulent or material, (b) would correct a mistake of the other party as to a basic assumption on which that party is making the contract, if non-disclosure amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing, or (c) would correct a mistake of the other party as to the contents or effect of a writing. The section also provides that where the other person is entitled to know the non-disclosed facts because a relation of trust and confidence exists between the parties, non-disclosure is equivalent to an assertion of facts.

2. Materiality

In section 162, comment c, the Restatement (Second) explains that a misrepresentation is material “if it would be likely to induce a reasonable person to manifest his assent.” The court in *Cousineau v. Walker* elaborated on the materiality requirement, noting that it is a mixed question of law and fact that asks whether the assertion is one to which a reasonable person might be expected to attach importance in making a choice of action. A material fact is one that could reasonably be expected to influence a person’s judgment or conduct concerning a transaction.

The justification for the materiality requirement is that it is believed to encourage stability in contract relations. It prevents parties who become disappointed at the outcome of their bargain from seizing upon any insignificant discrepancy to void the contract.

3. Reliance

Section 167 requires that the misrepresentation be causally related to the recipient’s decision to agree to the contract—that it have been an inducement to agree. Inducement, as comment a explains, is shown through actual reliance. Comment a goes on to state that this reliance need not, however, be the sole or predominant

factor influencing the recipient's decision. Comment b indicates that circumstantial evidence is often important in determining whether there was actual reliance.

4. Justifiability of Reliance

Section 172 of the Restatement (Second) provides that a recipient's fault in not knowing or discovering the facts before making the contract does not make his reliance unjustified unless it amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.

While section 169 suggests that reliance on an assertion of opinion often is not justified, section 168(2) and the accompanying comment d make clear that in some situations the recipient may reasonably understand a statement of opinion to be more than an assertion as to the maker's state of mind. Where circumstances justify it, a statement of opinion may also be reasonably understood as carrying with it an assertion that the maker knows facts sufficient to justify him in forming it.

5. Detriment

Because the Restatement (Second) does not require a showing of detriment for rescission, it does not define it. We think that, in the innocent material misrepresentation context, a recipient is appropriately considered to have relied to his detriment where he receives something that is less valuable or different in some significant respect from that which he reasonably expected.

C. Application of Legal Standards

Application of the foregoing principles to the facts of this case requires that the case be remanded for trial. The magistrate tested Barrer's alleged misrepresentations against only two of the five elements necessary for rescission—he asked only if the representations were in accord with the facts and if they were material. In making this inquiry, the magistrate failed to consider the legal distinctions between assertions of fact and nondisclosure and between assertions of fact and statements of opinion. He neglected to investigate whether the Bank actually relied on the representations in deciding to make the loan; whether that reliance, if it existed, was justifiable; and whether the Bank relied to its detriment. Furthermore, the magistrate incorrectly concluded that there were no legally probative, material issues of fact in dispute.

1. Elements the Magistrate Failed to Consider

Initially, assuming for a moment that Barrer actually "misrepresented" certain facts, the materiality of the representations is hardly obvious. After deciding which representations meet the legal definition of misrepresentation, the trial court must determine with regard to each individual misrepresentation whether it was "likely to induce a reasonable [bank] to manifest [its] assent" to the loan agreement. If no single misrepresentation is found to be material, the court may consider, after ascertaining the assertions upon which WNB justifiably relied, whether those assertions are material when taken together.

All five alleged “misrepresentations” also raise serious factual questions as to whether the Bank actually and justifiably relied on them. Womack’s expressed sympathy for Barrer combined with the fact that the loan was issued in a very short time, without either a credit check, which was obtainable in minutes, or an inquiry into the status of Barrer’s mortgage, and the fact that the loan was withdrawn only when the Bank was placed in an embarrassing position by the tax sale purchaser—all these circumstances could suggest that the Bank was not very interested in the particulars of Barrer’s financial condition. Indeed, it was clear from the loan application that Barrer did admit that he was experiencing financial difficulties, yet WNB chose to make no further inquiry into the details of these problems. These facts could be construed to show that Womack’s sympathy for Barrer’s predicament was the real inducement for the loan. If the trial court finds that the Bank actually relied on Barrer’s alleged “misrepresentations,” it nonetheless must proceed to decide whether that reliance was justified.

The trial court must also determine whether the Bank’s reliance on Barrer’s alleged “misrepresentations” caused it any detriment. Did WNB receive as its benefit of the bargain something less valuable or significantly different from what it reasonably expected? In addition, the trial court should consider whether the subordination agreement, in combination with the right to a security interest in Barrer’s house granted by the collateral note, fully satisfied the Bank’s expectations.

The magistrate also made individual errors with respect to the five representations. These errors are outlined below.

2. Delinquency in Mortgage Payments

Barrer and Womack disagree over whether he told her that he “thought” he was two months behind in his mortgage payments or whether he said that he was current. Because this case is before us on appeal from the magistrate’s grant of summary judgment for the Bank, we must accept Barrer’s statement of the facts. The Bank argues that even if Barrer’s version is accepted, a misrepresentation still occurred because Barrer was actually six months behind. The Bank’s position is not necessarily correct.

Barrer’s statement that he “thought” he was in arrears by two months initially raises the factual question whether he made any misrepresentation. On the surface, the fact asserted by Barrer was his state of mind—what he thought. No finding was made below that Barrer’s state of mind was other than what he declared. On remand, before it may determine that this statement constituted a misrepresentation, the court must find either that Barrer misstated his thoughts, in accordance with the rule laid out in section 159, comment d of the Restatement (Second), or that Barrer’s statement could reasonably have been understood as carrying with it an assertion that Barrer knew sufficient facts that justified him in forming his opinion, in accordance with section 168(2).

When evaluating the materiality of this particular representation, the court should keep in mind the concession made by WNB’s counsel at oral argument—that by itself this representation might not be sufficient to justify summary judgment.

3. Failure to Disclose Mortgage Foreclosure Proceedings

Although the Bank evidently did not ask Barrer directly whether his mortgage was being foreclosed upon, it contends that he had an obligation to volunteer that information and that his failure to do so is tantamount to a misrepresentation. Barrer argues that he had no duty to reveal the existence of the foreclosure proceedings because he did not know about them. The Bank maintains that he must have known, because before Barrer applied for the loan his teen-age daughter signed for a certified letter from Columbia notifying him of the foreclosure.

The magistrate erred in finding on summary judgment that this non-disclosure is equivalent to a misrepresentation. The Restatement (Second) provides that a non-disclosure may be considered an assertion of fact for purposes of misrepresentation analysis only if the non-disclosed fact is known to the maker and if certain other conditions are met. Because there exists a material issue of fact as to whether Barrer knew that Columbia had begun to foreclose, summary judgment was inappropriate.

4. \$11,000 Contingent Liability

The magistrate also erred in finding on summary judgment that Barrer's alleged failure to list as a personal contingent liability an \$11,000 tax debt owed to the IRS by his corporation constituted a misrepresentation. First, summary judgment is precluded by the existence of a factual dispute over whether this \$11,000 was included in the \$38,000 tax liability that Barrer did list. Barrer seems to contend that at least some of this amount was included in the \$38,000 figure; the Bank seems to dispute this contention. Second, there is a mixed question of law and fact as to whether the IRS had, at the time of the loan application, taken any action to assert the \$11,000 tax debt owed by Today News Service, Inc., against Barrer personally and, if not, whether the corporation's liability may be considered Barrer's contingent liability. If the \$11,000 tax debt could not at that time have been considered Barrer's liability, his failure to list such a debt was not a misrepresentation.

5. \$5,300 Debt Owed to IBM

The magistrate found that Barrer's failure to reveal as a personal liability a \$5,300 debt owed to IBM for equipment purchased by his wife was a misrepresentation. We disagree as a matter of law. Although Barrer asked the probate court handling his wife's estate to charge him with the debt, the court refused, ruling that the debt was hers alone. Contrary to the Bank's protestations, it makes no difference to the determination whether a misrepresentation occurred that Barrer asked the probate court to charge him with the debt before, and the court refused after, Barrer submitted the loan application. A misrepresentation is "an assertion that is not in accord with the facts." The fact is that a court decided that this debt never legally belonged to Barrer. Barrer's thoughts or wishes on the matter are irrelevant. He made no legal misrepresentation to the Bank on this subject.

6. \$1,500 in Judgments

Finally, the magistrate determined that Barrer's failure to list \$1,500 in judgments that were outstanding against him constituted a misrepresentation. This issue should not have been resolved on summary judgment. Barrer disclosed on the loan application that he was a defendant in some lawsuits. Furthermore, in his deposition he stated that he had informed Womack that he owed some small judgments arising out of these suits and that he expected his health insurance to cover most of them. Accepting Barrer's version of the facts, as we must in reviewing a grant of summary judgment, he revealed both his defendant status and the existence of judgments against him. It is true that he did not list them on the application form. Because, however, Barrer contends that he adequately disclosed these debts in connection with the question concerning lawsuits and in his discussion with Womack, there exists a dispute over whether he actually revealed these debts; consequently the magistrate should not have resolved this issue on summary judgment. On remand, two factual questions must be decided. First, what information concerning these judgments did Barrer give to Womack? Second, was that information sufficient to give the Bank notice of them? If it was sufficient, then Barrer made no misrepresentation.

III. Conclusion

The magistrate both failed to utilize the correct legal test for determining when an innocent material misrepresentation permits the rescission of a contract and to recognize that this case presents disputed material issues of fact that render summary judgment inappropriate. We reverse and remand for further proceedings consistent with this opinion.

Reflection

Barrer is an example of how to analyze a case of innocent misrepresentation. In an innocent misrepresentation, the assertion must be material and justifiably relied on by the recipient in manifesting her assent to the agreement.

In its analysis of the rules, the court first defined misrepresentation and determined that the assertion may be a non-disclosure. The assertion must be material enough to reasonably induce a person to manifest their assent. An assertion of an opinion is not normally something that can be justifiably relied upon but may be under certain circumstances. The additional requirement of detrimental reliance is determined by whether the recipient received something less in value than reasonably expected.

The court believed that the magistrate did not distinguish between statements of non-disclosure and statements of opinion, and this was a factual dispute that needed to be resolved in a trial court. Even assuming Barrer's statements were misrepresentations, there was also a factual dispute over whether the bank justifiably relied on the misrepresentations and whether there was a detriment suffered. Only when all

these elements are met can a contract be voided by the bank. Therefore, the case was remanded consistent with the court's analysis.

Discussion

1. What are each of the purported misrepresentations in the *Barrer* case? For each, apply the R2d's definition of misrepresentation to confirm whether each is in fact a misrepresentation under the legal definition.
 2. The trial court in *Barrer* failed to consider whether the misrepresentations were material. For each misrepresentation, analyze whether it was material and/or fraudulent.
 3. The defense of misrepresentation is said to be "stronger" than the defense of mistake, in the sense that courts are more likely to permit avoidance of a contract on the ground of misrepresentation than mistake. Why might courts be more willing to grant the misrepresentation defense than the mistake defense? Present your opinion in terms of a policy analysis.
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Reading Hill v. Jones. The next case addresses the doctrine of misrepresentation, specifically the doctrine of misrepresentation due to non-disclosure. This case also raises the question of whether a buyer of residential real estate has a duty to inspect the property to learn all of its defects or can instead rely on the seller to reveal significant defects.

Under the traditional approach, the default rule was "*caveat emptor*." This Latin phrase roughly translates to "let the buyer beware." Under this doctrine, buyers—especially buyers of real property—were generally responsible for discovering defects, absent egregious facts like deliberate fraud or concealment by the seller. Sellers were not responsible for affirmatively disclosing defects to buyers.

However, the traditional approach has given way, at least in some contexts. Today, in many real estate contracts and in contracts for the sale of goods, buyers can typically rely more heavily on sellers to disclose significant defects in property and goods. That said, in determining whether *caveat emptor* applies, the facts and context matter.

Sometimes the law is more protective of buyers. In contracts for the sale of residential real estate, if the seller of a house knows that a house has a serious (material) defect but fails to disclose this defect to a buyer, the seller's suppression of the fact can constitute voidable misrepresentation, assuming the

elements are met and the seller has a duty to disclose. The R2d § 161 lists several situations in which a seller has a duty to disclose material facts under the common law of contracts. In addition, state laws and regulations often require residential sellers to make disclosures regarding their properties. The UCC, when dealing with the sale of goods, also tends to be more protective of buyers. As you will learn in Chapter 18 on warranties, in contracts for the sales of goods, the UCC provides various implied warranties that automatically enter contracts in order to protect buyers.

In contrast, in contracts for the sale of commercial real estate, the standard is closer to “buyer beware.” Commercial buyers of real estate are generally expected to conduct their own due diligence. State laws tend not to require specific disclosures, although some states may require disclosing certain property conditions in commercial real estate transactions as well.

As you read *Hill*, consider whether the seller engaged in misrepresentation, and, if so, what kind(s). Also consider why, as a matter of policy, the law might be construed to require sellers to affirmatively disclose known defects in residential property.

Hill v. Jones

725 P.2d 1115 (Ariz. Ct. App. 1986)

BRUCE E. MEYERSON, Judge.

Must the seller of a residence disclose to the buyer facts pertaining to past termite infestation? This is the primary question presented in this appeal. Plaintiffs Warren G. Hill and Gloria R. Hill (buyers) filed suit to rescind an agreement to purchase a residence. Buyers alleged that Ora G. Jones and Barbara R. Jones (sellers) had made misrepresentations concerning termite damage in the residence and had failed to disclose to them the existence of the damage and history of termite infestation in the residence. The trial court dismissed the claim for misrepresentation based upon a so-called integration clause in the parties’ agreement.

Sellers then sought summary judgment on the “concealment” claim arguing that they had no duty to disclose information pertaining to termite infestation and that even if they did, the record failed to show all of the elements necessary for fraudulent concealment. The trial court granted summary judgment, finding that there was “no genuinely disputed issue of material fact and that the law favors the . . . defendants.” The trial court awarded sellers \$ 1,000.00 in attorney’s fees. Buyers have appealed from the judgment and sellers have cross-appealed from the trial court’s ruling on attorney’s fees.

I. FACTS

In 1982, buyers entered into an agreement to purchase sellers’ residence for \$72,000. The agreement was entered after buyers made several visits to the home. The purchase

agreement provided that sellers were to pay for and place in escrow a termite inspection report stating that the property was free from evidence of termite infestation. Escrow was scheduled to close two months later.

One of the central features of the house is a parquet teak floor covering the sunken living room, the dining room, the entryway and portions of the halls. On a subsequent visit to the house, and when sellers were present, buyers noticed a small “ripple” in the wood floor on the step leading up to the dining room from the sunken living room. Mr. Hill asked if the ripple could be termite damage. Mrs. Jones answered that it was water damage. A few years previously, a broken water heater in the house had in fact caused water damage in the area of the dining room and steps which necessitated that some repairs be made to the floor. No further discussion on the subject, however, took place between the parties at that time or afterwards.

Mr. Hill, through his job as maintenance supervisor at a school district, had seen similar “ripples” in wood which had turned out to be termite damage. Mr. Hill was not totally satisfied with Mrs. Jones’s explanation, but he felt that the termite inspection report would reveal whether the ripple was due to termites or some other cause.

The termite inspection report stated that there was no visible evidence of infestation. The report failed to note the existence of physical damage or evidence of previous treatment. The realtor notified the parties that the property had passed the termite inspection. Apparently, neither party actually saw the report prior to close of escrow.

After moving into the house, buyers found a pamphlet left in one of the drawers entitled “Termites, the Silent Saboteurs.” They learned from a neighbor that the house had some termite infestation in the past. Shortly after the close of escrow, Mrs. Hill noticed that the wood on the steps leading down to the sunken living room was crumbling. She called an exterminator who confirmed the existence of termite damage to the floor and steps and to wood columns in the house. The estimated cost of repairing the wood floor alone was approximately \$5,000.

Through discovery after their lawsuit was filed, buyers learned the following. When sellers purchased the residence in 1974, they received two termite guarantees that had been given to the previous owner by Truly Nolen, as well as a diagram showing termite treatment at the residence that had taken place in 1963. The guarantees provided for semi-annual inspections and annual termite booster treatments. The accompanying diagram stated that the existing damage had not been repaired. The second guarantee, dated 1965, reinstated the earlier contract for inspection and treatment. Mr. Jones admitted that he read the guarantees when he received them. Sellers renewed the guarantees when they purchased the residence in 1974. They also paid the annual fee each year until they sold the home.

On two occasions during sellers’ ownership of the house but while they were at their other residence in Minnesota, a neighbor noticed “streamers” evidencing live termites in the wood tile floor near the entryway. On both occasions, Truly Nolen gave a booster treatment for termites. On the second incident, Truly Nolen drilled through one of the wood tiles to treat for termites. The neighbor showed Mr. Jones the

area where the damage and treatment had occurred. Sellers had also seen termites on the back fence and had replaced and treated portions of the fence.

Sellers did not mention any of this information to buyers prior to close of escrow. They did not mention the past termite infestation and treatment to the realtor or to the termite inspector. There was evidence of holes on the patio that had been drilled years previously to treat for termites. The inspector returned to the residence to determine why he had not found evidence of prior treatment and termite damage. He indicated that he had not seen the holes in the patio because of boxes stacked there. It is unclear whether the boxes had been placed there by buyers or sellers. He had not found the damage inside the house because a large plant, which buyers had purchased from sellers, covered the area. After investigating the second time, the inspector found the damage and evidence of past treatment. He acknowledged that this information should have appeared in the report. He complained, however, that he should have been told of any history of termite infestation and treatment before he performed his inspection and that it was customary for the inspector to be given such information.

Other evidence presented to the trial court was that during their numerous visits to the residence before close of escrow, buyers had unrestricted access to view and inspect the entire house. Both Mr. and Mrs. Hill had seen termite damage and were therefore familiar with what it might look like. Mr. Hill had seen termite damage on the fence at this property. Mrs. Hill had noticed the holes on the patio but claimed not to realize at the time what they were for. Buyers asked no questions about termites except when they asked if the “ripple” on the stairs was termite damage. Mrs. Hill admitted she was not “trying” to find problems with the house because she really wanted it.

II. Contract Integration Clause

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III. Duty to Disclose

The principal legal question presented in this appeal is whether a seller has a duty to disclose to the buyer the existence of termite damage in a residential dwelling known to the seller, but not to the buyer, which materially affects the value of the property. For the reasons stated herein, we hold that such a duty exists.

This is not the place to trace the history of the doctrine of caveat emptor. Suffice it to say that its vitality has waned during the latter half of the 20th century [For example, courts found various implied warranties that protect buyers, such as the implied warranty of habitability.] The modern view is that a vendor has an affirmative duty to disclose material facts where:

1. Disclosure is necessary to prevent a previous assertion from being a misrepresentation or from being fraudulent or material;
2. Disclosure would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if nondisclosure

amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing;

3. Disclosure would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part;

4. The other person is entitled to know the fact because of a relationship of trust and confidence between them.

R2d § 161 (1981) (*Restatement*); see *Restatement (Second) of Torts* § 551 (1977).

Arizona courts have long recognized that under certain circumstances there may be a “duty to speak.” As the supreme court noted in the context of a confidential relationship, “suppression of a material fact which a party is bound in good faith to disclose is equivalent to a false representation.”

Thus, the important question we must answer is whether under the facts of this case, buyers should have been permitted to present to the jury their claim that sellers were under a duty to disclose their (sellers’) knowledge of termite infestation in the residence. This broader question involves two inquiries.

First, must a seller of residential property advise the buyer of material facts within his knowledge pertaining to the value of the property?

Second, may termite damage and the existence of past infestation constitute such material facts?

The doctrine imposing a duty to disclose is akin to the well-established contractual rules pertaining to relief from contracts based upon mistake. Although the law of contracts supports the finality of transactions, over the years courts have recognized that under certain limited circumstances it is unjust to strictly enforce the policy favoring finality. Thus, for example, even a unilateral mistake of one party to a transaction may justify rescission. R2d § 153.

There is also a judicial policy promoting honesty and fair dealing in business relationships. This policy is expressed in the law of fraudulent and negligent misrepresentations. Where a misrepresentation is fraudulent or where a negligent misrepresentation is one of material fact, the policy of finality rightly gives way to the policy of promoting honest dealings between the parties. See R2d § 164(1).

Under certain circumstances nondisclosure of a fact known to one party may be equivalent to the assertion that the fact does not exist. For example, “when one conveys a false impression by the disclosure of some facts and the concealment of others, such concealment is in effect a false representation that what is disclosed is the whole truth.” Thus, nondisclosure may be equated with and given the same legal effect as fraud and misrepresentation. One category of cases where this has been done involves the area of nondisclosure of material facts affecting the value of property, known to the seller but not reasonably capable of being known to the buyer.

Courts have formulated this “duty to disclose” in slightly different ways. For example, the Florida Supreme Court recently declared that “where the seller of a home

knows of facts materially affecting the value of the property which are not readily observable and are not known to the buyer, the seller is under a duty to disclose them to the buyer.” In California, the rule has been stated this way:

“Where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer.”

We find that the Florida formulation of the disclosure rule properly balances the legitimate interests of the parties in a transaction for the sale of a private residence and accordingly adopt it for such cases.

As can be seen, the rule requiring disclosure is invoked in the case of material facts. Thus, we are led to the second inquiry—whether the existence of termite damage in a residential dwelling is the type of material fact which gives rise to the duty to disclose. The existence of termite damage and past termite infestation has been considered by other courts to be sufficiently material to warrant disclosure.

In *Lynn v. Taylor*, the purchaser of a termite-damaged residence brought suit against the seller and realtor for fraud and against the termite inspector for negligence. An initial termite report found evidence of prior termite infestation and recommended treatment. A second report indicated that the house was termite free. The first report was not given to the buyer. The seller contended that because treatment would not have repaired the existing damage, the first report was not material. The buyer testified that he would not have purchased the house had he known of the first report. Under these circumstances, the court concluded that the facts contained in the first report were material.

Although sellers have attempted to draw a distinction between live termites and past infestation, the concept of materiality is an elastic one which is not limited by the termites' health. “A matter is material if it is one to which a reasonable person would attach importance in determining his choice of action in the transaction in question.” For example, termite damage substantially affecting the structural soundness of the residence may be material even if there is no evidence of present infestation. Unless reasonable minds could not differ, materiality is a factual matter which must be determined by the trier of fact. The termite damage in this case may or may not be material. Accordingly, we conclude that buyers should be allowed to present their case to a jury.

Sellers argue that even assuming the existence of a duty to disclose, summary judgment was proper because the record shows that their “silence . . . did not induce or influence” the buyers. This is so, sellers contend, because Mr. Hill stated in his deposition that he intended to rely on the termite inspection report. But this argument begs the question. If sellers were fully aware of the extent of termite damage and if such information had been disclosed to buyers, a jury could accept Mr. Hill's testimony that had he known of the termite damage he would not have purchased the house.

Sellers further contend that buyers were put on notice of the possible existence of termite infestation and were therefore “chargeable with the knowledge which an

inquiry, if made, would have revealed.” It is also true that “a party may . . . reasonably expect the other to take normal steps to inform himself and to draw his own conclusions.” R2d § 161 comment d. Under the facts of this case, the question of buyers’ knowledge of the termite problem (or their diligence in attempting to inform themselves about the termite problem) should be left to the jury.

By virtue of our holding, sellers’ cross-appeal is moot. Reversed and remanded.

Reflection

Hill v. Jones is a case about termites—and trust. It raises a triable issue of fact, asking when silence is a lie. In a world where buyers often depend on sellers for information about hidden defects, the court signals that silence can distort just as much as speech. Disclosure, when material, can become a legal duty. This isn’t just about real estate; it’s about how the law responds to information asymmetry.

Information asymmetry—when one party knows more than the other—is common in contracting. Sellers usually know more about what they are selling than buyers know about what they are buying. This common situation does not necessarily trigger a duty to speak. If it did, that would destroy incentives for sellers to gather information. Rather, the contract itself is the mechanism that shifts the risks of known and unknown risks and uncertainties.

What matters is context. When silence conceals something the other side has no practical way to discover—and when the stakes are high enough to affect the fairness of the bargain—the law may treat that silence as misrepresentation. Contract law doesn’t punish mere advantage, but it does intervene when the structure of a deal becomes distorted by withheld truths that matter.

Hill reminds us that contract law is not just about formal assent. Contract law is also concerned with the boundary between sharp strategy and unethical deception.

Discussion

1. What is the duty to disclose with regard to the seller of a residential property? What, exactly, does this duty require a seller to do?
2. The implied warranty of habitability and other doctrines that soften or restrict *caveat emptor* regarding sales of residential homes seem directed toward protecting home buyers. Should a judge consider whether a home buyer is a private person or a home flipping company? For example, Invitation Homes (INVH), a publicly traded corporation, is the largest owner of single-family homes in America. INVH owns over 80,000 single-family homes, which it rents or flips for resale. Should the law pertaining to sales of homes pertain equally to all buyers, or should the doctrine of *caveat emptor* apply more strictly where the buyer is a powerful corporation? If

you believe the law should apply differently to different parties, explain how you'd draft a contract that achieves your distinction.

3. Applying the rules in the R2d to the facts in *Hill*: (a) Did the seller make a misrepresentation? If so, identify it. (b) Was the misrepresentation you identified material? (c) Was the misrepresentation you identified fraudulent? (d) Was it reasonable for the buyer to rely on the misrepresentation you identified?

Reading Quebodeaux v. Quebodeaux. The following case exhibits both duress and undue influence. This case was selected for inclusion because the threats by one party are so egregious that they would likely constitute duress even if the parties did not have a special relationship. But you may also notice in the case caption that the parties have the same last name. The parties in this case were husband and wife. In such a relationship, a defense of undue influence might also be raised. As you read this case, think about why the court voided this contract on the basis of duress and not undue influence.

Quebodeaux v. Quebodeaux

102 Ohio App. 3d 502 (1995)

SLABY, Judge.

Anthony Quebodeaux appeals from a trial court order granting Merry Quebodeaux her motion for relief from judgment. We affirm.

Anthony and Merry sought a dissolution of their eleven-year marriage. The dissolution petition included a separation agreement signed by both parties. This agreement gave custody of the couple's two sons to Anthony and the couple's daughter to Merry. Although Merry's annual income was less than half of Anthony's, the agreement stated that Merry would not receive spousal support. Similarly, the agreement did not require either party to pay child support.

The trial judge extensively questioned Merry about the terms of the separation agreement. Merry stated that she consented to the terms. Despite having "some distinct reservations" about the agreement, the trial judge ordered the dissolution pursuant to the terms specified in the agreement.

About two months later, Merry moved for relief from judgment, alleging that she had entered into the separation agreement while under duress. She further claimed that Anthony had misrepresented his financial status.

After a lengthy hearing, the trial court granted Merry's motion and found that Merry had not entered into the agreement freely. The court also found that Anthony

had failed to report his financial interest in a house. The parties had leased the house for approximately one and one-half years prior to the dissolution. Anthony bought the house after the dissolution petition was filed. The court found that he received credit for the lease payments, which were made from the parties' joint checking account, against the price of the house.

Anthony appeals, assigning three errors.

Assignments of Error I and II

I. The trial court erred to the prejudice of [Anthony] when it permitted Marily Zeidner to testify to general aspects of the battered woman syndrome, where there was no testimony from an expert indicating that [Merry] suffered from the syndrome.

II. The trial court erred and abused its discretion when it granted [Merry's] motion for relief from the separation agreement pursuant to Civ.R. 60(B)(5) and found that [Merry] had been coerced into signing the separation agreement, where [Merry's] testimony regarding abuse was not corroborated and where [Merry] failed to present sufficient evidence as a matter of law that she signed the separation agreement under duress.

Anthony argues that the trial court abused its discretion in finding that Merry signed the separation agreement while under duress and by invalidating the agreement on that basis. Anthony contests the admissibility of the hearing testimony of Marilyn Zeidner, an assistant director of a local battered woman shelter. He notes that Zeidner never observed Merry prior to the dissolution and that her testimony concerned only general aspects of battered woman syndrome. He also argued that *State v. Koss* limits the admissibility of evidence of battered woman syndrome to criminal proceedings in which the woman seeks to use the syndrome as a defense.

In her motion, Merry asserted that she signed the separation agreement while under duress. Three elements are necessary to establish duress; first, that one side involuntarily accepted the terms of another; second, that circumstances permitted no other alternative; and third, that the opposite party's coercive acts caused those circumstances. *Blodgett v. Blodgett*.

We find that the trial court did not abuse its discretion in granting Merry's motion for relief from judgment. The agreement was drafted by Anthony and his attorney. Merry testified that Anthony threatened to take all three of the children from her unless she assented to the agreement:

"Q. Why did you give those answers [indicating consent to the separation agreement] to Judge Basinski?"

"A. Because I had to tell him that. I mean. I didn't have any choice but to tell him that."

"Q. Tell us why you are saying that."

"A. Because Tony told me, as long as I signed everything and did what he said, that he would let me keep [their daughter]. And, if I gave him a hard

time, that he would leave and take the kids with him, and I wouldn't have any of them. And that he would have me declared as unfit."

Merry also testified to repeated acts of actual and threatened abuse by Anthony during the marriage. She repeatedly stated her belief that she had no alternative to signing the agreement, believing that she stood to lose her children otherwise. Based on the foregoing, the trial court did not abuse its discretion in finding that Merry signed the agreement while under duress.

We reject Anthony's argument regarding testimony on the battered woman syndrome. The court was not required to find that Merry was suffering from battered woman syndrome as a prerequisite to determining that she was under duress. Indeed, the trial court's journal entry specifically declined to acknowledge Merry as a victim of battered woman syndrome. Accordingly, any error in admitting Zeidner's testimony was harmless.

Anthony's first and second assignments of error are overruled.

Assignment of Error III

[Discussion regarding trial court's abuse of discretion omitted.]

Anthony's third assignment of error is overruled. . . .

Reflection

Quebodeaux is a duress case. There are three elements necessary to establish a duress case: first, one side involuntarily accepted the terms of another; second, that circumstances permitted no other alternative; and third, that the opposite party's coercive acts caused those circumstances.

The first element is that one side involuntarily accepted the terms of another. In this case, Merry involuntarily agreed to Anthony's terms. Merry did not want to agree to her ex-husband's terms but felt that she had to.

The second element is that the circumstances permitted no other alternative. Merry had no choice but to agree to Anthony's terms. Had Merry not agreed to the terms, Anthony was going to have Merry deemed an unfit mother and take all three children away.

Finally, the opposite party's coercive acts must have caused those circumstances. Merry did not want to agree to Anthony's terms, but she believed that she had no alternatives and had to agree to his terms because Anthony threatened to take all three of her children from her if she did not agree.

Why didn't the court characterize Merry's defense as undue influence? Perhaps the reason is that the parties, although married in a technical sense, were undergoing a bitter divorce at the time. While, in a typical situation, a wife should be entitled to rely on her husband, under these circumstances, perhaps the court found it unreasonable for Merry to rely on Anthony to look out for her best interests.

It is also important to note that in addition to physical duress, there is also what is called economic duress. However, economic duress is very rarely found to be a basis for avoidance of a contract, whereas physical duress commonly is.

Discussion

1. Duress can arise due to physical compulsion or an improper threat. List all the potential instances of compulsion and all the potential threats. For each threat, analyze where it was improper pursuant to R2d § 175.
 2. In general, contract law considers objective manifestations. But in the case of duress, there is a subjective test for inducement. Explain that subjective test in general and then apply it to the specific facts of *Quebodeaux*. In other words, how and what did Anthony's threat to Merry make Merry feel and think?
 3. Why does contract law generally take an objective approach, and why does it take a subjective approach with regard to the duress doctrine?
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Problems

Problem 12.1. Motor Home Misrepresentation

In early January 2004, John Powers, III, attended a motor home show in Tucson, Arizona, where he and Damon Rapozo, a salesman for Guaranty RV, Inc., discussed Powers's purchasing a Country Coach, Inc. (Country Coach) motor home from Guaranty.

Powers had certain specifications that he wanted in a motor home, including an engine sufficiently powerful to tow a large trailer. On January 21, 2004, Rapozo sent Powers a proposal for a Country Coach Intrigue motor home with a C-13 Caterpillar 525 hp engine.

Because Powers had heard of instances in which large engines in motor homes overheated, he specifically asked for an assurance that the C-13 engine would not overheat in the Intrigue. In response, Rapozo emailed Jeff Howe, an employee with Country Coach, the following:

Hi Jeff,

I have a customer ready to fly up and order a new Intrigue Serenade. He wants a letter from CC that states the C-13 will not overheat in the Intrigue, then he said he will fly up. Is that possible?

Damon

Howe forwarded Rapozo's email to Bently Buchanan, Country Coach's chassis engineering manager, who replied via email as follows:

The cooling system for each power train installation is required to be tested by the engine manufacturer. The cooling system consists of a radiator, charge air cooler, transmission cooler, hydraulic oil cooler, air conditioning condenser, hydraulic pump, hydraulic motor and the cooling fan. Recently we successfully completed this testing for our C-13 installation on our Magna and Affinity chassis. This same cooling system will be used on your Intrigue with the C-13. The only difference between our Magna/Affinity installation and the Intrigue is the engine access door. On our Magnas and Affinities the doors have "hidden horizontal louvers" cut into them. On Intrigues we install a door which has a perforated aluminum panel on it. These louvers and perforations aid in engine compartment heat dissipation. Whereas I have faith that our cooling package installation on the C-13 Intrigue will be successful, the effect that the different door has on cooling is unknown at this time. Because our cooling system equipment is the same on all chassis with the C-13, we are not required to test our Intrigue installation.

Rapozo then transmitted Buchanan's response to Powers. On July 19, 2004, Powers and Guaranty executed the purchase documents for the 2004 Intrigue for a sales price of \$344,382.00. The Intrigue overheated during its initial drive from the lot in Oregon to Arizona, and repeatedly thereafter.

On July 18, 2005, Powers filed a complaint against Country Coach and Guaranty alleging, among other things, fraudulent inducement to contract.

Should the court void the agreement on the basis of fraudulent misrepresentation?

See Powers v. Guar. RV, Inc., 278 P.3d 333, 340 (Ariz. Ct. App. 2012).

Problem 12.2. The Blodgetts under Duress

Nancy and William Blodgett were married in Connecticut on November 22, 1975. William signed an antenuptial agreement the day before their marriage; Nancy did not sign the agreement until December 31, 1975. Shortly after they married, the Blodgetts moved to Ohio.

On November 10, 1975, William entered into an agreement to purchase the assets of Roberts Cartage, Inc., later known as Roberts Express, Inc. William ran the company, and Nancy assisted in its operations by performing at various times duties such as clerical work, delivering freight, dispatching drivers, and sales. The company prospered and was sold to Roadway Services, Inc., in 1984 for \$6 million in cash, \$3 million in incentives if certain profit goals were reached by 1989, and \$3 million for a non-competition provision between William Blodgett and Roadway Services.

Nancy and William separated in February 1986, and in April 1986, Nancy filed a complaint for divorce. The trial court granted the divorce in January 1988. With regard to property division, the trial court found the \$6 million in proceeds from the sale of Roberts Express to be a marital asset. The non-competition and incentive

payments were found to be non-marital assets and solely the property of William. Nancy's share of the marital assets, including the sale of Roberts Express, was set at \$3.1 million. Because of tax consequences, the trial court ordered that Nancy be paid \$2.765 million if she signed a satisfaction of judgment within forty-five days of the trial court's judgment entry, filed on January 29, 1988.

Both parties appealed the distribution of assets. Nancy contended that the incentive and non-competition payments should have been treated as marital assets. William appealed the trial court's refusal to enforce the antenuptial agreement. While her appeal was pending, Nancy requested the court of appeals to order that \$2.765 million be released to her from escrow, and the same amount to William.

On May 11, 1988, Nancy signed and executed the satisfaction of judgment. In return, \$2.765 million was released from escrow, and William executed a deed to the family home.

The next day, William filed a motion to dismiss Nancy's appeal based on her execution of the satisfaction of judgment, which he claimed had terminated her right to appeal. The court of appeals took the motion under advisement, indicating it would rule on the motion prior to its decision on the merits.

In order for Nancy to use the excuse of duress, what elements must she be able to prove?

See Blodgett v. Blodgett, 551 N.E.2d 1249 (Ohio 1990).

Problem 12.3. Undue Bequest

Florence Goldman, a widow in her eighties, sued August Bequai, an attorney and long-time friend of Goldman's family. Goldman alleges that Bequai fraudulently induced her to convey to him substantially all of her property shortly after the death of her husband. Goldman brought claims against Bequai for fraud and deceit, breach of fiduciary obligation, tortious conversion, and legal malpractice. She also brought a claim against Bequai's wife, Mary Ryan Bequai, for breach of fiduciary obligation. After permitting limited discovery, the District Court ruled that Goldman's claims against appellee were barred by the three-year statute of limitations in the District of Columbia. The trial court rejected Goldman's contentions that the running of the limitations period should have been equitably tolled.

In response to the ruling, Goldman brought a new claim for rescission of the agreement to convey her property to Bequai under the defense of undue influence. Her complaint seeking rescission based on this defense included the following facts:

Florence Goldman's husband died on October 31, 1985, after a long bout with Alzheimer's and Parkinson's diseases. For several years prior to her husband's death, Goldman cared for him at home. During much of her husband's illness and for some time thereafter, Goldman was under the care of a psychiatrist, who treated her for depression stemming from the strain and grief she experienced because of her husband's declining health. As part of this therapy Goldman was treated

with antidepressant drugs, which she alleges had a negative effect on her cognitive processes.

Goldman's complaint described August Bequai as a long-time friend whom she regarded as almost a member of her family. Bequai in turn described Goldman's husband as a "surrogate father," and stated that both Mr. and Mrs. Goldman often referred to him as their "good son."

Bequai is an attorney and has written several books about white-collar crime and served as an adjunct professor or lecturer at several universities. Goldman alleged in her complaint that during her husband's illness and after his death, she looked to Bequai as her "adviser and attorney" in her financial affairs.

In January 1986, three months after her husband's death, Goldman conveyed to Bequai joint tenancy with a right of survivorship in a condominium in Bethesda, Maryland, and in a partnership interest in property at 423 Massachusetts Avenue, N.W., in Washington, DC. Ten dollars (\$10) was given in consideration for the transfer of each property. Goldman had no legal counsel or independent advice of any sort, and she alleges that Bequai did not fully explain the nature of the transactions to her. There were no witnesses to the transactions other than the notary, whose commission apparently had expired several months prior to the signing of the deeds.

The Massachusetts Avenue property was sold in January 1990, and the proceeds attributable to the Goldman/Bequai partnership share were distributed to them. Both Bequai and Goldman were represented at the closing by Robert Pollock, an attorney hired by Bequai. Goldman, however, described Pollock as "a flunky who did [Bequai's] bidding."

After the sale of the Massachusetts Avenue property, Bequai accompanied Goldman to the bank, where both placed their proceeds in investment accounts that were opened that day. Bequai placed his money in an account he owned jointly with his wife. Goldman placed her share in a joint account with Bequai.

In her deposition, appellant stated that, at least as early as 1986, she, her son (Dennis Goldman), and Bequai had discussed starting a business that would employ both Goldman and her son. Dennis Goldman stated in an affidavit that Bequai had said that he needed to be listed as an owner of the Massachusetts Avenue property in order adequately to represent the Goldmans' interests during negotiations over the sale of the property, and that Bequai told him that the transfer "would be temporary, and solely for the limited purpose of inflating his financial worth on paper" while he looked for a business in which to invest. Florence Goldman stated that Bequai told her that he needed to be a part owner in order to "participate fully" in negotiations for the sale of the property, and to locate a suitable business opportunity for himself and the Goldmans. Goldman further stated that:

He said that it was necessary in order to represent me that he had to have his name on the property as a half owner. But all the proceeds from whatever I had, except to live on, would be going into the business and a future for my son and a future for me. That's what we were building on.

According to Goldman, “This is why we let him do this, not ever realizing that I was relinquishing my full interest.” Goldman stated that it was her understanding that the purpose of the documents she signed conveying a joint tenancy in her properties to Bequai was: “To give him stature in negotiating for the business for the three of us.” At several points in her deposition, Goldman stated that she relied on Bequai’s representations and so did not read the documents she signed.

In August 1987, at Bequai’s dictation, Goldman hand wrote a power of attorney authorizing her son to represent her “in all matters pertaining to the sale” of the Massachusetts Avenue property. The purpose of this power of attorney was ostensibly to allow Dennis Goldman to attend partnership meetings concerning the sale of the property. Florence Goldman indicated that Bequai suggested to her that it would be too much of a strain for her to attend these meetings herself.

Goldman stated in her deposition that her “first inklings” that Bequai had “deceived” her came in June of 1990, after she received the money for the sale of the Massachusetts Avenue property: “His name was on my half. His name was on everything I had: my checking account, my savings account. The other half he put in his name and his wife’s name and I couldn’t understand that.”

It appears that there was also a disagreement between Dennis Goldman and Bequai at about this time. Both men stated that they formerly were very close friends, and Bequai had employed Dennis Goldman for some time as an administrative member of his legal practice. However, in middle to late 1990, the two had an argument stemming at least in part from Bequai’s handling of Florence Goldman’s finances. As a result of this quarrel, Bequai dismissed Dennis Goldman from his employ.

Should the court rescind the agreement under which Goldman bequeathed her property to Bequai based on the defense of undue influence?

See Goldman v. Bequai, 19 F.3d 666 (D.C. Cir. 1994).

Chapter 13

Incapacity

Contract law hinges on the principle of voluntary agreement, requiring parties to understand and willingly enter binding commitments. However, not all individuals possess the capacity to contract. Incapacity as a defense reflects the legal recognition that certain individuals, due to their status or condition, may lack the ability to provide meaningful consent. This chapter examines how incapacity operates to protect vulnerable parties while maintaining the legitimacy of the contractual system.

R2d § 12(1) establishes the foundational principle:

No one can be bound by contract who has not legal capacity to incur at least voidable contractual duties.

This general rule requiring capacity to contract is followed by several specific instances of incapacity:

A natural person who manifests assent to a transaction has full legal capacity to incur contractual duties thereby unless he is (a) under guardianship, (b) an infant, (c) mentally ill or defective, or (d) intoxicated. R2d § 12(2).

Common law identifies specific categories of incapacity, such as guardianship, infancy, mental illness, and intoxication, that limit an individual's ability to contract. Some of these doctrines, like guardianship and infancy, function as bright-line rules that promote predictability. Others, like mental illness and intoxication, require a more nuanced assessment of the individual's ability to understand or engage in the transaction.

Incapacity defenses underscore the tension between autonomy and fairness. While clear rules can prevent exploitation and streamline dispute resolution, they may also limit individual freedom by categorically excluding some from the ability to contract. Conversely, standards offer flexibility but increase uncertainty and litigation costs. This chapter explores this balancing act, illustrating how incapacity doctrines range from rigid categorical rules to flexible standards of assessment.

Ultimately, the incapacity doctrines share a common purpose of ensuring that contracts are founded on voluntary, informed consent while protecting individuals from exploitation or undue disadvantage. Through the study of these rules and their application, we gain insight into how contract law reconciles its core principles of autonomy, fairness, and efficiency.

Rules

A. Guardianship

A guardian is someone who has the legal authority to care for another's person or property. A person who is under a guardian's care or protection is called a "ward." Also termed a conservator, a guardian may be appointed because of a ward's infancy, incapacity, or disability. A person under guardianship cannot contract.

A person has no capacity to incur contractual duties if his property is under guardianship by reason of an adjudication of mental illness or defect. R2d § 13.

Guardianship is a legal state of affairs, where the state, through a legal process, determines someone is incompetent to make decisions about their own person or property. This is a serious deprivation of freedom and civil liberties that is not taken lightly. A guardianship is usually an involuntary procedure imposed by the state onto a person who thus becomes the state's ward. A ward who is placed under a guardianship lacks the legal power to make binding contracts during the term of the guardianship. Instead, their appointed guardian has authority to enter contracts on their behalf, subject to court oversight and approval. The rules governing guardianships vary by jurisdiction.

B. Infancy

The second category of incapacity, "infant," counterintuitively, does not mean a little baby. Rather, an infant is a person who, in the eyes of the law, has not yet reached the full age of maturity. The more common term for such a person is a "minor." Under the common law of contracts, the terms "infant" and "minor" are synonyms.

Generally, an infant has the right to disaffirm or avoid contracts made while he or she is a minor. The age of majority is usually eighteen, though jurisdictions differ.

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. R2d § 14.

A minor can actively choose to disaffirm the contract until the age of majority and for a "reasonable" time thereafter. If the minor is sued for breach of contract, the minor can raise infancy as a defense. After reaching the age of majority, infants must promptly elect to disaffirm their obligation; otherwise, they may impliedly agree to be bound to it.

A former infant who continues to perform on a contract may be deemed to have ratified the contract through conduct. In contrast, an infant who disaffirms the contract within a reasonable time is protected against a breach of contract claim and

can even recover contractual payments already made. If any property remains in the infant's possession, this must be returned.

An infant need not take any action to disaffirm his contracts until he comes of age. If sued upon the contract, he may defend on the ground of infancy without returning the consideration received. His disaffirmance revests in the other party the title to any property received by the infant under the contract. R2d § 14 cmt. c.

In *Webster St. Partnership, Ltd. v. Sheridan*, 220 Neb. 9 (1985), below, the court found that teenagers who rented an apartment did not wait too long to disaffirm their lease, even though one of them continued paying rent and living in the apartment for seven days after reaching the age of majority in the jurisdiction (which in Nebraska is nineteen).

A major exception to this right of disaffirmance is that the infant may be liable for any necessities they buy.

Persons having no capacity . . . to contract are often liable for necessities furnished to them . . . [T]he liability is measured by the value of the necessities rather than by the terms of the promise. R2d § 12 cmt. f.

The difficulty in applying this exception is deciding what constitutes a “necessary.” For example, if a minor rents an apartment when he could instead live at home, is that rental a necessary? If an infant orders a crate of ramen noodle soup when she could instead go to a soup kitchen, is that soup a necessary? If a car dealership leases a basic Toyota Corolla to a sixteen-year-old who lives in a rural area and needs a car to drive to work in order to afford basic living expenses, is this a necessary? Is a more expensive Ford Ranger truck with off-road capabilities still a necessary? What if the same infant leases a much more expensive luxury car, like a fully loaded Lexus GX SUV?

If the contract regards a necessary, then the infant's power to void the contract becomes limited. The infant must pay for the reasonable value of the necessary, if not the full contract price.

Arthur Corbin's treatise (3d ed.), citing to an older treatise, gives some guidance on what constitutes necessities, such that infants who contract for them have a binding obligation:

Things may be of a useful character, but the quality or quantity supplied may take them out of the character of necessities. Elementary textbooks might be a necessary to a student of law, but not a rare edition of “Littleton's Tenures,” or eight or ten copies of “Stephen's Commentaries.” Necessaries also vary according to the station in life of the infant or his peculiar circumstances at the time. The quality of clothing suitable to an Eton boy would be unnecessary for a telegraph clerk; the medical attendance and diet required by an invalid would be unnecessary to one in ordinary health. It does not follow therefore that because a thing is of a useful class, a judge is bound to allow a jury to say

whether or not it is a necessary. WILLIAM R. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 172 (1891).

Once you get past the archaic language, the point of the above passage is clear: what is necessary depends on the circumstances but should always be distinguished from luxuries. While reading *Webster*, consider why the court found that the apartment that the teenagers rented was not a necessary under the circumstances of the case.

C. Mental Illness

Mental illness results in incapacity to contract in two situations. First, if a mental illness specifically impacts a person's ability to understand a particular transaction, this can result in incapacity.

A person incurs only voidable contractual duties by entering into a transaction if by reason of mental illness or defect he is unable to understand in a reasonable manner the nature and consequences of the transaction. R2d § 15(1)(a).

Second, if the mental illness impacts a person's ability to act reasonably in relation to a transaction and the other party knows or should know of the person's condition, this, too, can result in incapacity.

A person incurs only voidable contractual duties by entering into a transaction if by reason of mental illness or defect . . . 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. R2d § 15(1)(b).

Determining whether someone is so cognitively impaired that they lack the capacity to contract is a complex matter, and there is a fair amount of debate about what the standard for mental incapacity should be. The following example illustrates that assessing mental incapacity issues requires precise analysis, and it varies depending upon the nature of the transaction and the nature of the mental condition.

Pat works as a car mechanic at a local tire shop. One day at work, a customer named Alex approaches Pat and says, "I am selling a Subaru WRX STI. It's wicked fast. Would you like to buy it for \$15,000?" Without hesitation, Pat responds, "Yes! I will buy your car. I'll get the cash from my bank after my shift today and pay you \$15,000 tomorrow. Thanks for the offer! I accept." However, Pat goes home after work and, for many reasons, regrets having accepted Alex's offer.

Pat decides to avoid the contract by relying on mental incapacity. What facts must Pat evidence to succeed?

What if Pat had been diagnosed with Attention-Deficit Hyperactivity Disorder (ADHD) as a child and continued to struggle with impulsivity as an adult? A court would still likely enforce the contract against Pat. Despite suffering from ADHD, Pat

still apparently had the capacity to understand the nature of the transaction under R2d § 15(1)(a). And R2d § 15(1)(b) does not apply because *Alex* had no reason to know of Pat's ADHD or impulsivity issues and therefore should not reasonably expect this condition to impact Pat's behavior.

In contrast, what if, immediately prior to Alex's offer, Pat had told Alex about Pat's personal history of impulsivity due to ADHD, and Pat had mentioned to Alex during contracting that a drug shortage had made it difficult for Pat to obtain ADHD medication? Then Alex would have reasonably been aware of Pat's mental illness and Pat's specific symptom of impulsivity. Under these conditions, in accordance with R2d § 15(1)(b), it is unlikely that a court would require Pat to comply with the contract or to pay damages to Alex. Pat was unable to act reasonably in relation to the transaction due to impulsivity symptoms of ADHD, and Alex had reason to know of Pat's ADHD and impulsivity.

Finally, what if, unbeknownst to Alex, Pat had experienced an episode of psychosis when accepting Alex's offer? Then Pat may be able to avoid the contract. Psychosis makes it difficult for a person to recognize what is real. If, when Pat accepted Alex's offer, Pat had held false beliefs about the need to purchase a vehicle immediately in order to save all humanity from imminent destruction, a court may determine that Pat lacked capacity to contract; Pat might not, in the moment, have been able understand the nature of the transaction to purchase Alex's car. However, for a court to determine that Pat lacked the capacity to enter into a contract due to mental illness in this case, Pat would have to prove that psychosis was why Pat had accepted Alex's offer. If Pat can prove this, then Pat does not also have to prove that Alex knew or should have known about Pat's psychosis.

In sum, unlike guardianship or infancy, which are clearly defined legal states, whether a person lacks capacity for reasons of mental illness is a much more difficult assessment. It may require testimony from medical experts about the nature of the illness.

D. Intoxication

The term "intoxication" may also differ legally from common or lay conceptions of the term. One may be too intoxicated to drive, for example, but still well within his capacities to contract. The legal standard for incapacity in contract law is that one must be so drunk or intoxicated from drugs that he does not know what he is doing. Moreover, the other party must know or have reason to know of the intoxication.

A person incurs only voidable contractual duties by entering into a transaction if the other party has reason to know that by reason of intoxication (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. R2d § 16.

For example, Aaron and Betsy have been communicating for weeks about the purchase and sale of a boat. One day, the parties conclude their oral conversation with Aaron's presenting a clear offer to sell his boat and Betsy's saying, "I'll think about it and get back to you as soon as possible." That night, Betsy drinks to the point of blacking out. While totally drunk, Betsy texts the seller with the simple message "I accept your offer." Unless Aaron has some reason to know that Betsy was totally drunk—which would not be apparent from the text message—the contract is binding.

If, on the other hand, Betsy first texted, "Just took ten shots of vodka!" and then texted that she wishes to accept Aaron's offer, then Aaron might reasonably know that Betsy was not competent to accept his offer at that time.

E. Reflections on Incapacity

The study of incapacity provides a fitting conclusion to the module on defenses and the larger exploration of contract formation. At its core, formation depends on the principle of voluntary agreement—contracts are enforceable because parties choose to bind themselves to their commitments. Yet incapacity reminds us that this voluntariness is not absolute. The law recognizes that consent may be compromised, whether by an individual's internal limitations or by external pressures, such as duress or undue influence.

Incapacity also offers a conceptual lens through which to consider the structure of contract law. Some jurisdictions and scholars (and a prior edition of this casebook) treat capacity as a prerequisite to mutual assent, positioning it as part of the foundational elements of formation. This view reflects its placement in the R2d, where capacity is addressed before assent and separately from defenses. The procedural reality, however, often dictates its treatment as a defense, as it is typically raised affirmatively by parties seeking to avoid enforcement. This dual characterization highlights the interplay between doctrine and procedural context, underscoring that capacity's role in contract law is both foundational and reactive.

At a deeper level, incapacity doctrines illuminate the limits of formation. Capacity is the gateway to enforceability; without it, the foundation of mutual assent—the hallmark of binding agreements—cannot exist. By excluding those who lack the ability to consent meaningfully, incapacity rules ensure that formation reflects genuine, informed participation. In doing so, they protect the vulnerable while reinforcing the legitimacy of the contractual system.

This chapter also highlights how formation doctrine balances clarity with flexibility. Some incapacity rules, such as those governing infancy and guardianship, rely on bright-line thresholds to promote efficiency and certainty in transactions. Others, like mental illness and intoxication, demand careful, fact-specific analysis to ensure fairness in complex and marginal cases. This dual approach mirrors the broader challenge of formation law: reconciling the need for predictable rules with the complex realities of human behavior and fairness.

As this module comes to a close, the discussion of incapacity serves as a capstone for the principles underlying contract formation. It demonstrates that the boundaries of enforceability are not mere technicalities; they reflect profound judgments about the nature of human decision-making, the limits of individual responsibility, and the role of law in shaping private agreements. By enforcing only those contracts formed with genuine capacity and consent, contract law not only protects vulnerable parties but also affirms the legitimacy of the system itself.

Cases

Reading Webster St. Partnership, Ltd. v. Sheridan. Contract law protects certain people from contractual liability as a matter of public policy. One such protection applies to minors and children, who are referred to in contract law as “infants.” Contract law defines “infant” to mean someone who has not yet reached the age of majority, which is eighteen years old in most states—though it varies based on the jurisdiction. For example, in Nebraska, the age of majority is nineteen.

The question in the following case is not whether one party is an infant. This is usually a simple factual inquiry with a binary result (infant or major). The question, instead, is whether said infant—here, a couple of teenagers—contracted for a necessary. If so, they might be responsible for their contractual obligations, despite their minority status.

Before exploring what constitutes a necessary under the common law, think about why this rule exists. Put yourself in the position of someone who has received an offer to contract from an infant. You know this infant incurs only voidable obligations. Might that make you less likely to accept the infant’s offer to contract? It should, because you will not have certainty that the infant will perform his obligations, and you will have no recourse for breach. While this rule protects infants from making bad deals, it also discourages people from making deals with infants at all, even ones that benefit the infant. For example, it is very hard for an infant to lease a car because car dealers know that the infant could void the contract at any time.

This rule, although intended to benefit infants, thus has the unintended consequence of creating a hardship for them. The way around that hardship is to make contracts for necessities binding. If an emancipated minor (one who has been granted legal independence from parental control) is homeless, then renting an apartment would be a necessary, at least in this case. Because the apartment is necessary for this particular minor, the contract will be binding on this minor, despite the capacity rule for infants generally. Consider how the necessities exception plays out in *Webster*.

Webster St. Partnership, Ltd. v. Sheridan

220 Neb. 9 (1985)

KRIVOSHA, Chief Justice.

Webster Street Partnership, Ltd. ("Webster Street"), appeals from an order of the district court for Douglas County, Nebraska, which modified an earlier judgment entered by the municipal court of the city of Omaha, Douglas County, Nebraska. The municipal court entered judgment in favor of Webster Street and against the appellees, Matthew Sheridan and Pat Wilwerding, in the amount of \$630.94.

On appeal, the district court found that Webster Street was entitled to a judgment in the amount of \$146.75, and that Sheridan and Wilwerding were entitled to a credit in the amount of \$150. The district court therefore entered judgment in favor of Sheridan and Wilwerding and against Webster Street in the amount of \$3.25. It is from this \$3.25 judgment that appeal is taken to this court.

Webster Street is a partnership owning real estate in Omaha, Nebraska. On September 18, 1982, Webster Street, through one of its agents, Norman Sargent, entered into a written lease with Sheridan and Wilwerding for a second-floor apartment at 3007 Webster Street. The lease provided that Sheridan and Wilwerding would pay to Webster Street, by way of monthly rental, the sum of \$250 due on the first day of each month until August 15, 1983. The lease also required a security deposit in the amount of \$150 and a payment of \$20 per month for utilities during the months of December, January, February, and March. Liquidated damages in the amount of \$5 per day for each day the rent was late were also provided for by the lease.

The evidence conclusively establishes that at the time the lease was executed both tenants were minors and, further, that Webster Street knew. At the time the lease was entered, Sheridan was 18 and did not become 19 until November 5, 1982. Wilwerding was 17 at the time the lease was executed and never gained his majority during any time relevant to this case. [The age of majority in Nebraska is 19.]

The tenants paid the \$150 security deposit, \$100 rent for the remaining portion of September 1982, and \$250 rent for October 1982. They did not pay the rent for the month of November 1982, and on November 5, Sargent advised Wilwerding that unless the rent was paid immediately, both boys would be required to vacate the premises. The tenants both testified that, being unable to pay the rent, they moved from the premises on November 12. In fact, a dispute exists as to when the two tenants relinquished possession of the premises, but in view of our decision, that dispute is not of any relevance.

In a letter dated January 7, 1983, Webster Street's attorney made written demand upon the tenants for damages in the amount of \$630.94. On January 12, 1983, the tenants' attorney denied any liability, refused to pay any portion of the amount demanded, stated that neither tenant was of legal age at the time the lease was executed, and demanded return of the \$150 security deposit.

Webster Street thereafter commenced suit against the tenants and sought judgment in the amount of \$630.94[.] . . . To this petition the tenants filed an answer alleging that they were minors at the time they signed the lease, that the lease was therefore voidable, and that the rental property did not constitute a necessary for which they were otherwise liable. [The tenants won at the district court. Webster Street appealed.] It appears . . . to be Webster Street's position that the district court erred in failing to find that Sheridan had ratified the lease within a reasonable time after obtaining majority, and was therefore responsible for the lease, and that the minors had become emancipated and were therefore liable, even though Wilwerding had not reached majority.

Webster Street is simply wrong in both matters. As a general rule, an infant does not have the capacity to bind himself absolutely by contract. The right of the infant to avoid his contract is one conferred by law for his protection against his own improvidence and the designs of others. The policy of the law is to discourage adults from contracting with an infant; they cannot complain if, as a consequence of violating that rule, they are unable to enforce their contracts. "The result seems hardly just to the [adult], but persons dealing with infants do so at their peril. The law is plain as to their disability to contract, and safety lies in refusing to transact business with them."

However, the privilege of infancy will not enable an infant to escape liability in all cases and under all circumstances. For example, it is well established that an infant is liable for the value of necessities furnished him. An infant's liability for necessities is based not upon his actual contract to pay for them but upon a contract implied by law, or, in other words, a quasi-contract. Just what are necessities, however, has no exact definition. The term is flexible and varies according to the facts of each individual case. A number of factors must be considered before a court can conclude whether a particular product or service is a necessary. As stated in *Schoenung v. Gallet*:

"The term 'necessaries,' as used in the law relating to the liability of infants therefor, is a relative term, somewhat flexible, except when applied to such things as are obviously requisite for the maintenance of existence, and depends on the social position and situation in life of the infant, as well as upon his own fortune and that of his parents. The particular infant must have an actual need for the articles furnished; not for mere ornament or pleasure. The articles must be useful and suitable, but they are not necessities merely because useful or beneficial. Concerning the general character of the things furnished, to be necessities the articles must supply the infant's personal needs, either those of his body or those of his mind. However, the term 'necessaries' is not confined to merely such things as are required for a bare subsistence. There is no positive rule by means of which it may be determined what are or what are not necessities, for what may be considered necessary for one infant may not be necessities for another infant whose state is different as to rank, social position, fortune, health, or other circumstances, the question being one to be determined from the particular facts and circumstances of each case."

In *Ballinger v. Craig*, the defendants were husband and wife and were 19 years of age at the time they purchased a trailer. [In this jurisdiction at this time, people the age of 19 had not reached majority and were therefore considered infants]. Both were employed. However, prior to the purchase of the trailer, the defendants were living with the parents of the husband. The Court of Appeals for the State of Ohio held that under the facts presented, the trailer was not a necessary. The court stated:

“To enable an infant to contract for articles as necessities, he must have been in actual need of them, and obliged to procure them for himself. They are not necessities as to him, however necessary they may be in their nature, if he was already supplied with sufficient articles of the kind, or if he had a parent or guardian who was able and willing to supply them. The burden of proof is on the plaintiff to show that the infant was destitute of the articles and had no way of procuring them except by his own contract.”

... [In this case,] [t]he undisputed testimony is that both tenants were living away from home, apparently with the understanding that they could return home at any time. Sheridan testified:

Q. *During the time that you were living at 3007 Webster, did you at any time, feel free to go home or anything like that?*

A. *Well, I had a feeling I could, but I just wanted to see if I could make it on my own.*

Q. *Had you been driven from your home?*

A. *No.*

Q. *You didn't have to go?*

A. *No.*

Q. *You went freely?*

A. *Yes.*

Q. *Then, after you moved out and went to 3007 for a week or so, you were again to return home, is that correct?*

A. *Yes, sir.*

It would therefore appear that in the present case neither Sheridan nor Wilwerding was in need of shelter but, rather, had chosen to voluntarily leave home, with the understanding that they could return whenever they desired. One may at first blush believe that such a rule is unfair. Yet, on further consideration, the wisdom of the rule is apparent. If, indeed, landlords may not contract with minors, except at their peril, they may refuse to do so. In that event, minors who voluntarily leave home but who are free to return will be compelled to return to their parents' home—a result which is desirable. We therefore find that both the municipal court and the district court erred in finding that the apartment, under the facts in this case, was a necessary. Having concluded that the apartment was not a necessary, the question of whether Sheridan

and Wilwerding were emancipated is of no significance. The effect of emancipation is only relevant with regard to necessities. If the minors were not emancipated, then their parents would be liable for necessities provided to the minors. As we recently noted in *Accent Service Co., Inc. v. Ebsen*:

“In general, even in the absence of statute, parents are under a legal as well as a moral obligation to support, maintain, and care for their children, the basis of such a duty resting not only upon the fact of the parent-child relationship, but also upon the interest of the state as parents patriae of children and of the community at large in preventing them from becoming a public burden. However, various voluntary acts of a child, such as marriage or enlistment in military service, have been held to terminate the parent’s obligation of support, the issue generally being considered by the courts in terms of whether an emancipation of the child has been effectuated. In those cases, involving the issue of whether a parent is obligated to support an unmarried minor child who has voluntarily left home without the consent of the parent, the courts, in actions to compel support from the parent, have uniformly held that such conduct on the part of the child terminated the support obligation.”

If, on the other hand, it was determined that the minors were emancipated and the apartment was a necessary, then the minors would be liable. But where, as here, we determine that the apartment was not a necessary, then neither the parents nor the infants are liable, and the question of emancipation is of no moment. Because the rental of the apartment was not a necessary, the minors had the right to avoid the contract, either during their minority or within a reasonable time after reaching their majority. Disaffirmance by an infant completely puts an end to the contract’s existence, both as to him and as to the adult with whom he contracted. Because the parties then stand as if no contract had ever existed, the infant can recover payments made to the adult, and the adult is entitled to the return of whatever was received by the infant.

The record shows that Pat Wilwerding clearly disaffirmed the contract during his minority. Moreover, the record supports the view that when the agent for Webster Street ordered the minors out for failure to pay rent and they vacated the premises, Sheridan likewise disaffirmed the contract. The record indicates that Sheridan reached majority on November 5. To suggest that a lapse of 7 days was not disaffirmance within a reasonable time would be foolish. Once disaffirmed, the contract became void; therefore, no contract existed between the parties, and the minors were entitled to recover all of the moneys which they paid and to be relieved of any further obligation under the contract. The judgment of the district court for Douglas County, Nebraska, is therefore reversed and the cause remanded with directions to vacate the judgment in favor of Webster Street and to enter a judgment in favor of Matthew Sheridan and Pat Wilwerding in the amount of \$500, representing September rent in the amount of \$100, October rent in the amount of \$250, and the security deposit in the amount of \$150.

REVERSED AND REMANDED WITH DIRECTIONS.

Reflection

Webster established that an infant generally does not have the capacity to contract. In order to protect infants, adults are discouraged from contracting with them. If an adult enters a contract with an infant, the contract may consequently be unenforceable against the infant.

However, the privilege of infancy is not applicable under all circumstances. Infants are liable for the value of necessities. There is no strict definition for necessities. What is defined as a necessary varies from case to case. In general, “necessaries” refers to things that are useful and required for existence. However, many factors can influence whether something is deemed a necessary. What may be deemed a necessary for one party may not be deemed a necessary for another party. Generally, items are not deemed necessities for an infant if their parent/guardian is able to supply them. Specifically looking at *Webster*, the apartment they leased was not a necessary because they were able to return to housing provided to them by their parents.

Another important rule from *Webster* is that an infant may disaffirm a contract until the age of majority and for a “reasonable” time thereafter. The court held that Sheridan was able to claim infancy, even though he vacated the property seven days after he reached the age of majority. The court held that seven days was not an unreasonable delay, and so Sheridan was still able to use infancy as a defense against contractual liability.

Discussion

1. Who is an “infant” as defined in contract law? Why should the law protect infants?
2. Can you foresee any problems that might result from a legal effort to protect infants?
3. What are “necessaries”? Why is there an exception to the protection for infants from contractual liability with regard to necessities?
4. The necessities exception should ideally encourage landlords to rent apartments to minors who otherwise have nowhere else to live. But does it work? If you were a landlord, would you rent an apartment to infants, or would you ask for proof that tenants are over the age of majority?

Reading *Estate of McGovern v. Commonwealth State Employees’ Retirement Bd.* Along with infancy, another basis for incapacity is mental illness. Under R2d § 15, a person lacks capacity to contract by reason of mental illness if: (1) their condition prevents them from understanding the particular

transaction at issue, or (2) their condition prevents them from acting reasonably in relation to the transaction, and the other party knows or should know of their condition. Courts struggle with determining when mental illness is so severe that it results in incapacity. The following case, *Estate of McGovern*, provides an excellent discussion of the reasoning for and against the R2d's approach to this thorny problem. Not only does *McGovern* present relatively straightforward and memorable facts, but it also goes into significant depth as to what legal standard should be applied to such facts and why. As you will see, most of the members of the Supreme Court of Pennsylvania refuse to accept the R2d's approach. But a well-reasoned dissent in the case supports the R2d's approach, arguing that it would produce more equitable results. After reading this case, you should have a better understanding of different legal standards that are applied to determine mental capacity to contract, and you should have some arguments that will help you decide for yourself which legal standard is best.

Estate of McGovern v. Commonwealth State Employees' Retirement Bd.

512 Pa. 377 (1986)

FLAHERTY, Justice.

On January 9, 1981, Francis J. McGovern retired after thirty years of service with the Delaware Joint Toll Bridge Commission. In December of 1980, just prior to his retirement, Mr. McGovern executed and filed a retirement application in which he selected two of several options for payout under the retirement plan offered by his employer. Under the options selected by Mr. McGovern, he would receive a lump sum payment of \$27,105, a joint survivor annuity paying him \$750 monthly for life, and if he predeceased his wife, she would receive a survivor's annuity of \$375 monthly for life.

Mrs. McGovern, who had been ill with Hodgkins disease since 1979, died of cancer on January 23, 1981. Five days later, on January 28, 1981, Mr. McGovern died. The Board determined that Mr. McGovern's estate was due the lump sum of \$27,105.00 plus \$499.92, a portion of the first month's annuity payment. Had Mr. McGovern chosen a living survivor annuitant, or no beneficiary at all, the sum of \$151,311.45 would have been available to the living beneficiary or his estate.

Michael J. McGovern, Mr. McGovern's son, requested that the Board review the amount payable to the estate, on the grounds that his father was not mentally competent when he executed the retirement papers.

According to testimony of Michael McGovern, his sister, and friends of the elder Mr. McGovern, Mr. McGovern suffered during the last year of his life from alcoholism and apparent distress at the state of his wife's health. Although Mrs. McGovern was told in March of 1980 that she was terminally ill, Mr. McGovern, refused to

acknowledge that his wife was going to die. Occasionally, Mr. McGovern would admit that his wife was seriously ill, but Mr. McGovern's friends testified that he was so sensitive to any conversation concerning his wife's health that they would never mention it unless he introduced the subject. When Mrs. McGovern was hospitalized for almost two months during the last year of her life, Mr. McGovern visited her only once, for five minutes, and would sometimes insist that his wife was malingering, or that she had a bleeding ulcer. Additionally, although Mr. McGovern had an alcohol problem for many years, when his wife's illness became apparent, he drank more heavily, even to the point of missing work and being too drunk to keep appointments. Finally, there was some evidence that Mr. McGovern was not always attuned to reality in other ways: after he retired, he would, on occasion, dress in his uniform and demand to be taken to work, and after his wife died, Mr. McGovern refused to eat and was heard having conversations with his dead father.

The Board advised the junior Mr. McGovern that his father's retirement documents were binding and could not be changed. On November 25, 1981, an administrative hearing was conducted at which Mr. McGovern contended that on December 17, 1980, the day his father completed his retirement application forms, his father did not have the requisite mental capacity to execute a retirement application. After hearing testimony from Mr. McGovern's friends and family, including a letter from the family doctor, and evidence from the retirement official who dealt with Mr. McGovern, a hearing examiner rejected this claim.

The Board affirmed the hearing officer, based on its conclusion that Mr. McGovern did, in fact, possess the requisite mental capacity on the day in question and that he understood the nature of the transaction.

Commonwealth Court reversed the Board, holding that it capriciously disregarded the evidence of Mr. McGovern's incapacity. We granted *allocatur* [Latin for "it is allowed," *allocatur* is used to denote permission to appeal to the Supreme Court of Pennsylvania] to examine whether Commonwealth Court applied the appropriate standard of review of the Board's findings of fact and whether that court's statement of the law of capacity to enter into a legally binding contract was correct.

[Discussion of the standard of review omitted.]

Since there is no allegation in this case that any party's constitutional rights have been violated or that the proceedings were irregular, the question on review is whether the agency's adjudication is supported by findings of fact which are, in turn, supported by substantial evidence.

The Board determined, in essence, that Mr. McGovern was mentally competent to execute his retirement papers and that he understood the nature of the transaction.

In support of this adjudication, the Board found that although Mr. McGovern had an alcohol problem and was distressed about his wife's illness with cancer, Mr. McGovern, some two months before his retirement, executed a will which even his son believed to be competently executed; he conducted his job over the years in a

controlled and responsible fashion; he sometimes admitted and sometimes denied the seriousness of his wife's illness; he appeared coherent and responsive to the retirement official on December 17, 1980 during the meeting at which he selected his retirement options; and after the meeting of December 17, he sent a check to the retirement fund, as discussed at that meeting, to purchase his military buy-back retirement time.

Whether these facts support a conclusion that Mr. McGovern was legally competent to execute his retirement papers on the day in question will depend on the legal definition of competence.

It is well established that the State Employee's Retirement System creates a contract between the Commonwealth and its employees. When a member retires and elects a retirement option, he enters into a contract with the Board. If the benefit contract is freely entered into with an understanding of its terms, the contract cannot be set aside.

Here the contract is challenged on the grounds that Mr. McGovern lacked the mental capacity to enter into an agreement. Under Pennsylvania law, it is presumed that an adult is competent to enter into an agreement, and a signed document gives rise to "the presumption that it accurately expresses the state of mind of the signing party." To rebut this presumption, the challenger must present evidence of mental incompetency which is "clear, precise and convincing."

This Court has held that where mental capacity to execute an instrument is at issue, "the real question is the condition of the person at the very time he executed the instrument or made the gift in question." . . . "We further held that a person's mental capacity is best determined by his spoken words and his conduct, and that the testimony of persons who observed such conduct on the date in question outranks testimony as to observations made prior to and subsequent to that date." "Mere mental weakness, if it does not amount to inability to comprehend the contract, and is unaccompanied by evidence of imposition or undue influence," is insufficient to set aside a contract.

Finally, a presumption of mental incapacity does not arise merely because of an unreasonable or unnatural disposition of property.

Contrary to these principles concerning the Pennsylvania law of competence, Commonwealth Court in this case adopted a new standard of competence based on the Restatement of Contracts, 2d. Section 15 of the Restatement, relied on by the court below, states:

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. R2d § 15(1).

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. R2d § 15(2).

This Court has never adopted Section 15 of the Restatement, which requires a post-hoc determination of reasonableness, and we decline to do so now. In fact, because the provisions of Section 15 establish new tests for incompetence which conflict with those previously established by this Court, Commonwealth Court exceeded its authority in purporting to adopt Section 15 of the Restatement.

Accepting, as we do, that the common law of incompetence as it has been articulated in our prior cases is the law that controls this case, even if it were conceded that Mr. McGovern may have been incompetent to execute any legal document at certain intervals of time within months of his wife's death, substantial evidence also supports the conclusion that on December 17, 1980, he was lucid and understood the terms of the retirement contract. This evidence, which consists of testimony of the retirement official who met with Mr. McGovern on December 17, is significant because it concerns Mr. McGovern's state of mind on the date in question. Moreover, in support of the official's observations, immediately after the December 17th meeting, Mr. McGovern mailed a check to the retirement fund to purchase his military buy-back time, which was discussed at that meeting. Such an act is consistent with the Board's determination that Mr. McGovern acted with deliberation and understanding on December 17, 1980.

It is our conclusion, therefore, that Commonwealth Court was in error in reversing the Board's determination, which properly applied the law of incompetency and which was supported by substantial evidence.

Ironically, the junior Mr. McGovern's explanation of what his father did in this case may be very close to the truth:

Q. *Let me ask you the critical question. Why did he [the elder Mr. McGovern] designate a joint survivor of benefits on that application after all the counseling and the dialogue that you had with him regarding the pension? Can you attribute anything for that choice?*

A. *[The junior Mr. McGovern]. I think my father had . . . arrived at a frame of reference in his mind that was—permitted him to function, and I think that this frame of reference was totally out of touch with the reality of his real-life situation. I think he had convinced himself that my mother was going to outlive all of us and that he was just—he just refused to accept, I think he just refused to accept the truth that my mother was dying and that he decided that this illusion that he created for himself that he was going to live and that my mother was going to live and was not sick at all was the truth and that she was going to live for twenty years or whatever.*

They were going to have a golden retirement together and that he decided to name her at the last minute to ensure that he was right; that we were all wrong and that he was right, that she was going to live forever. . . .

The real thrust of Mr. McGovern's claim in this case is that his father's designation of his mother as a secondary beneficiary was unreasonable and unwise. From some points of view, that may be true, but no one can say that belief that another will overcome a terrible disease and live is lunatic; no one can successfully assert that such a belief, even against the medical evidence, renders one incompetent. Such a belief may be, from some points of view, thoughtless, against scientific probabilities, irrational, and when combined with what amounts to a testamentary disposition of property in favor of the ill person as opposed to another who seems to be healthy, it may even be said to be selfish and heedless of the needs of others. But whatever may be said about it, it cannot, without more, be said to prove incompetence. Thus, the claim that is made here in the name of incompetence is in reality a challenge to the wisdom, the desirability, the thoughtfulness and the rationality of the disposition. But such a challenge may not succeed, for neither courts nor disappointed heirs may alter the disposition of the property of a deceased person merely on the grounds that that person acted in a way that the challenger believes to be irrational.

Order of Commonwealth Court is reversed, and the determination of the Pennsylvania State Employee's Retirement Board is reinstated.

LARSEN, Justice, dissenting.

I dissent. In view of the obvious diminished mental capacity of the decedent Francis J. McGovern, I would hold that the contract created by decedent's election of option 3 and the designation of his then terminally ill wife as his sole beneficiary is voidable. The evidence introduced at the hearing before the State Employees' Retirement Board (Board) is clear and persuasive. It shows that the decedent was laboring in a defective mental state when he signed his job termination and retirement papers on December 17, 1980. The decedent's flawed mental condition rendered him unable to act reasonably and deal with his retirement options in a reasonable fashion.

Contrary to the evidence, the Board found that the decedent "did not lack the requisites or mental capacity to execute his retirement application on December 17, 1980, and did understand the nature of the transaction." The Commonwealth Court reversed the Board, relying upon Section 15 of the Restatement of Contracts Second.

The comment to Section 15 of the Restatement is particularly apropos.

Comment:

a. Rationale. A contract made by a person who is mentally incompetent requires the reconciliation of two conflicting policies: the protection of justifiable expectations and of the security of transactions, and the protection of persons unable to protect themselves against imposition. Each policy has sometimes prevailed to a greater extent than is stated in this Section. At one extreme, it has been said that a lunatic has no capacity to contract because he has no mind; this view has given way to a better understanding of mental phenomena and to the doctrine that contractual obligation depends on manifestation of assent rather than on mental assent. See [R2d] §§ 2, 19.

At the other extreme, it has been asserted that mental incompetency has no effect on a contract unless other grounds of avoidance are present, such as fraud, undue influence, or gross inadequacy of consideration; it is now widely believed that such a rule gives inadequate protection to the incompetent and his family, particularly where the contract is entirely executory.

b. The standard of competency. It is now recognized that there is a wide variety of types and degrees of mental incompetency. Among them are congenital deficiencies in intelligence, the mental deterioration of old age, the effects of brain damage caused by accident or organic disease, and mental illnesses evidenced by such symptoms as delusions, hallucinations, delirium, confusion, and depression. Where no guardian has been appointed, there is full contractual capacity in any case unless the mental illness or defect has affected the particular transaction: a person may be able to understand almost nothing, or only simple or routine transactions, or he may be incompetent only with respect to a particular type of transaction. Even though understanding is complete, he may lack the ability to control his acts in the way that the normal individual can and does control them; in such cases the inability makes the contract voidable only if the other party has reason to know of his condition. Where a person has some understanding of a particular transaction which is affected by mental illness or defect, the controlling consideration is whether the transaction in its result is one which a reasonably competent person might have made.

Illustration:

1. A school teacher, is a member of a retirement plan and has elected a lower monthly benefit in order to provide a benefit to her husband if she dies first. At age 60 she suffers a "nervous breakdown," takes a leave of absence, and is treated for cerebral arteriosclerosis. When the leave expires, she applies for retirement, revokes her previous election, and elects a larger annuity with no death benefit. In view of her reduced life expectancy, the change is foolhardy, and there are no other circumstances to explain the change. She fully understands the plan, but by reason of mental illness is unable to make a decision based on the prospect of her dying before her husband. The officers of the plan have reason to know of her condition. Two months after the changed election she dies. The change of election is voidable.

c. Proof of incompetency. Where there has been no previous adjudication of incompetency, the burden of proof is on the party asserting incompetency. Proof of irrational or unintelligent behavior is essential; almost any conduct of the person may be relevant, as may lay and expert opinions and prior and subsequent adjudications of incompetency. Age, bodily infirmity or disease, use of alcohol or drugs, and illiteracy may bolster other evidence of incompetency. Other facts have significance when there is mental illness or defect but some understanding: absence of independent advice, confidential or

fiduciary relationship, undue influence, fraud, or secrecy; in such cases the critical fact often is departure from the normal pattern of similar transactions, and particularly inadequacy of consideration.

The above comment and illustration are specifically germane to the instant case. The final months of the decedent's life were pathetic. They depict an existence dominated by "delusion, hallucination, delirium, confusion and depression." During that time of progressive deterioration, the decedent's acts and decisions were influenced by his corrupted view of reality. His conduct often was based upon false perceptions. Such perceptions apparently prompted his selection of pension option 3.1.

The decedent may have understood the pension plan as presented to him by the pension officer but the evidence establishes that he was unable to make a rational decision based upon the very real prospect of his wife dying before him. The decedent's wife and sole beneficiary, Loretta M. McGovern, was first diagnosed in October of 1979 as suffering from Hodgkin's disease. In March of 1980 she was informed that the disease was in its late stages. Upon being apprised of these medical findings, the decedent became despondent, his "drinking" habits worsened and he, at times, refused to accept the fact that his wife was terminally ill with cancer.

The majority expresses the view that a person who believes, contrary to scientific probability, that another will overcome a usually terminal disease and live is not rendered incompetent by holding such a belief. The majority goes on to say that this is true even if we consider that such a belief is irrational. These, however, are not the circumstances presented in the instant case. Here the decedent did not express a belief that his wife would overcome a terrible disease. Rather, the decedent, at times, flatly denied that Mrs. McGovern was ill, accusing her of malingering. At other times he seemed to acknowledge her illness. This kind of irrational conduct when considered in conjunction with the decedent's other aberrant behavior demonstrates a lack of mental capacity sufficient to render the decedent's pension option election voidable.

Additionally, the pension officer, James Kendig, who accepted decedent's application had reason to know of decedent's condition. Starting in early 1978, pension officer Kendig had many discussions with the decedent. Those discussions included face to face meetings and numerous telephone conversations. It was established that Mr. Kendig had reason to know of decedent's alcohol problem. Further, at the time of his application, the decedent failed to give Mr. Kendig comprehensible answers to questions concerning the health of Mrs. McGovern. Considering all of the evidence there was sufficient and clear proof of irrational behavior and debilitating alcohol abuse on the part of the decedent to render voidable his choice of pension option 3.

I would adopt the principles set forth in the Restatement of the Law of Contracts Second, § 15, apply those principles to this case, and affirm the Commonwealth Court.

I dissent.

Reflection

Estate of McGovern reflects the view that mental incapacity to comprehend a contract is based on the words and conduct of the person at the time the contract was entered. In other words, observations made on the date of entering the contract are more important than those made prior to or after entering the contract. R2d § 15 cmt. b reflects an alternative view, which *Estate of McGovern* declines to follow.

As you might have noticed, there is no perfect way to measure a person's mental incapacity. *Estate of McGovern* and R2d § 15 cmt. b conflict in two distinct ways on how to determine a person's capacity to contract. First, they disagree on what observations can be used. *Estate of McGovern* found that McGovern Sr. was able to comprehend the contract at the moment of application despite a history of believing his wife could overcome a terminal illness. The dissent, relying on R2d § 15 cmt. b, believed that his history of delusions, hallucinations, delirium, confusion, and depression corrupted his view of reality. Thus, these observations, made before, during, and after entering the contract, could be used as proof that he was incompetent.

The second distinction concerns whether the legal standard for contractual capacity includes an objective component—such as whether the person acted as a reasonably competent person would—and whether the other party had reason to know of the incapacity. The majority in *Estate of McGovern* held that even if the decedent's decision was unreasonable or unwise, that alone did not render him legally incompetent. Mere irrationality, they said, is not enough; legal incompetence requires more. By contrast, the dissent emphasized that McGovern Sr. did not merely hope his wife would recover—at times, he denied she was ill at all. That delusional belief, the dissent argued, reflected a break from reality, not just poor judgment. Moreover, the pension officer had reason to question McGovern Sr.'s capacity when he failed to give coherent answers about his wife's health. On this view, the decedent's impaired perception and the other party's notice made the contract voidable under the Restatement's standard.

Discussion

1. How does the rule applied in the *Estate of McGovern* majority opinion differ from the rule articulated by the R2d? Which rule do you think is better, and why?
 2. What are the advantages to a rule granting the defense of incapacity for the reason of mental incompetency in a wider range of cases? How problematic would such a broad rule be for individuals or society?
 3. Do you agree with the majority opinion or the dissent in this case? Explain your reasoning.
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Problems

Problem 13.1. The Infant and the Lemon

Dobson entered an oral contract with Rosini Motor Company (Rosini) for the purchase of a used automobile. At the time of contracting, Dobson was an infant. The two agreed that Dobson would pay \$2,500 for the vehicle, and Rosini would bear liability for any expenses incurred by reason of repairs needed to put the vehicle in “proper working condition.”

Dobson paid the purchase price. Two months later, Dobson was required to pay Apichell Motors, an automobile repair company, \$350 for repairs. Another two months passed, and Dobson was forced to pay \$450 to Apichell for even more repairs. The car continued to be mechanically defective.

Four months after the contract was entered, Dobson notified Rosini that he was disaffirming the contract and provided Rosini with the precise location of the vehicle. “Disaffirmance” is “the act by which a person who has entered into a voidable contract, as, for example, an infant, disagrees to such contract and declares he will not abide by it.”

Dobson brings a claim against Rosini to recover the purchase price of the car and the amount he was required to spend on repairs.

Will Dobson be able to recover the purchase price of the car, the amount he was required to spend on repairs, or both?

See Dobson v. Rosini, 20 Pa. D. & C.2d 537 (1959).

Problem 13.2. Bipolar Disorder and Contractual Capacity

Stanley Fingerhut was the sole general partner in a private and successful investment company. He wanted to buy a golf club and obtained an appraisal of Bel Aire Golf & Country Club that valued the club to be worth \$21 million. Several months later, Fingerhut and his attorney drove to Bel Aire to meet the sellers (defendants) of the golf club and purchase it. Negotiations took place, and parties agreed on the price of \$23.6 million. Fingerhut signed a binder (an informal agreement that states the buyer is interested) that was written by his own lawyer and gave the sellers a check for \$200,000 as a down payment. The parties met again three days later, and, after six hours of negotiations, a contract was made. The next day, the contract was executed by all the parties, and Fingerhut paid a further down payment of \$1.5 million. The rest of the price for the property was to be paid at closing (or potentially sooner).

In less than a month, Fingerhut, through his attorney, sent a letter to the seller. The letter stated, “We were apprised for the first time that Mr. Fingerhut suffers from a manic-depressive psychosis, also known as bipolar disorder, a condition for which he has received medical treatment for the past years. We were advised, and competent medical authority will substantiate, that Mr. Fingerhut prior to the first meeting, and

until recently, was in the manic stage of his illness and wholly incompetent and totally incapable of managing his own affairs during that time.” The lawyer also requested that the binder and contract be rescinded and the \$1.7 million be returned to Fingerhut. The seller denied his request. Fingerhut filed a complaint asking for the contract to be rescinded and declared null and void and a return of the \$1.7 million from seller.

Applying the standard set out in R2d § 15 cmt. b, should the court allow Fingerhut to rescind the contract?

See Fingerhut v. Kralyn Enterprises, Inc., 337 N.Y.S.2d 394 (N.Y. Sup. Ct. 1971), *aff’d*, 335 N.Y.S.2d 926 (N.Y. App. Div. 1972).

Problem 13.3. The Italian Gambler

Mario LaBarbera is an Italian citizen and business owner who serves as a consultant for the pharmaceutical industry. He claims to suffer from gambling addiction, a condition he has been treated for in Italy. LaBarbera does not speak any English.

LaBarbera decided to visit Las Vegas and stay at the Wynn Hotel in late March through early April of 2008 after being recruited by Alex Pariente, an Italian-speaking employee and VIP host of the Wynn. While staying at the Wynn, LaBarbera gambled and lost \$1 million of his own money. The Wynn then extended \$1 million worth of gaming credit in the form of casino markers to LaBarbera. When LaBarbera checked out of the Wynn, Pariente brought LaBarbera the signed casino marker and asked LaBarbera to wire \$1 million to cover the debt. LaBarbera refused, claiming that he had no recollection of taking that debt and that the signature on the agreement was not his. The \$1 million marker was left unpaid. The Wynn then filed a breach of contract action to collect \$1 million in unpaid casino markers from LaBarbera.

At trial, LaBarbera claims he has no recollection of the debt, and that even if he did take that debt, he was intoxicated at the time and therefore should be allowed to void the agreement. LaBarbera claimed that Wynn employees continually brought him drinks he did not order, that he was especially intoxicated while gambling, and that on one occasion, he became intoxicated to the point where he became physically ill and vomited.

The Wynn claims that LaBarbera never complained or brought attention to his intoxication while he executed multiple gaming markers over several days. The Wynn cites cases showing the extremely high burden required to prove a voluntary intoxication defense and claims that LaBarbera’s argument fails because he cannot identify any specific facts about how much or how long he drank.

Should the court allow LaBarbera to void the alleged agreement to borrow \$1 million from the Wynn?

See LaBarbera v. Wynn Las Vegas, LLC, 134 Nev. 393 (2018).

MODULE IV

Interpretation

Interpretation is the process through which courts clarify the rights and obligations of the parties under a contract to ensure that the agreement reflects their intended bargain.

Interpretation of a promise or agreement or a term thereof is the ascertainment of its meaning. R2d § 200.

Contracts are essential tools for managing relationships and allocating risk. However, ambiguity—when language is open to more than one reasonable interpretation—can undermine these functions. For example, unclear terms in a supply agreement might lead to disputes over delivery schedules or product specifications. In some cases, unresolved ambiguity can even render contracts unenforceable, defeating their purpose as reliable mechanisms for cooperation.

This module presents a comprehensive framework for interpreting contracts. Each chapter explores a specific step in the process, offering students a systematic approach to understanding and resolving ambiguity.

Chapter 14 introduces the threshold question of identifying ambiguity. Courts distinguish between **patent ambiguities**, which are evident on the face of the contract, and **latent ambiguities**, which arise only when external circumstances are considered.

Chapter 15 focuses on **intrinsic evidence**, such as the plain language and structure of the contract, as a primary tool for resolving ambiguity. This step emphasizes the importance of the written agreement as the clearest reflection of the parties' intentions.

Chapter 16 explains when and how courts turn to **extrinsic evidence**—including course of performance, course of dealing, and trade usage—to clarify intent. These contextual tools provide additional insight into how the parties understood and intended their obligations.

Chapter 17 examines the **parol evidence rule**, which limits the admissibility of extrinsic evidence. This rule ensures that external evidence is used appropriately to clarify—not contradict—the contract. Its application demonstrates the balance courts must strike between the integrity of written agreements and concepts of fairness.

Finally, Chapter 18 applies these interpretive principles to specific obligations, focusing on **warranties**. By examining how courts balance express and implied warranties, students gain practical insight into how the framework operates in real-world contexts.

By studying this framework, students will develop a systematic approach to interpreting contracts. Litigators rely on these steps to resolve disputes and reconstruct intent, while transactional lawyers use them proactively to draft clear and enforceable agreements. Mastering this process equips students with the skills to ensure clarity, fairness, and predictability in contractual relationships.

Chapter 14

Ambiguity

Contractual ambiguity arises when a term or provision is reasonably susceptible to more than one interpretation. This chapter explores how courts identify and address ambiguity. It examines why ambiguity arises and how it impacts enforceability. It introduces the key distinctions between patent ambiguities, which are evident on the face of a contract, and latent ambiguities, which become apparent only when external circumstances are considered. Understanding these distinctions provides the foundation for interpreting ambiguous terms.

Ambiguity is central to determining the enforceability of agreements. Litigators approach ambiguity in hindsight—they resolve disputes by reconstructing intent from evidence. In contrast, transactional lawyers use foresight—they draft agreements to minimize ambiguity and prevent disputes. Both roles rely on recognizing and addressing ambiguity as a core skill in contract practice.

This chapter previews a structured approach to ambiguity analysis. It guides students through identifying ambiguity, classifying it as patent or latent, and systematically evaluating evidence to uncover intent. By mastering this process, students will develop practical tools for interpreting contracts in litigation and drafting agreements that reduce potential conflicts.

Rules

A. Ambiguity

Ambiguity arises when a contractual term or provision is reasonably susceptible to more than one interpretation. This is a significant issue in contract disputes because ambiguity can create uncertainty about legal obligations, and that uncertainty can lead to misunderstandings and disagreements over performance. Resolving ambiguity ensures that the parties' intentions are clarified and enforceable. Determining ambiguity is a threshold issue. Courts begin by examining the language of the contract itself. If the dispute can be resolved through a close reading of the text, the court will rely on the contract's plain meaning. In many cases, however, courts may turn to circumstantial evidence to clarify intent, particularly when the written terms alone cannot fully resolve the issue.

1. Patent Ambiguity

Patent ambiguities are evident on the face of the contract. They differ from latent ambiguities, which only become apparent when the contract is applied to external facts or circumstances. This distinction guides how courts approach the evidence needed to resolve each type of ambiguity. Patent ambiguities arise from contradictions, unclear language, or gaps within the written text. Courts typically resolve patent ambiguities using intrinsic evidence, such as the plain language of the contract, its structure, and any defined terms.

For example, a contract might state that a consultant will submit invoices quarterly but will be paid monthly. This inconsistency between quarterly and monthly obligations is a patent ambiguity. Courts might resolve this by prioritizing the provision that reflects the more specific obligation. If the contract includes a clause emphasizing “quarterly compliance with reporting requirements,” the court might conclude that invoicing aligns with this timeline while interpreting payment as a secondary mechanism to balance administrative needs.

Another example is a contract specifying delivery on the fifteenth of each month while also stating that delivery schedules are flexible with notice. Courts might resolve this by examining related clauses. If the contract prioritizes timely delivery for customer satisfaction, the flexibility clause might apply only under extraordinary circumstances.

2. Latent Ambiguity

Latent ambiguities are not apparent from the contract itself but arise when the contract is applied to external circumstances. These ambiguities highlight the importance of careful drafting.

For example, specifying a single address in a property maintenance agreement can prevent confusion when multiple properties are involved, reducing the risk of disputes over which property is covered. Similarly, a contract for the sale of cotton might state that shipment will occur on the vessel *Peerless*, but there are two ships with the same name sailing at different times. This creates a latent ambiguity. In the famous *Raffles v. Wichelhaus* case, EWHC Exch J19 (1864), courts could resolve the dispute by examining extrinsic evidence such as purchase orders or communication records to determine which *Peerless* the parties intended.

In *Peerless*, the court determined the ambiguity was material and unresolvable, rendering the contract invalid because the parties had a fundamental misunderstanding. This case serves as a reminder that ambiguity, if unresolved, can undermine enforceability.

B. Evidence of Ambiguity

Courts rely on evidence to determine whether ambiguity exists in a contract term. This evidence is used to show that a term is reasonably susceptible to more than one interpretation.

1. *Intrinsic Evidence*

Intrinsic evidence comes from within the “four corners” of the contract. This evidence falls into three main categories: the text of the contract, its defined terms, and its structure.

Text of the contract includes the actual words and phrases chosen by the parties. Courts often begin interpretation by considering the plain meaning of these words in their ordinary sense, unless the contract explicitly defines them otherwise.

Defined terms are words or phrases explicitly clarified within the contract. These definitions take precedence over ordinary meanings and provide a clear framework for interpreting specific terms. For example, if a contract defines “delivery” as “transfer of title,” courts will prioritize this definition over general understandings of the term.

Structure of the contract refers to the organization and hierarchy of its provisions. Courts look at how sections and clauses interact to determine whether an ambiguity can be resolved by aligning the terms with the document’s overall logic.

2. *Extrinsic Evidence*

Extrinsic evidence comes from outside the contract and is often required to reveal latent ambiguities. This type of evidence includes information such as course of performance, course of dealing, trade usage, and evidence of preliminary negotiations. Each plays a distinct role in helping courts understand the context of the contract.

Course of performance refers to how the parties have behaved under the specific contract at issue. For instance, if one party consistently accepts deliveries on the 16th despite a contract specifying the 15th, this performance may clarify how both parties interpreted the delivery term.

Course of dealing looks at prior transactions between the same parties. Repeated conduct in earlier agreements can shed light on the intended meaning of ambiguous terms. For example, if prior contracts involved similar terms and were understood in a particular way, that understanding can inform the interpretation of the current agreement.

Trade usage reflects industry norms or practices that provide meaning to terms used within a specific trade or profession. For instance, in the grain industry, the term “bushel” might have a specific weight attached to it, such as 60 pounds, based on trade usage. This type of evidence becomes especially important when intrinsic evidence and more specific extrinsic evidence, such as course of performance or course of dealing,

fail to clarify the term. Courts rely on trade usage to ensure that contracts align with standard practices, offering consistency and predictability within an industry.

Preliminary negotiations include pre-contractual communications or drafts that reveal the parties' intentions. While often inadmissible to contradict the final written agreement, such evidence can sometimes clarify ambiguities by showing how the parties discussed specific terms before finalizing the contract.

C. Evidence Resolving Ambiguity

Once ambiguity is established, courts use evidence to determine the most reasonable interpretation. Intrinsic evidence remains the primary resource for resolving patent ambiguities. For example, courts may reconcile conflicting terms by prioritizing the provision that aligns with the contract's overall structure and purpose.

Intrinsic evidence, which comes from within the contract, carries the most weight. Courts start with:

- (1) Plain meaning (ordinary meaning of the words in the contract)
- (2) Specific terms (defined or precise terms in the contract, which take precedence over general language)
- (3) Structure (headings, placement, and arrangement of terms within the agreement)

If intrinsic evidence does not resolve the ambiguity, courts may turn to extrinsic evidence. Contract law prescribes a hierarchy, where some extrinsic evidence is prioritized over others, in this order:

- (4) Course of performance (how the parties acted under the contract after it was formed)
- (5) Course of dealing (patterns of behavior in prior transactions between the same parties)
- (6) Trade usage (common practices or standards in the relevant industry)
- (7) Parol evidence (statements or agreements made during preliminary negotiations but not included in the final written contract)

Although both the common law and the UCC prescribe the same hierarchy of priorities for contract evidence, their underlying rationales for the hierarchy illustrate different approaches to resolving ambiguity. Intrinsic evidence—plain meaning, specific terms, and structure—is given the highest priority because it reflects the written agreement as the clearest record of the parties' intent.

Among extrinsic evidence, courts prioritize course of performance and course of dealing because they provide direct insights into the behavior and history of the contracting parties. Usage of trade is weighed next, as it offers valuable context taken from industry norms even though it lacks the specificity of party conduct. Parol evidence ranks lowest due to its susceptibility to self-serving interpretations. These differences

in weighting reflect the balancing act courts perform to respect the integrity of written agreements while ensuring fairness in interpretation. The UCC's broader admissibility of evidence underscores its pragmatic focus on resolving commercial disputes within their real-world context.

Although both the common law and the UCC have the same hierarchy of priorities of contract evidence, the admissibility of evidence differs under their respective frameworks. The UCC allows broader consideration of context to resolve commercial disputes efficiently.

D. Admissibility of Evidence

The common law and the UCC reflect fundamentally different priorities in their treatment of extrinsic evidence. The common law emphasizes predictability and formalism: it treats the written agreement as the final expression of the parties' intent and generally excludes outside evidence unless the contract is ambiguous on its face. This restrictive approach seeks to promote stability, reduce litigation risk, and preserve the integrity of written agreements by insulating them from after-the-fact reinterpretation.

The UCC, by contrast, embraces commercial realism. It permits a broader range of extrinsic evidence—including course of performance, course of dealing, and trade usage—even where the written agreement appears complete. This flexible framework recognizes that business relationships often depend on evolving context, shared understandings, and industry norms that may not be fully captured in writing.

This section examines how these differing frameworks shape contract interpretation and enforcement—and how they reflect deeper values in contract law: formality and certainty on one side, context and fairness on the other.

1. Common Law Admissibility

Under the common law, courts generally require the contract to be ambiguous on its face (intrinsically ambiguous) before admitting extrinsic evidence. This approach emphasizes the primacy of the written agreement and restricts additional evidence to situations where the text alone cannot yield a single reasonable interpretation.

For example, in a contract for IT services, extrinsic evidence might only be admitted if the contract refers to a “schedule” that is undefined or missing. By focusing on the written contract, courts aim to provide predictability and limit disputes over extrinsic factors.

2. UCC Admissibility

The UCC takes a more expansive view. In contracts for the sale of goods, extrinsic evidence such as trade usage, course of dealing, and course of performance may be considered even if the written terms appear unambiguous.

For instance, if a contract specifies delivery of widgets “on or before the 15th,” but prior transactions consistently allowed delivery on the 16th without objection, courts might conclude that the 16th is within the scope of acceptable performance based on course of dealing. This approach recognizes the importance of context and commercial practices in determining contractual meaning.

By accommodating broader evidence, the UCC seeks to balance the need for certainty with the realities of commerce. This broader approach incorporates trade usage within its evidentiary framework, respecting its role as a reflection of widely accepted industry practices. However, the UCC also maintains a hierarchy, which ensures that trade usage does not override more direct forms of evidence, such as course of performance and course of dealing, which provide clearer insights into the parties’ specific intentions.

This balance aligns with the UCC’s broader approach of facilitating commercial transactions while upholding fairness and predictability. By considering a wider range of evidence, courts can interpret agreements in ways that reflect the parties’ true intentions and the practical realities of their industries, which helps to ensure equitable outcomes without undermining the reliability of written contracts.

For example, in rapidly evolving industries like technology or renewable energy, standard practices may shift frequently. Courts might rely on evidence of recent trade usage or evolving industry norms to ensure that contract terms are interpreted in line with current realities, thus enabling agreements to remain functional and effective. While this approach allows for greater flexibility, it still seeks to preserve the integrity of the written agreement by ensuring that extrinsic evidence is used to clarify, not contradict, the terms of the contract.

E. Steps for Addressing Ambiguity

Courts and practitioners follow a structured framework to resolve contractual ambiguity systematically and in a way that ensures that interpretations align with the parties’ intentions and broader legal principles.

The first step is to identify whether an ambiguity exists. Courts determine whether a term or provision is reasonably susceptible to more than one interpretation by distinguishing between patent ambiguities, which are evident on the face of the contract, and latent ambiguities, which become apparent only when the contract is applied to external circumstances. This initial classification provides the foundation for further analysis.

Once they identify ambiguity, courts examine intrinsic evidence to resolve the issue wherever possible. This includes the plain meaning of the contract’s language, the structure and organization of its provisions, and any definitions explicitly included in the agreement. Intrinsic evidence carries the greatest weight because it reflects the written record of the parties’ intent and promotes predictability and stability in contract enforcement.

If ambiguity cannot be resolved using intrinsic evidence, courts turn to extrinsic evidence for additional context. Sources such as course of performance, course of dealing, and trade usage illuminate how the parties understood their obligations and how similar terms are interpreted in the relevant industry. This step ensures that interpretation aligns with practical realities and the parties' conduct.

Throughout the process, courts adhere to a hierarchy of evidence to prioritize the most reliable and relevant information. Specific and direct evidence, such as course of performance, typically carries more weight than generalized evidence like trade usage. This hierarchy balances the need for clarity with the realities of commercial practice and ensures that courts rely on evidence most closely tied to the parties' agreement.

This framework not only helps litigators reconstruct intent and resolve disputes but also serves as a guide for transactional lawyers drafting contracts to minimize ambiguity. By understanding why ambiguity arises and how courts address it, transactional lawyers can craft agreements that reduce uncertainty and anticipate potential conflicts, thereby ensuring greater enforceability and clarity.

F. Why Does Ambiguity Exist in Contracts?

Ambiguity in contracts is a persistent and often inevitable challenge. It arises from the interplay between language's inherent limitations, the complexity of real-world applications, and the unpredictability of future events. Understanding these causes helps practitioners identify and address ambiguity effectively during drafting and litigation.

Language is inherently imprecise. Even carefully chosen words can have multiple meanings, and slight differences in phrasing may lead to significant interpretive disputes. While drafters aim for precision, the flexibility of language often leaves room for differing interpretations. In *McGinnis v. Union Pacific Railroad Co.*, 612 F. Supp. 2d 776 (D. Neb. 2009), the court addressed ambiguity in an insurance policy using the term "work." The term was unclear as to whether it referred to the physical act of laying tracks or the geographic area of construction. This latent ambiguity demonstrates how even simple terms can create disputes when applied to specific contexts.

Contracts often address multifaceted transactions, and applying their language to real-world scenarios can reveal latent ambiguities. These ambiguities become apparent only when the contract interacts with unforeseen facts or complexities. In *Ezrasons, Inc. v. Travelers Indemnity Co.*, 89 F.4th 388 (2d Cir. 2023), an insurance policy listed an "Approved Location" for coverage. Although the address seemed clear, the property included multiple warehouses, which raised questions about whether the policy applied to all buildings. The court resolved the ambiguity in favor of the insured. This case demonstrates how real-world complexities can expose gaps in contractual language.

Future events are inherently uncertain, and drafters cannot predict every contingency. Even well-drafted agreements may become ambiguous when significant changes in context, technology, or industry practices arise. For instance, in *Brotherhood of*

Maintenance of Way Employes Division of International Brotherhood of Teamsters v. Union Pacific Railroad, 475 F. Supp. 2d 819 (N.D. Iowa 2007), the introduction of iris-recognition technology for tracking employee attendance raised questions about whether it constituted a “technological change” permitted under a collective bargaining agreement. The ambiguity arose because the drafters could not have foreseen such a specific technological advancement.

In some cases, ambiguity is intentional. Drafters may deliberately leave terms open-ended to expedite negotiations or allow flexibility for future developments. While this approach can make agreements more adaptable, it also increases the risk of disputes. In *Bohler-Uddeholm America, Inc. v. Ellwood Group, Inc.*, 247 F.3d 79 (3d Cir. 2001), a joint venture agreement was ambiguous about whether rebates applied to sales made to third parties. This deliberate drafting choice deferred contentious negotiations but ultimately required the court to interpret the parties’ intent using extrinsic evidence.

And drafting comprehensive agreements is time-consuming and expensive. Parties often balance the need for detail with the desire to finalize agreements efficiently. This trade-off can leave gaps or ambiguities in contract terms. In *MW Builders, Inc. v. United States*, 134 Fed. Cl. 469 (2017), a construction contract was ambiguous about which party was responsible for signing a line extension agreement. The lack of clarity likely stemmed from prioritizing simplicity over exhaustive detail. The court resolved the ambiguity using the doctrine of *contra proferentem*, interpreting the ambiguity against the drafter.

Ambiguity in contracts arises from the inherent limitations of language, the complexity of real-world facts, the uncertainty of future events, deliberate choices, and practical drafting constraints. Recognizing these sources is essential for both litigators and transactional lawyers. Litigators must adeptly resolve ambiguities through extrinsic evidence and interpretive rules, while transactional lawyers can mitigate ambiguity by defining key terms, drafting clearly, and anticipating disputes. While ambiguity cannot always be avoided, its impact can be managed through thoughtful legal practice.

G. Reflections on Ambiguity

Ambiguity is not just a challenge for courts and lawyers; it is a defining feature of how contracts function in the real world. This chapter has demonstrated how ambiguity arises from the inherent limitations of language, the complexity of applying contractual terms to real-world facts, and the unpredictability of future circumstances. While ambiguity complicates the certainty that contracts aim to provide, it also highlights contract law’s adaptability to varied and unforeseen situations.

For transactional lawyers, the challenge lies in minimizing ambiguity through precise drafting while leaving room for flexibility in cases where rigidity could undermine an agreement’s purpose. For litigators, ambiguity provides an opportunity to

reconstruct the parties' intent and ensure fairness in the application of unclear terms. These complementary roles underscore why ambiguity, though often frustrating, is an inevitable aspect of contracting.

Looking ahead, students should consider how ambiguity intersects with other foundational issues in contract law. Disputes about performance and breach frequently hinge on resolving ambiguous obligations and require courts to clarify what constitutes compliance. Remedies are also shaped by ambiguity, as courts must determine how to enforce or adjust agreements when terms lack clarity. Furthermore, ambiguity challenges the principle of autonomy by forcing courts to interpret terms in ways that may not fully reflect the parties' intentions. This interpretive process often requires balancing respect for private agreements with broader public policy considerations, such as fairness, protecting weaker parties, and ensuring commercial consistency. This interplay reveals how ambiguity, while rooted in private agreements, intersects with judicial concerns about equity and broader legal norms.

Cases

Reading Frigaliment Importing Co., Ltd., v. B.N.S. International Sales Corp.

The *Frigaliment* case involves an agreement for the purchase and sale of chicken from a U.S. company to a German company. The dispute arose when the seller delivered stewing chickens. The buyer claimed that the seller should have delivered frying chickens. The legal question presented is, what is the meaning of chicken?



Figure 14.1. Gallina Poulle, Albert Flamen (1659). CC0 1.0.

In studying this case, make sure to identify all the different strategies that the court uses to determine the meaning of chicken. In particular, try to list all the various sources of evidence that a court could consider when determining the meaning of contractual terms. Then explain which sources of evidence take priority over which others, and be prepared to discuss why this prioritization of evidence of contractual meaning makes sense.

**Frigaliment Importing Co., Ltd., v. B.N.S.
International Sales Corp.**

190 F. Supp. 116 (S.D.N.Y. 1960)

FRIENDLY, J.

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 [argument], 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, New York Personal Property Law, McKinney’s Consol. Laws, c. 41, § 95. Two contracts are in suit. In the first, dated May 2, 1957, defendant, a New York sales corporation, confirmed the sale to plaintiff, a Swiss corporation, of

US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated 2½–3 lbs. and 1½–2 lbs. each all chicken individually wrapped in cryovac, packed in secured fiber cartons or wooden boxes, suitable for export

75,000 lbs. 2½–3 lbs. @\$33.00

25,000 lbs. 1½–2 lbs. @\$36.50

per 100 lbs. FAS New York, scheduled May 10, 1957 pursuant to instructions from Penson & Co., New York.

The second contract, also dated May 2, 1957, was identical save that only 50,000 lbs. of the heavier “chicken” were called for, the price of the smaller birds was \$37 per 100 lbs., and shipment was scheduled for May 30. The initial shipment under the first

contract was short but the balance was shipped on May 17. When the initial shipment arrived in Switzerland, plaintiff found, on May 28, that the 2½–3 lbs. birds were not young chicken suitable for broiling and frying but stewing chicken or “fowl”; indeed, many of the cartons and bags plainly so indicated. Protests ensued. Nevertheless, shipment under the second contract was made on May 29, the 2½–3 lbs. birds again being stewing chicken. Defendant stopped the transportation of these at Rotterdam.

This action followed. Plaintiff says that, notwithstanding that its acceptance was in Switzerland, New York law controls; defendant does not dispute this, and relies on New York decisions. I shall follow the apparent agreement of the parties as to the applicable law.

Since the word “chicken” standing alone is ambiguous, I turn first to see whether the contract itself offers any aid to its interpretation. Plaintiff says the 1½–2 lbs. birds necessarily had to be young chicken since the older birds do not come in that size, hence the 2½–3 lbs. birds must likewise be young.

This is unpersuasive—a contract for “apples” of two different sizes could be filled with different kinds of apples even though only one species came in both sizes. Defendant notes that the contract called not simply for chicken but for “US Fresh Frozen Chicken, Grade A, Government Inspected.” It says the contract thereby incorporated by reference the Department of Agriculture’s regulations, which favor its interpretation; I shall return to this after reviewing plaintiff’s other contentions.

The first hinges on an exchange of cablegrams which preceded execution of the formal contracts. The negotiations leading up to the contracts were conducted in New York between defendant’s secretary, Ernest R. Bauer, and a Mr. Stovicek, who was in New York for the Czechoslovak government at the World Trade Fair. A few days after meeting Bauer at the fair, Stovicek telephoned and inquired whether defendant would be interested in exporting poultry to Switzerland. Bauer then met with Stovicek, who showed him a cable from plaintiff dated April 26, 1957, announcing that they “are buyer” of 25,000 lbs. of chicken 2½–3 lbs. weight, Cryovac packed, grade A Government inspected, at a price up to 33¢ per pound, for shipment on May 10, to be confirmed by the following morning, and were interested in further offerings. After testing the market for price, Bauer accepted, and Stovicek sent a confirmation that evening. Plaintiff stresses that, although these and subsequent cables between plaintiff and defendant, which laid the basis for the additional quantities under the first and for all of the second contract, were predominantly in German, they used the English word “chicken”; it claims this was done because it understood “chicken” meant young chicken whereas the German word, “Huhn,” included both “Brathuhn” (broilers) and “Suppenhuhn” (stewing chicken), and that defendant, whose officers were thoroughly conversant with German, should have realized this. Whatever force this argument might otherwise have is largely drained away by Bauer’s testimony that he asked Stovicek what kind of chickens were wanted, received the answer “any kind of chickens,” and then, in German, asked whether the cable meant “Huhn” and received an affirmative response. Plaintiff attacks this as contrary to what Bauer testified on

his deposition in March, 1959, and also on the ground that Stovicek had no authority to interpret the meaning of the cable. The first contention would be persuasive if sustained by the record, since Bauer was free at the trial from the threat of contradiction by Stovicek as he was not at the time of the deposition; however, review of the deposition does not convince me of the claimed inconsistency. As to the second contention, it may well be that Stovicek lacked authority to commit plaintiff for prices or delivery dates other than those specified in the cable; but plaintiff cannot at the same time rely on its cable to Stovicek as its dictionary to the meaning of the contract and repudiate the interpretation given the dictionary by the man in whose hands it was put. Plaintiff's reliance on the fact that the contract forms contain the words "through the intermediary of:" with the blank not filled, as negating agency, is wholly unpersuasive; the purpose of this clause was to permit filling in the name of an intermediary to whom a commission would be payable, not to blot out what had been the fact.

Plaintiff's next contention is that there was a definite trade usage that "chicken" meant "young chicken." Defendant showed that it was only beginning in the poultry trade in 1957, thereby bringing itself within the principle that "when one of the parties is not a member of the trade or other circle, his acceptance of the standard must be made to appear" by proving either that he had actual knowledge of the usage or that the usage is "so generally known in the community that his actual individual knowledge of it may be inferred." Here there was no proof of actual knowledge of the alleged usage; indeed, it is quite plain that defendant's belief was to the contrary. In order to meet the alternative requirement, the law of New York demands a showing that "the usage is of so long continuance, so well established, so notorious, so universal and so reasonable in itself, as that the presumption is violent that the parties contracted with reference to it, and made it a part of their agreement."

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

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

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

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¢ price offered by plaintiff for the 2½–3 lbs. birds. There is no substantial dispute that, in late April, 1957, the price for 2½–3 lbs. broilers was between 35 and 37¢ per pound, and that when defendant entered into the contracts, it was well aware of this and intended to fill them by supplying fowl in these weights. It claims that plaintiff must likewise have known the market since plaintiff had reserved shipping space on April 23, three days before plaintiff's cable to Stovicek, or, at least, that Stovicek was chargeable with such knowledge. It is scarcely an answer to say, as plaintiff does in its brief, that the 33¢ price offered by the 2½–3 lbs. "chickens" was closer to the prevailing 35¢ price for broilers than to the 30¢ at which defendant procured fowl. Plaintiff must have expected defendant to make some profit—certainly it could not have expected defendant deliberately to incur a loss.

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

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

made at least oblique 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.

Reflection

According to the R2d, "[i]nterpretation of a promise or agreement or a term thereof is the ascertainment of its meaning." R2d § 200. But, by studying *Frigaliment*, you have found that there is an inherent tension in contract interpretation in cases where a party challenges the meaning of a term written in an agreement. Should a court consider evidence that tends to show that a contract does not mean what it seems to say? The question of whether to admit such evidence turns out to have a great deal of bearing on the result of the contract interpretation process.

The famous *Frigaliment* case was decided before the UCC was enacted or the R2d was established, but it takes a similar approach to both. Judge Friendly asks, "[W]hat is chicken?" He recognizes that one party intended "frying chickens," whereas the other meant "broiling chickens," but he does not begin the analysis by inquiring why they held these different meanings. Rather, Judge Friendly begins with the dictionaries, which "give both meanings." Upon thus finding that the term "chicken" is patently ambiguous with regard to what kind of chicken, Judge Friendly then proceeds to entertain extrinsic evidence. It is not clear what the judge would have done had some universal dictionary offered a singular definition, but one suspects that he would have agreed with the R2d § 201 cmt. b that "ordinarily a party has reason to know of meanings in a general usage" and therefore thrown the book, so to speak, at whichever party was attesting to be ignorant of such a clearly established term.

Discussion

1. Generally, courts apply the plain meaning to a contractual term. Why did the court not apply the plain meaning of "chicken" in this case? What does its reasoning indicate about the plain meaning rule in general?
 2. What constitutes an ambiguity? Should courts hear evidence that tends to show a term is latently ambiguous, or should courts only admit extrinsic evidence where a term is patently ambiguous?
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Problems

Problem 14.1. IRAC *Frigaliment*

A party who wishes to show that a written contract should be interpreted according to the meaning it supplies usually must first show that the written term is susceptible to multiple meanings; in other words, that party must first prove the term is ambiguous. Was the term “chicken” in the *Frigaliment* case ambiguous? Would this famous historic case come out the same way under modern rules? Answer this question using the IRAC paradigm. First, frame the issue in terms of whether the word chicken is ambiguous. Second, write, cite, and explain the key rules (including a definition of what is a patent or latent ambiguity). Third, analyze the term “chicken” as it appears in the *Frigaliment* case under those rules. Finally, conclude whether the term “chicken” is ambiguous.

Problem 14.2. Approved Location

A marine cargo insurance policy issued by Travelers Indemnity Company lists an “Approved Location” as “Chamad Warehouse, Inc., 56 Branch Street, Brooklyn, NY.” The property at this address includes three separate warehouse buildings: a primary warehouse visible from the street, a second building at the rear of the parcel, and a smaller storage unit located near the loading docks. A fire destroys goods stored in the second building. Travelers denies coverage, arguing that the “Approved Location” refers only to the primary warehouse fronting 56 Branch Street. Ezrasons, Inc., the insured, claims that the entire property, including all three buildings, is covered under the policy.

What is the best argument that the term “Approved Location” is unambiguous?

Does one, both, or neither party strategically benefit from claiming the term is ambiguous? Why?

If the term is ambiguous, what kind of ambiguity is it—patent or latent?

See *Ezrasons, Inc. v. Travelers Indem. Co.*, 89 F.4th 388 (2d Cir. 2023).

Problem 14.3. Work Insurance

A liability insurance policy issued by Zurich American Insurance covers claims “arising out of the insured’s work” during a railway construction project. An accident occurs on site during the Union Pacific Railroad Company’s railway expansion, and the contractor, Herzog Contracting Corporation, files a claim. The dispute centers on the term “work” in the policy. Zurich denies the claim, arguing that “work” refers only to the specific tasks Herzog was contractually obligated to perform, such as laying track. Herzog contends that “work” includes all activities at the construction site, including general site preparation and equipment use, where the accident occurred.

What is the best argument that the term “work” is unambiguous?

Does one, both, or neither party strategically benefit from claiming the term is ambiguous? Why?

If the term is ambiguous, what kind of ambiguity is it—patent or latent?

See McGinnis v. Union Pac. R.R. Co., 612 F. Supp. 2d 776 (D. Neb. 2009).

Problem 14.4. Licensing Ambiguity

XYZ Productions licenses software to Acme Corp. under an agreement that states: “Licensee may use the Licensed Software in connection with its business operations.” Years later, Acme begins using the software to power an e-commerce platform, which generates substantial revenue. XYZ claims this usage exceeds the scope of the license, arguing that “in connection with its business operations” was intended to mean internal use only. Acme counters that the phrase unambiguously permits all business-related applications, including revenue-generating uses.

What is the best argument that the phrase “in connection with its business operations” is unambiguous?

Does one, both, or neither party strategically benefit from claiming the term is ambiguous? Why?

If the term is ambiguous, what kind of ambiguity is it—patent or latent?

See generally Bohler-Uddeholm Am., Inc. v. Ellwood Group, Inc., 247 F.3d 79 (3d Cir. 2001).

Chapter 15

Intrinsic Evidence

Contracts aim to provide clarity and enforceability. Yet, disputes often arise over the meaning of specific terms or provisions. When parties disagree about written terms, courts begin with intrinsic evidence—the words of the contract itself. Courts prioritize intrinsic evidence because it reflects the parties’ shared intent at the time of drafting, offering a foundation for resolving disputes without resorting to external evidence. But how do courts interpret contracts when ambiguities or conflicts arise? This chapter examines the “canons of construction,” the interpretive tools courts use to clarify terms, harmonize provisions, and ensure agreements function as intended.

The canons of construction fall into two categories: semantic and policy. Semantic canons focus on the language and structure of the contract. These rules operate like tools in a toolbox, each suited for a specific purpose. Some, like the plain meaning rule, are versatile and foundational, much like a screwdriver used in many situations. Others, such as the last antecedent rule, are specialized tools designed for resolving precise issues—more akin to a torque wrench that tightens bolts to exact specifications. While this chapter does not exhaustively catalog every semantic canon, it introduces several key rules that help courts and practitioners interpret contracts with precision.

Policy canons address fairness and equity by ensuring that contract interpretation aligns with broader legal norms. For example, consider the doctrine of *contra proferentem*, which resolves ambiguities against the drafter—this rule of contractual interpretation aligns with the legal norms of protecting reasonable expectations and preventing one party from exploiting unclear language. Policy canons reflect contract law’s dual purpose: promoting predictability and autonomy while safeguarding fairness and equity.

Learning the canons of construction will help students to resolve disputes over intrinsic evidence. These principles form a critical foundation for understanding how courts apply contract terms in practice—by balancing textual precision with the practicalities of real-world agreements.

Rules

A. Semantic Canons

Semantic canons of construction are the primary tools courts use to interpret the written language of contracts. These rules prioritize clarity, coherence, and consistency by focusing exclusively on the contract's text and structure to resolve disputes. They help courts determine the intent of the parties based on the language they chose and ensure that every provision is given effect. Semantic canons operate within the "four corners" of the document, applying logic and structure to interpret terms without relying on external evidence.

These canons range from broad principles to precise tools. For example, the plain meaning rule gives words their ordinary sense unless the context indicates otherwise. Other canons, such as the last antecedent rule, resolve specific questions about how modifiers apply to preceding terms. Together, these rules ensure that contracts are interpreted logically and predictably, enabling courts to resolve ambiguity while preserving the integrity of the agreement.

This chapter introduces twelve semantic canons that illustrate the range of interpretive tools courts commonly use. While these canons are not an exhaustive list, they represent foundational principles that recur in judicial decisions. They provide students with a reliable framework for analyzing contract language and addressing ambiguities. Other lists of canons, such as those outlined in key legal treatises, include additional rules that may apply in specific contexts. For example, R2d § 203 highlights canons such as avoiding redundancy and favoring interpretations that preserve validity. Similarly, Scalia and Garner's work on textual interpretation includes a wide array of linguistic, syntactic, and contextual canons used across legal disciplines.

By focusing on these twelve canons, this chapter provides a practical and accessible introduction to semantic canons. These tools are foundational for interpreting intrinsic evidence in a way that ensures logical, consistent, and fair outcomes in contract disputes.

1. Dictionary Meaning

Courts often begin interpreting contract terms by considering their dictionary meaning—the isolated, standalone definition of a word. This ensures that interpretation starts with a precise understanding of language before introducing additional layers of complexity. By effectively "consulting the dictionary," courts select the most appropriate source for the term in question, whether ordinary, technical, or legal.

The **plain meaning rule** directs courts to interpret words in their ordinary sense unless the contract specifies otherwise. For example, in a service agreement requiring the contractor to "repair damage," courts would interpret "repair" in its everyday sense: restoring the property to its prior condition. This meaning excludes upgrades

or improvements unless explicitly required, thus ensuring predictable and uniform application of common language.

The **technical meaning rule** applies when contracts use terms specific to a particular trade, profession, or industry. For instance, in an IT service agreement, “server maintenance” has a technical meaning that includes tasks like software updates and hardware checks but excludes broader activities like equipment upgrades. Courts rely on trade-specific definitions to align the interpretation with industry practices and the parties’ shared understanding.

These rules reflect the importance of grounding interpretation in precise, isolated definitions before considering broader context. However, dictionary meaning alone rarely resolves all ambiguities, as words often gain their true significance from the structure and context of the contract. Courts, therefore, treat dictionary meaning as a starting point rather than a definitive resolution. From there, courts consider how terms interact with surrounding language and the agreement as a whole.

2. Contextual Meaning

Courts determine the contextual meaning of contract terms by examining how those terms interact with surrounding language and the broader framework of the agreement. This ensures that terms are not interpreted in isolation but as part of a cohesive and logical document. Contextual tools help clarify ambiguous language by aligning general provisions with their immediate and overall context.

The **general terms rule** provides that broad language be interpreted reasonably within the contract’s context, which ensures that the contract does not impose obligations or grant rights that are overly expansive or unintended. For example, in a commercial lease, a clause stating that “Tenant shall maintain all areas of the property” might reasonably be interpreted to exclude structural repairs, as such responsibilities typically fall to the landlord. This rule ensures that general terms align with the broader agreement by preventing them from being stretched beyond their logical scope.

The **recognition by association rule** (*noscitur a sociis*) holds that the meaning of a word is informed by its association with surrounding terms. For instance, in an insurance policy covering “fire, flood, or other disasters,” the phrase “other disasters” would be interpreted to include natural catastrophes of similar magnitude, such as hurricanes or earthquakes, but not minor issues like a leaky pipe. This rule ensures that general terms are limited by the specific terms that accompany them.

The **same kind, class, or nature rule** (*ejusdem generis*) limits general terms that follow a list of specific items to those of the same kind. For example, in the same insurance policy, if the clause states, “losses caused by fire, flood, lightning, or other perils,” the term “other perils” would be limited to comparable natural or physical phenomena, excluding theft or vandalism. This canon ensures that general terms remain consistent with the more specific terms that precede them.

The **grammar rules** (such as the last antecedent rule) provide that modifiers typically apply to the nearest antecedent unless the context suggests otherwise. For example, in the same policy, a clause stating, “damages resulting from fire, flood, or other disasters occurring during the policy period,” would likely apply “occurring during the policy period” only to “other disasters” and not to “fire” or “flood,” unless other language in the contract clearly indicates a broader application.

These contextual tools operate simultaneously rather than sequentially, as courts often apply them in tandem when ambiguity persists. This interplay underscores the inherent challenges of contract interpretation, where terms must be harmonized across multiple provisions to reflect the intent of the parties.

3. *Structural Meaning*

Courts interpret contracts as unified documents, applying structural principles to ensure that every provision contributes to a coherent and harmonious agreement. These rules emphasize how terms fit together within the overall structure of the contract, which prevents interpretations that isolate clauses or render parts of the agreement meaningless. Structural canons work alongside dictionary and contextual principles to clarify how terms interact within the broader framework of the contract.

The **whole agreement rule** requires courts to read the contract as a cohesive whole to reconcile potentially conflicting provisions. For example, in a commercial lease, a clause requiring the tenant to “maintain the property in good repair” must be interpreted alongside another clause assigning the landlord responsibility for “repairing structural damage.” Courts would harmonize these terms by assigning routine upkeep to the tenant while reserving major structural repairs for the landlord, thus ensuring that both provisions are effective and not contradictory.

The **avoid surplusage rule** directs courts to give meaning to every word and clause and to avoid interpretations that render language redundant or superfluous. In the same lease, if one clause states that the tenant must “promptly repair damage to the premises” and another requires the tenant to “address all issues of damage in a timely manner,” courts would interpret “promptly” and “timely” as addressing different levels of urgency. For example, “promptly” might apply to emergency repairs, while “timely” might address routine maintenance tasks.

The **consistent usage rule** (and the related meaningful variation rule) assumes that identical terms are used consistently throughout the contract, while variations in terms indicate intentional differences. For instance, if the lease refers to “shared spaces” in one section and “common areas” in another, courts would presume that these terms have distinct meanings unless the contract explicitly defines them as interchangeable.

By considering structural meaning, courts ensure that contracts function as integrated and logically consistent documents. These canons work in tandem with other

interpretive principles to clarify responsibilities, harmonize the parties' obligations, and reflect the parties' intent in a cohesive manner.

4. *Tailored Meaning*

Courts often rely on principles of specificity and negotiation to prioritize language that is most tailored to the agreement. These canons emphasize the deliberate choices made by the parties and ensure that precise and customized terms prevail over broader or pre-drafted provisions. In the context of service agreements, these principles guide courts in resolving ambiguities and conflicts.

The **specific terms rule** gives greater weight to precise and tailored provisions over more general language. For example, if a service agreement requires the provider to "upgrade all network software to the latest version," this specific term would override a general provision requiring the provider to "maintain an up-to-date system." The specific term reflects the parties' deliberate focus on addressing a particular issue in detail.

The **negotiated terms rule** prioritizes individually negotiated or added terms over standardized or boilerplate provisions. For instance, in the same IT service agreement, a preprinted clause stating, "Support is provided during regular business hours," might be overridden by a handwritten term specifying, "Support is available 24/7." The handwritten term reflects the parties' specific negotiation, capturing their unique agreement more accurately than the default boilerplate language.

These rules often work alongside other interpretive principles to ensure that contracts reflect the unique considerations of the parties' agreement. By prioritizing tailored language, courts honor the parties' deliberate intent and incentivize careful drafting and negotiation to reduce the risk of future disputes.

5. *Legal Meaning*

When interpreting contracts, courts often turn to the **legal meaning rule** to ensure that terms align with established legal definitions. This canon prioritizes interpretations that reflect the broader legal and regulatory frameworks governing the agreement. Legal meaning is particularly significant in contracts involving regulated industries, complex transactions, or statutory terminology. It serves as the ultimate semantic canon, grounding interpretation in external legal authority.

Courts apply the legal meaning rule when a contract term has a specific legal definition that takes precedence over its ordinary or technical meaning. For example, in a construction contract requiring "installation of safety measures," courts would interpret "safety measures" to include fire exits and other requirements mandated by local building codes, even if the term could colloquially refer to broader precautions. By anchoring interpretation in legal standards, this rule ensures consistency with external norms and enforceability under the law.

This canon also applies to established legal terms of art. For instance, in a loan agreement, the term “security interest” would be interpreted based on its formal definition under the UCC Article 9. Courts would not rely on a lay interpretation of “security” as general protection but would instead treat the term as referring to a legally recognized right in collateral. This precision reinforces consistency and predictability by ensuring that contracts conform to legal frameworks and shared professional expectations.

The legal meaning rule is often invoked alongside other canons, such as the plain meaning rule and technical meaning rule, to clarify ambiguous language. While courts prioritize the parties’ intent, they also recognize that contracts must operate within the bounds of the law. By integrating legal meaning, courts bridge the gap between the parties’ agreement and the broader regulatory and statutory context in which it exists, thus ensuring that the contract is not only enforceable but also compliant with applicable laws.

6. *Conflicting Meanings*

Semantic canons are powerful tools for interpreting contracts, but they do not always lead to a single, definitive meaning. Different canons can sometimes point to conflicting interpretations, leaving ambiguity unresolved even after applying the principles of dictionary, contextual, structural, and tailored meaning. This underscores the inherent limitations of language and the complexity of contractual relationships.

Consider a commercial lease requiring the tenant to “repair damage to the premises.” The plain meaning rule might suggest that “repair” refers to restoring any damage to its previous condition, including structural repairs; however, the whole agreement rule could prioritize a separate clause assigning the landlord responsibility for “structural repairs.” Applying these canons creates a conflict between the general duty to repair and the specific allocation of structural repairs. This tension leaves ambiguity unresolved, as both interpretations are plausible.

Another example arises in a service agreement that requires the contractor to “use materials suitable for the task.” The general terms rule might interpret “suitable for the task” broadly, thus allowing for flexibility in choosing materials. At the same time, the avoid surplusage rule might emphasize a clause that specifies “ABC-brand materials,” which would suggest that the broad language be narrowed to align with the explicit mention of ABC-brand products. This conflict between broad and narrow interpretations may leave the term ambiguous, as both readings align with different canons.

In cases like these, courts attempt to reconcile the conflicting meanings by considering the contract as a whole and seeking the interpretation that best reflects the parties’ intent. However, when semantic tools fail to resolve ambiguity, courts may turn to other interpretive methods. Policy canons, such as *contra proferentem*, guide courts to construe ambiguities against the drafting party, particularly in contracts of adhesion or those with significant power imbalances. These policy-driven principles,

discussed in the next section, offer fairness-based resolutions when textual interpretation alone is insufficient.

When even policy canons cannot fully resolve ambiguity, courts may evaluate extrinsic evidence, such as course of performance, course of dealing, or trade usage, to uncover the intent of the parties. The evaluation of extrinsic evidence is explored in Chapter 16.

The simultaneous application of semantic canons reflects the complexity of contract interpretation. While these tools aim to clarify meaning and reduce uncertainty, they are not infallible. The potential for conflicting meanings underscores the limitations of purely textual approaches and highlights the need for flexibility in applying policy principles and considering external evidence. By addressing these conflicts, courts balance precision and fairness, and, in doing so, ensure that agreements remain enforceable and adaptable to real-world complexities.

B. Policy Canons

When ambiguity persists despite applying semantic canons, courts turn to policy canons to resolve disputes in ways that promote fairness, equity, and the public interest. These rules reflect broader principles of contract law and ensure that interpretation aligns with societal values, reasonable expectations, and the duty of good faith.

1. Good Faith

A fundamental principle of contract law is good faith, which requires parties to act honestly and fairly in the performance and enforcement of their agreements. This principle is codified in both the common law and statutory frameworks. R2d states:

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement. R2d § 205.

Similarly, UCC provides:

Every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement. NC UCC § 1-304.

The UCC defines good faith in general:

“Good faith” . . . means honesty in fact and the observance of reasonable commercial standards of fair dealing. NH UCC § 2-201(b).

The UCC also defines good faith for merchants:

“Good faith” in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade. NH UCC § 2-103.

These provisions establish good faith as a universal obligation, thus ensuring that parties do not undermine the purpose of their agreements through opportunistic or unfair behavior.

In *Nānākuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772 (9th Cir. 1981), reproduced in Chapter 16, the court addressed the concept of good faith under the UCC in the context of price increases for asphalt. Nānākuli, a paving contractor in Hawai‘i, had a long-term supply agreement with Shell Oil to purchase asphalt. The contract specified that prices would be determined by Shell’s “posted price at the time of delivery.” However, Nānākuli argued that Shell had repeatedly provided price protection, meaning Shell would honor the price posted at the time of an order rather than at delivery.

In January 1974, during a dramatic increase in oil prices, Shell raised the price of asphalt from \$44 to \$76 per ton, effective immediately. Shell failed to provide advance notice of the price increase and did not honor the previously agreed-upon pricing for pending orders. Nānākuli sued, claiming that Shell’s actions violated the obligation of good faith in the contract’s performance.

The court found that Shell’s abrupt price increase and lack of advance notice violated the standard of good faith because it failed to meet commercially reasonable standards in the asphalt paving trade. Other suppliers, like Chevron, provided six weeks’ advance notice, which the court considered a reasonable standard in the industry. The jury likewise concluded that Shell’s failure to provide price protection and its lack of notice breached the duty of good faith, as Nānākuli had relied on the previous pricing structure in its bids for projects.

Good faith ensures that contracts fulfill their intended purpose without creating undue harm or unfair advantage. This example also highlights the interplay between the UCC’s good-faith provisions and evidence of trade usage, demonstrating how courts use context to evaluate fairness in commercial relationships.

Courts invoke the principle of good faith to resolve ambiguities in favor of fairness, especially when semantic tools fail to provide clarity. For instance, a term requiring “reasonable efforts” to deliver goods on time may be interpreted through the lens of good faith to ensure that both parties fulfill their obligations fairly and consistently with industry norms. The duty of good faith serves as a safety net to ensure that contracts are not only enforceable but also equitable in their execution.

2. Interpretation against the Drafter

When ambiguity persists in a contract, courts often invoke the principle of *contra proferentem*—the rule that ambiguous terms should be construed against the party who drafted the agreement. This principle reflects a broader policy aim of fairness by ensuring that the drafting party, who had the power to clarify terms, bears the consequences of any lack of clarity.

In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the

party who supplies the words or from whom a writing otherwise proceeds.
R2d § 206.

The rationale is straightforward. The party drafting the contract has greater control over its language and is in the best position to prevent ambiguity. By interpreting unclear terms against the drafter, courts incentivize clear and precise drafting while protecting the reasonable expectations of the non-drafting party.

This principle is particularly important in contracts of adhesion, where one party, typically the drafter, wields significantly more bargaining power. For example, in an insurance policy drafted by the insurer, a clause ambiguously requiring coverage for “water damage” could be interpreted against the insurer to include flood damage if the insured reasonably expected such coverage. The ambiguity is resolved in favor of the weaker party, reflecting the policy aim of fairness.

UCC § 2-316 provides a statutory example of this principle, particularly in the context of disclaimers or limitations of warranties (warranties are covered in Chapter 18). If a disclaimer is ambiguous or unclear, courts will construe it narrowly against the seller, which ensures that buyers are not unfairly deprived of reasonable protections. For instance, a clause stating, “Seller is not responsible for defects,” might be interpreted to exclude only minor or cosmetic defects rather than serious safety issues unless the clause is explicitly clear.

Courts apply *contra proferentem* cautiously, recognizing that not all ambiguities result from bad drafting or unfair power dynamics. In negotiated agreements between sophisticated parties, courts may weigh additional factors such as the parties’ relative expertise and the evidence of bargaining. However, even in these contexts, the rule serves as a baseline policy canon to guide interpretation.

By resolving ambiguities against the drafter, courts achieve multiple aims of contract law. This rule protects reliance by ensuring that reasonable expectations are not undermined by unclear language. It promotes fairness by discouraging opportunism in drafting and incentivizes autonomy by ensuring that agreements reflect mutual understanding rather than unilateral control.

3. Public Policy

Contracts are designed to govern private relationships, but their terms must align with public policy. Courts interpret ambiguous provisions in ways that uphold societal values and ensure compliance with legal norms.

A meaning that serves the public interest is generally preferred. R2d § 207.

When courts encounter ambiguity, they adopt interpretations that preserve fundamental principles of fairness, equity, and justice. For example, a non-compete clause ambiguously restricting a former employee from engaging in similar work might be interpreted narrowly to apply only within a reasonable geographic area or for a limited duration. This approach reflects public policy favoring free competition and

economic mobility by ensuring that restrictive covenants do not unduly harm the public interest.

Similarly, public policy often informs interpretations of waiver clauses. In an employment agreement, a provision waiving the employee's right to pursue legal claims might be construed narrowly to avoid infringing on statutory protections such as anti-discrimination laws. Courts favor interpretations that preserve these rights, consistent with public policy goals of preventing workplace exploitation.

While R2d § 178 and UCC § 2-302 address public policy concerns more directly in the context of unconscionability, as discussed in Chapter 12, R2d § 207 emphasizes public policy as a guiding principle for interpretation. It ensures that courts prefer meanings consistent with societal interests even when enforcing the contract itself is not at issue.

The public policy rule reflects the broader purpose of contract law: balancing private autonomy with public welfare. By favoring interpretations that align with the public interest, courts ensure that contracts are not only enforceable but also equitable and consistent with societal norms.

4. Unconscionability

The unconscionability doctrine protects parties from unfair or oppressive contract terms by allowing courts to refuse enforcement of such provisions. While it is most often used as a defense to enforcement, the concept also informs contract interpretation. Courts will interpret ambiguous terms in a way that avoids unconscionable outcomes, aligning with the broader public policy goal of promoting fairness and equity in contracting.

If a contract or term thereof is unconscionable at the time the contract is made, a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result. R2d § 208.

Comment a to § 208 elaborates on the doctrine, noting that unconscionability may arise from “weaknesses in the bargaining process” or “unfair surprise.” These procedural defects include hidden terms, lack of negotiation, or significant disparities in bargaining power. Courts use these concerns to interpret ambiguous terms narrowly and prevent one-sided outcomes. As discussed in Chapter 12, unconscionability is often divided into two categories.

Procedural unconscionability focuses on the fairness of the contract formation process, including whether one party lacked a meaningful choice or was misled about the agreement's terms. Courts rely on R2d § 208 to address such concerns, interpreting ambiguous provisions in ways that mitigate the effects of procedural defects. For example, a credit agreement presented as a non-negotiable form contract includes a clause stating, “Borrower agrees to pay all fees related to enforcement.” If the lender

drafted the agreement with no opportunity for the borrower to review or negotiate the terms, courts might interpret “all fees” narrowly to exclude unreasonable charges, such as excessive attorney’s fees. This prevents procedural defects, like lack of negotiation or notice, from resulting in an unconscionable outcome.

Substantive unconscionability addresses whether the terms themselves are overly harsh or one-sided. While R2d § 208 allows courts to refuse enforcement of clearly unconscionable terms, it also guides interpretation to avoid unfair results. For example, a lease includes a clause stating, “Tenant must pay six months’ rent as a penalty for early termination.” If the clause’s scope or intent is ambiguous, courts may interpret the term narrowly to apply only in cases of willful abandonment, limiting its application to avoid an excessively punitive result.

While courts often require both procedural and substantive unconscionability to refuse enforcement, R2d § 208 cmt. a allows either concern to guide interpretation. This ensures that ambiguous terms are construed narrowly in favor of the weaker party, even when substantive unfairness is not extreme enough to invalidate the provision outright.

Unconscionability serves as a safeguard in contract interpretation; it ensures that agreements operate within boundaries of fairness and equity. Courts address procedural defects and substantive unfairness to resolve ambiguities and prevent one party from exploiting another. This interpretive use of unconscionability reinforces public policy while preserving the enforceability of equitable agreements.

C. Reflections on Evaluation of Intrinsic Evidence

The principles of contract interpretation explored in this chapter highlight the central role of intrinsic evidence, the language of the contract itself, in resolving disputes. Semantic canons provide a systematic framework for interpreting contracts, prioritizing textual clarity, internal consistency, and the deliberate choices of the parties. These tools underscore the importance of well-drafted agreements, where precise language and careful organization can reduce ambiguity and preempt disputes.

However, as we have seen, even the most carefully drafted contracts can give rise to conflicting meanings. The canons of construction serve as the first line of defense, guiding courts to interpret terms in ways that honor the parties’ intent and harmonize the provisions within the four corners of the document. When these tools yield conflicting outcomes, doctrines like *contra proferentem* and public policy ensure that ambiguity is resolved in ways that preserve fairness and protect reasonable expectations.

Interpretation of intrinsic evidence reflects the broader themes of contract law. The emphasis on the written terms promotes efficiency by reducing reliance on external evidence and streamlining dispute resolution. Courts’ preference for coherent

and harmonious interpretations supports reliance, which allows parties to plan their affairs with confidence that their contracts will be enforced as written. Meanwhile, the application of fairness principles, such as good faith and unconscionability, ensures that even intrinsic evidence is interpreted in a way that avoids injustice and reflects the practical realities of contractual relationships.

Ultimately, the interpretation of intrinsic evidence demonstrates the dual purpose of contract law: enforcing private agreements while safeguarding equitable outcomes. The tools and principles outlined in this chapter provide courts with the means to uncover meaning within the four corners of a contract while balancing the competing goals of predictability and fairness. As contracts grow in complexity, these interpretive principles remain essential to ensuring that agreements are both effective and just.

Cases

Reading In re Motors Liquidation Co. On June 11, 2009, General Motors, which thus became known as “Old GM,” obtained chapter 11 bankruptcy protection in federal court. Chapter 11 of the United States Bankruptcy Code permits business entities (usually large corporations) to seek relief from creditors. When a corporation cannot pay all its debt and is therefore at risk of failing completely, the law provides this avenue for the debtor to work out with creditors some mutually agreeable way to pay back a significant portion of the debt.

One source of corporate debt may arise from corporate torts. When a corporation harms a person and that person successfully sues in federal court, the corporation may be required to pay damages. If the corporate harm impacts a large number of people at once, that alone could drive the corporation into a bankruptcy. In GM’s case, however, many factors came together in the automotive industry crisis of 2008–2010—including, as you will read, GM’s tort liability to a certain Beverly Deutsch for an accident that occurred in June 2007 and led to her death in August 2009.

The Bankruptcy Court functions in some ways like a moderator who takes all the creditors’ interests into account and approves any settlement among all the parties. In this case, the parties agreed that GM would cut expenses and raise cash, among other things, by discontinuing the Hummer and Saturn brands and by selling the Saab brand to Spyker Cars.

Substantially all of the core GM assets were auctioned off in a peculiar sale at which there was only one bidder: New GM. New GM was a corporation formed by the United States government (60.8%), the Canadian government (11.7%), the United and Canadian Auto Workers Union (17.5%), and unsecured bondholders of Old GM (10%) to “bail out” its General Motors. New GM

purchased Old GM according to the bankruptcy court-approved Amended and Restated Master Sale and Purchase Agreement (MSPA). This next case was driven by the interpretation of a key provision in that MSPA.

In re Motors Liquidation Co.

447 B.R. 142 (Bankr. S.D.N.Y. 2011)

ROBERT E. GERBER, United States Bankruptcy Judge

In this contested matter in the chapter 11 case of Motors Liquidation Company (formerly, General Motors Corp., and referred to here as “Old GM”) and its affiliates, General Motors LLC (“New GM”) seeks a determination from this Court that New GM did not assume the liabilities associated with a tort action in which a car accident took place before the date (“Closing Date”) upon which New GM acquired the business of Old GM, but the accident victim died thereafter.

The issue turns on the construction of the documents under which New GM agreed to assume liabilities from Old GM—which provided that New GM would assume liabilities relating to “accidents or incidents” “first occurring on or after the Closing Date”—and in that connection, whether a liability of this character is or is not one of the types of liabilities that New GM thereby agreed to assume.

Upon consideration of those documents, the Court concludes that the liability in question was not assumed by New GM. However, if a proof of claim was not previously filed against Old GM with respect to the accident in question, the Court will permit one to be filed within 30 days of the entry of the order implementing this Decision, without prejudice to rights to appeal this determination.

The Court’s Findings of Fact and Conclusions of Law in connection with this determination follow.

Findings of Fact

In June 2007, Beverly Deutsch was severely injured in an accident while she was driving a 2006 Cadillac sedan. She survived the car accident, but in August 2009, she died from the injuries that she previously had sustained.

In January 2010, the Estate of Beverly Deutsch, the Heirs of Beverly Deutsch, and Sanford Deutsch (collectively “Deutsch Estate”) filed a Third Amended Complaint against New GM (and others) in a state court lawsuit in California (the “Deutsch Estate Action”), claiming damages arising from the accident, the injuries which Beverly sustained, and her wrongful death. The current complaint superseded the original complaint in the Deutsch Estate Action, which was filed in April 2008, before the filing of Old GM’s chapter 11 case.

In July 2009, this Court entered its order (the “363 Sale Order”) approving the sale of Old GM’s assets, under section 363 of the Bankruptcy Code, to the entity now known

as New GM. The 363 Sale Order, among other things, approved an agreement that was called an Amended and Restated Master Sale and Purchase Agreement (the “MSPA”).

The MSPA detailed which liabilities would be assumed by New GM, and provided that all other liabilities would be retained by Old GM. The MSPA provided, in its § 2.3(a)(ix), that New GM would not assume any claims with respect to product liabilities (as such term was defined in the MSPA, “Product Liability Claims”) of the Debtors except those that “arise directly out of death, personal injury or other injury to Persons or damage to property caused by accidents or incidents first occurring on or after the Closing Date [July 10, 2009]” Thus, those Product Liability Claims that arose from “accidents or incidents” occurring before July 10, 2009 would not be assumed by New GM, but claims arising from “accidents or incidents” occurring on or after July 10, 2009 would be.

Language in an earlier version of the MSPA differed somewhat from its final language, as approved by the Court. Before its amendment, the MSPA provided for New GM to assume liabilities except those caused by “accidents, incidents, or other distinct and discrete occurrences.”

The 363 Sale Order provides that “[t]his Court retains exclusive jurisdiction to enforce and implement the terms and provisions of this Order” and the MSPA, including “to protect the Purchaser [New GM] against any of the Retained Liabilities or the assertion of any . . . claim . . . of any kind or nature whatsoever, against the Purchased Assets.”

Discussion

The issue here is one of contractual construction. As used in the MSPA, when defining the liabilities that New GM would assume, what do the words “accidents or incidents,” that appear before “first occurring on or after the Closing Date,” mean? It is undisputed that the accident that caused Beverly Deutsch’s death took place in June 2007, more than two years prior to the closing. But her death took place after the closing. New GM argues that Beverly Deutsch’s injuries arose from an “accident” and an “incident” that took place in 2007, and that her death did likewise. But the Deutsch Estate argues that while the “accident” took place in 2007, her death was a separate “incident”—and that the latter took place only in August 2009, after the closing of the sale to New GM had taken place.

Ultimately, while the Court respects the skill and fervor with which the point was argued, it cannot agree with the Deutsch Estate. Beverly Deutsch’s death in 2009 was the consequence of an event that took place in 2007, which undisputedly, was an accident and which also was an incident, which is a broader word, but fundamentally of a similar type. The resulting death in 2009 was not, however, an “incident[] first occurring on or after the Closing Date,” as that term was used in the MSPA.

As usual, the Court starts with textual analysis. The key provision of the MSPA, § 2.3(a)(ix), set forth the extent to which Product Liability Claims were assumed by New GM. Under that provision, New GM assumed:

(ix) all Liabilities to third parties for death, personal injury, or other injury to Persons or damage to property caused by motor vehicles designed for operation on public roadways or by the component parts of such motor vehicles and, in each case, manufactured, sold or delivered by Sellers (collectively, “Product Liabilities”), which arise directly out of death, personal injury or other injury to Persons or damage to property caused by accidents or incidents first occurring on or after the Closing Date and arising from such motor vehicles’ operation or performance (for avoidance of doubt, Purchaser shall not assume or become liable to pay, perform or discharge, any Liability arising or contended to arise by reason of exposure to materials utilized in the assembly or fabrication of motor vehicles manufactured by Sellers and delivered prior to the Closing Date, including asbestos, silicates or fluids, regardless of when such alleged exposure occurs).

The key words, of course, are “accidents” and “incidents,” neither of which are defined anywhere else in the MSPA, and whose interpretation, accordingly, must turn on their common meaning and any understandings expressed by one side to the other in the course of contractual negotiations. Also important are the words “first occurring on or after the Closing Date,” which modify the words “accidents” and “incidents,” and shed light on the former words’ meaning.

The word “accidents,” of course, is not ambiguous. “Accidents” has sufficiently clear meaning on its own, and in any event its interpretation is not subject to debate, as both sides agree that Beverly Deutsch’s death resulted from an accident that took place in 2007, at a time when, if “accidents” were the only controlling word, liability for the resulting death would not be assumed by New GM. The ambiguity, if any, is instead in the word “incidents,” which is a word that by its nature is more inclusive and less precise.

But while “incidents” may be deemed to be somewhat ambiguous, neither side asked for an evidentiary hearing to put forward parol evidence as to its meaning. Though it is undisputed that “incidents” remained in the MSPA after additional words “or other distinct and discrete occurrences,” were deleted, neither side was able, or chose, to explain, by evidence, why the latter words were dropped, and what, if any relevance the dropping of the additional words might have as to the meaning of the word “incidents” that remained. The words “or other distinct and discrete occurrences” could have been deleted as redundant, to narrow the universe of claims that were assumed, or for some other reason. Ultimately, the Court is unable to derive sufficient indication of the parties’ intent as to the significance, if any, of deleting the extra words.

So the Court is left with the task of deriving the meaning of the remaining words “accidents or incidents” from their ordinary meaning, the words that surround them, canons of construction, and the Court’s understanding when it approved the 363 Sale as to how the MSPA would deal with prepetition claims against Old GM. Ultimately these considerations, particularly in the aggregate, point in a single direction—that a

death resulting from an earlier “accident[] or incident[]” was not an “incident[] first occurring” after the closing.

Starting first with ordinary meaning, definitions of “incident” from multiple sources are quite similar. They include, as relevant here, “an occurrence of an action or situation felt as a separate unit of experience”; “an occurrence of an action or situation that is a separate unit of experience”; “[a] discrete occurrence or happening”; “something that happens, especially a single event”; “a definite and separate occurrence; an event”; or, as proffered by the Deutsch Estate, “[a] separate and definite occurrence: EVENT.”

In ways that vary only in immaterial respects, all of the definitions articulate the concept of a separate and identifiable event. And, and of course, from words that follow, “arising from such motor vehicles’ operation or performance,” the event must be understood to relate to be one that involves a motor vehicle. Accidents, explosions or fires all fit comfortably within that description. Deaths or other consequences that result from earlier accidents, explosions or fires technically might fit as well, but such a reading is much less natural and much more strained.

Turning next to words that surround the words “accidents or incidents,” these words provide an interpretive aid to the words they modify. The word “incident[]” is followed by the words “first occurring.” In addition to defining the relevant time at which the incident must take place (i.e., after the closing), that clause inserts the word “first” before “occurring.” That suggests, rather strongly, that it was envisioned that some types of incidents could take place over time or have separate sub-occurrences, or that one incident might relate to an earlier incident, with the earliest incident being the one that matters. Otherwise it would be sufficient to simply say “occurring,” without adding the word “first.” This too suggests that the consequences of an incident should not be regarded as a separate incident, or that even if they are, the incident that first occurs is the one that controls.

Canons of construction tend to cut in opposite directions, though on balance they favor New GM. The Deutsch Estate appropriately points to the canon of construction against “mere surplusage,” which requires different words of a contract or statute to be construed in a fashion that gives them separate meanings, so that no word is superfluous. The Court would not go as far as to say that the words “accident” and “incident” cannot ever cover the same thing—or, putting it another way, that they always must be different. But the Court agrees with the Deutsch Estate that they cannot always mean the same thing. “Incidents” must have been put there for a reason and should be construed to add something in at least some circumstances.

But how different the two words “accidents” and “incidents” can properly be understood to be—and in particular, whether “incidents” can be deemed to separately exist when they are a foreseeable consequence, or are the resulting injury, from the accidents or incidents that cause them—is quite a different matter. A second canon of construction, “*noscitur a sociis*,” provides that “words grouped in a list should be given related meaning.” Colloquially, “a word is known by the company it keeps.” For

instance, in *Dole* [*v. United Steelworkers of America*, 494 U.S. 26 (1990)], in interpreting a phrase of the Paper Work Reduction Act, the Supreme Court invoked *noscitur a sociis* to hold that words in a list, while meaning different things, should nevertheless be read to place limits on how broadly some of those words might be construed. The *Dole* court stated:

That a more limited reading of the phrase “reporting and recordkeeping requirements” was intended derives some further support from the words surrounding it. The traditional canon of construction, noscitur a sociis, dictates that words grouped in a list should be given related meaning.

Here application of the canon against surplusage makes clear, as the Deutsch Estate argues, that “incidents” must at least sometimes mean something different than “accidents”—but application of that canon does not tell us when and how. The second canon, *noscitur a sociis*, does that, and effectively trumps the doctrine of surplusage because it tells us that “accidents” and “incidents” should be given related meaning.

The Deutsch Estate argues that the Court should construe a death resulting from an earlier “accident” or “incident” to be a separate and new “incident” that took place at a later time. But ultimately, the Court concludes that it cannot do so. While it is easy to conclude that “accidents” and “incidents,” as used in the MSPA, will not necessarily be the same in all cases, they must still be somewhat similar. “Incidents” cannot be construed so broadly as to cover what are simply the consequences of earlier “accidents” or other “incidents.”

Applying *noscitur a sociis* in conjunction with the canon against “mere surplusage” tells us that the two words “accidents” and “incidents” must be understood as having separate meanings in at least some cases, but that these meanings should be conceptually related. At oral argument, the Court asked counsel for New GM an important question: if an “incident” would not necessarily be an “accident,” what would it be? What would it cover? Counsel for New GM came back with a crisp and very logical answer; he said that “incident” would cover a situation where a car caught fire or had blown up, or some problem had arisen by means other than a collision.

Conversely, the interpretation for which the Deutsch Estate argues—that “incidents” refers to consequences of earlier accidents or incidents—is itself violative or potentially violative, of the two interpretive canons discussed above. It is violative of *noscitur a sociis*, since a death or other particular injury is by its nature distinct from the circumstance—collision, explosion, fire, or other accident or incident—that causes the resulting injury in the first place. The Deutsch Estate interpretation also tends to run counter to the doctrine against mere surplusage upon which the Deutsch Estate otherwise relies, making meaningless the words “first occurring” which follow the words “accidents or incidents,” in any cases where death or other particular injury is the consequence of an explosion, fire, or other non-collision incident that causes the resulting injury.

The simple interpretation, and the one this Court ultimately provides, is that “incidents,” while covering more than just “accidents,” are similar; they relate to fires, explosions, or other definite events that cause injuries and result in the right to sue, as contrasted to describing the consequences of those earlier events, or that relate to the resulting damages.

Finally, this Court’s earlier understanding of the purposes of New GM’s willingness to assume certain liabilities of Old GM is consistent with the Court’s conclusion at this time as well. When the Court approved GM’s 363 Sale, this Court noted, in its opinion, that New GM had chosen to broaden its assumption of product liabilities. The MSPA was amended to provide for the assumption of liabilities not just for product liability claims for motor vehicles and parts delivered after the Closing Date (as in the original formulation), but also, for “all product liability claims arising from accidents or other discrete incidents arising from operation of GM vehicles occurring subsequent to the closing of the 363 Transaction, regardless of when the product was purchased.” As reflected in the Court’s decision at the time, the Court understood that New GM was undertaking to assume the liabilities for “accidents or other discrete incidents” that hadn’t yet taken place.

Finally, the Deutsch Estate notes another interpretative canon, that ambiguities in a contract must be read against the drafter. If the matter were closer, the Court might consider doing so. But the language in question is not that ambiguous, and the relevant considerations, fairly decisively, all tip in the same direction. While it cannot be said that the Deutsch Estate’s position is a frivolous one, the issues are not close enough to require reading the language against the drafter.

Conclusion

The Deutsch Estate’s interpretation of “accident or incident” is not supportable. Thus, the Debtor’s motion is granted, and the Deutsch Estate may not pursue this claim against New GM. New GM is to settle an order consistent with this opinion. The time to appeal from this determination will run from the time of the resulting order, and not from the date of filing of this Decision.

Reflection

This bankruptcy case might have introduced some new procedural concepts or legal terms, but the core learning relates directly to the canons of construction covered in this chapter. The case involved two parties’ disagreement about the meaning of a contract. One party said “accident or incident” meant an event like a car crash or a spontaneous explosion. The other party said that an incident included long-term consequences of an accident such as resulting death years after a car crash.

To resolve such disputes, courts must first determine whether the term in question is ambiguous such that it is susceptible to both meanings. If so, then courts must analyze which meaning prevails using the canons of construction. Where both interpretations remain plausible, courts may construe the meaning to favor the non-drafting

party as a last resort. The *Motors Liquidation* court followed these steps, illustrating how to effectively analyze and resolve a dispute regarding contractual interpretation.

Discussion

Without the benefit of the parties' arguments, how would you go about defining what is meant by "accidents and incidents"? Does it seem more intuitive that accidents and incidents are two types of unrelated things, or that incidents are the proximate result of accidents? What evidence from common speech can you give in defense of your position?

Problems

Problem 15.1. Matching the Canons of Construction to Case Applications

Below are examples from cases that applied the canons of construction. Identify which canon or canons were applied in each example.

- a. What canon(s) should be applied to determine whether a pharmaceutical drug is a "compound combination" in a patent license agreement?
- b. What canon(s) should be applied to determine whether a sales commission was owed where an agreement for sale of real estate provided that the broker would be paid a commission "upon the signing of this agreement" by both buyer and seller, but which agreement also included in the last paragraph "the commission being due and payable upon the transfer of the property"?
- c. What canon(s) should be used to interpret a contract including both a printed term saying "vessel to have turn in loading" and a handwritten term below that saying "vessel to be loaded promptly"?
- d. What canons(s) should be used to determine who bears the costs of regulations where a contract between a general contractor and a subcontractor has both a specific clause shifting the cost of complying with regulations enacted after the bid to the general contractor, and a more general clause requiring that the subcontractor's work comply with all relevant regulations?
- e. What canon(s) should be used to determine whether the term "insured" in an insurance policy includes company equipment operated by a company employee, where the term "insured" is defined as "any executive officer, director or stockholder thereof while acting within the scope of his duties"?
- f. What canon(s) should be used to determine the meaning of "flood" in an insurance contract where "flood" is defined to mean inundation from natural

water sources, not damage from a broken water main? Specifically, the contract refers to loss from “flood, surface water, waves, tidal water or tidal wave, overflow of streams or other bodies of water or spray from any of the foregoing, all whether driven by wind or not.”

- g. What canon(s) should be used to determine whether a lease prohibition is effective where the lease prohibits the lessee from subletting the property “for use as a pool parlor, beer parlor, or other business which would be undesirable and objectionable to the tenants in other parts of the building”? In particular, does this prohibition prevent the lessee from subletting for use as a restaurant?
- h. What canon(s) should be used to interpret an invoice from a contractor which contained a smaller typewritten amount and a larger handwritten number?
- i. What canon(s) should be used to determine whether a franchise contract contemplated a third site when it only specifically discussed and approved two locations?
- j. What canon(s) should be used to disambiguate an installment contract clause where one of two sensible constructions would violate usury laws?
- k. Is it appropriate to apply the canon of construction against the drafter to determine who has insurance coverage where the policy says it covers employees of companies “controlled by” the holding company that bought the insurance, where the insurance company primarily drafted the contract, and where the contract was negotiated between the parties for several months and involved teams of lawyers on both sides?
- l. What canon(s) should be used to disambiguate a guaranty agreement that contains the following phrase: “All amounts due, debts, liabilities and payment obligations described in clauses (i) and (ii), above, are referred to herein as ‘Indebtedness.’”? In particular, which canon(s) helps to determine whether “described in clauses (i) and (ii)” applies only to the “payment obligations,” and not to “amounts due, debts, liabilities”?
- m. What canon(s) of construction should be used to resolve a case where Rogers Communications of Toronto, Canada’s largest cable television provider, entered into a contract with the telephone company Aliant, for the use of Aliant’s telephone poles? The contract stated, “Subject to the termination provisions of this Agreement, this Agreement shall be effective from the date it is made and shall continue in force for a period of five (5) years from the date it is made, and thereafter for successive five (5) year terms, unless and until terminated by one year prior notice in writing by either party.” During the first five-year term of the contract, Aliant informed Rogers that it was terminating the contract one year early. Rogers argued that the termination provision did not apply to the initial five-year term of the contract.

Problem 15.2. Homeowner's Insurance?

The Hanover Commercial Umbrella Insurance Policy agreement (the Policy) provides the following coverage and exclusions:

The words we, us, and our refer to the Company providing the insurance. We will pay on behalf of the Named Insured for damages because of bodily injury, property damage, personal injury, and advertising injury. This insurance does not apply to any bodily injury, property damages, personal injury, or advertising injury arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants." "Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

Based on your analysis of the Policy and your application of the Canons of Construction, determine:

1. Whether personal injury claims arising out of ingestion of lead from flaked paint or paint dust shall be covered under the Policy, where the Named Insured owned and operated an apartment building that it rented to Plaintiff; where an official city inspector inspected the premises and established the presence of loose, peeling, flaking, or chipped paint which contained a hazardous concentration of lead; and where Plaintiff sustained lead poisoning by ingesting lead derived from paint chips, paint flakes and dust that was contaminated with lead derived from lead based paint. *See Peace v. Northwestern Nat'l Ins. Co.*, 596 N.W.2d 429 (Wis. 1999).
2. Whether property damages claims arising out of the accumulation of bat guano between a vacation home's siding and walls shall be covered under the Policy, where the Named Insured owned a vacation home rental business, discovered during an annual vacation the presence of bats and bat guano in a home, and noticed a "penetrating and offensive odor emanating from the home," and where a contractor determined that the cause of the odor was the accumulation of bat guano between the home's siding and walls and further determined that it was more practical financially to demolish and rebuild the home rather than attempt to spend the money to make it habitable again. *See Hirschhorn v. Auto-Owners Ins. Co.*, 809 N.W.2d 529 (Wis. 2011).
3. Whether personal injury claims arising out of the inadequate ventilation of exhaled carbon dioxide shall be covered under the Policy, where an inadequate air exchange ventilation system in an office building owned and operated by the Named Insured caused an excessive accumulation of carbon dioxide in their work area, and where the resultant poor air quality allegedly caused the plaintiffs to sustain the following injuries: headaches, sinus problems, eye irritation, extreme fatigue, upset stomach, asthma, sore throat, nausea, and pounding ears. *See Donaldson v. Urban Land Interests, Inc.*, 564 N.W.2d 728 (Wis. 1997).

Problem 15.3. What Is a “Cartoon”?

On November 28, 1998, the attorneys general of multiple states entered into a Tobacco Master Settlement Agreement (TMSA) with major manufacturers of cigarettes, including R.J. Reynolds Tobacco Co., as part of litigation over medical expenses from tobacco-related diseases. The TMSA prohibited such cigarette manufacturers from using cartoons in advertising.

Section II(l) of the TMSA states as follows:

- (l) “Cartoon” means any drawing or other depiction of an object, person, animal, creature or any similar caricature that satisfies any of the following criteria:
- (1) [T]he use of comically exaggerated features;
 - (2) [T]he attribution of human characteristics to animals, plants or other objects, or the similar use of anthropomorphic technique; or
 - (3) [T]he attribution of unnatural or extrahuman abilities, such as imperviousness to pain or injury, X-ray vision, tunneling at very high speeds or transformation.

While operating under the settlement agreement, Reynolds placed the advertisement shown here in the 40th Anniversary Edition of Rolling Stone magazine, which was published on November 15, 2007, promoting independent rock music and record labels in connection with its Camel cigarette brand and its Camel Farm campaign:



Figure 15.1. Camel cigarette ad. Is it a “cartoon”?

The Attorney General of Ohio sued Reynolds for violating the settlement agreement by promoting its cigarettes using cartoons. Reynolds claimed that the advertisement did not contain cartoons as that term is used in the settlement agreement.

Articulate the arguments that you think would support each side's interpretation of the contract. How would you rule if you were the judge?

See *State ex rel. Richard Cordray v. R.J. Reynolds Tobacco Co.*, 2010 WL 154720, 2010 Ohio App. LEXIS 73 (2010).

Problem 15.4. Meaning of a Comma

On January 1, 2000, Rappaport (Lessor) entered into a lease giving Interbroad, LLC (Lessee) the right to use the rooftop of a building to display a billboard. The lease ran until April 11, 2094. The lease gave Rappaport the following termination rights:

In the event that Lessor's building is damaged by fire or other casualty and Lessor elects not to restore such building, or Lessor elects to demolish the building, Lessor may terminate the Lease upon not less than 60 days' notice to Lessee upon paying Lessee ten (10) times the net operating income earned by Lessee from the Advertising Structures on the Premises for the immediately preceding twelve (12) month period.

In 2015, the building subject to the lease was purchased by BL Partners, Inc., which assumed the rights and obligations of Rappaport and so became the Lessor under the original lease. BL Partners sent Interbroad a letter stating that it had taken over the lease, had elected to demolish the building, and was terminating the lease effective 60 days from that date. The building had not been damaged by fire or any other casualty. BL Partners asked Interbroad to provide its net operating income earned by the billboard for the preceding twelve months, in order to calculate the amount owed in connection with the termination. Interbroad refused, arguing that BL Partners had no right to terminate the lease. BL Partners sought a declaratory judgment that it had the right to terminate the lease.

Articulate the arguments that you think would support each side's interpretation of the contract. How would you rule if you were the judge?

See *BL Partners Grp., L.P. v. Interbroad, LLC*, 2016 Phila. Ct. Com. Pl. LEXIS 156 (2016).

Problem 15.5. Vesting in Retirement

This problem addresses the issue of whose interpretation prevails where written agreements have internal contradictions. Before you read this problem, you may want to look up the words “vest” or “vesting” in a dictionary, as these terms may not be familiar to you. You could also consult a specialized dictionary, such as investopedia.com.

First, some background: Craig Klapp worked as an insurance agent for United Insurance Group Agency, Inc. (UIG) for seven years from 1990 to 1997, then he retired before turning the age of 65. Klapp sued UIG for breach of contract, claiming that UIG promised to pay him a pension equal to 100% of commissions on renewals of policies that he originally sold. UIG claimed that Klapp is not entitled to any post-retirement commission payments on renewals or otherwise.

When Klapp joined UIG, he signed two documents: an “Employment Agreement,” which set forth his salary, benefits, and conditions of employment specific to him; and an “Agent’s Manual,” which stated the rules and policies that apply to all UIG agents and employees.

UIG’s first argument is that Klapp is not entitled to any commission based on the express language of the Agent’s Manual, which states:

*Retirement is understood to be disengagement from the insurance industry.
Vestment for retirement is age 65 or 10 years of service, whichever is later.*

In addition, UIG wanted to admit evidence that (a) an international study of retirement benefits policies of insurance companies shows that only 20% allow partial vesting, and that over 75% of insurance company retirement plans did not fully (100%) vest until at least 10 years of continuous full-time employment.

UIG’s second argument was that Klapp was not entitled to any commission because he had not relinquished his license to sell insurance; therefore, Klapp had not “retired” as that term was defined in the Agent’s Manual.

Klapp responded to UIG’s second argument by seeking to introduce evidence that the ordinary meaning of “retired” meant not currently working or immediately planning to return to work and that he was in fact not currently working nor planning to work in the insurance industry.

Klapp argued that the judge should deprioritize the definition of vesting in the Agent’s Manual and instead use the definition provided in the Employment Agreement, Section 5 of which states:

5. Vested Commissions. Commissions shall be vested in the following manner:

(A) Death, disability, or retirement during term hereof. Upon the death, disability, or retirement (as those terms shall be then defined in the Agent’s Manual) of Agent at any time prior to the termination of this Agreement, Agent (or Agent’s designated death beneficiary who shall be designated by Agent in writing; or in the absence of such written designation, Agent’s estate) shall thereafter be entitled to receive one hundred percent (100%) of such renewal commissions then payable from premiums on Agent’s policies in place, in such amounts as would otherwise have been payable to Agent, until the aggregate renewals payable to Agent thereon shall equal less than Forty-One Dollars and Sixty-Seven Cents (\$41.67) per month. If upon the date of death, disability, or retirement, Agent shall have aggregated eight

(8) or more years of service under this Agreement, his then vesting shall be determined in accordance with the normal vesting schedule.

(B) *Vesting Schedule.* In the event of a termination of this Agreement for reasons of death, disability or retirement (as defined in the Agent's Manual), Agent as set forth below on the date of execution hereof shall be entitled to receive a percentage of renewal commissions then payable from premiums on Agent's policies in place, applicable to such amounts as would otherwise have been payable to Agent in accordance with the following vesting schedule:

AGENT'S YEARS OF SERVICE	% OF RENEWALS VESTED
LESS THAN 2 YEARS	0%
2 YEARS	10%
3 YEARS	30%
4 YEARS	50%
5 YEARS	70%
6 YEARS	90%
7 YEARS	100%
8 YEARS	110%
9 YEARS	120%
10 YEARS	130%
11 YEARS	140%
12 YEARS	150%

In addition, Klapp wanted to admit evidence that he had a conversation with the hiring manager at UIG who told Klapp that UIG has a "policy of helping out the most valuable agents" and that UIG would "take good care" of him, as evidence that he was guaranteed full retirement benefits.

- a. Characterize each piece of evidence that Klapp and UIG sought to admit as intrinsic or extrinsic, and discuss what that evidence would be admitted to show or prove.
- b. Does the parol evidence rule apply to any of the evidence in this case? Should any evidence have been excluded from the jury pursuant to the parol evidence rule?

- c. How should the court have ruled? Should UIG have been required to pay 100% commission on renewals to Klapp?
- d. How did looking up definitions for “vesting” and other financial terms affect your analysis of this case? How can you improve your ability to make legal decisions when contracts involve financial or other technical concepts?

Adapted from Klapp v. United Ins. Grp. Agency, Inc., 468 Mich. 459 (2003).

Chapter 16

Extrinsic Evidence

Contracts do not exist in isolation. Contracts operate within the context of the parties' actions, relationships, and the industries they inhabit. While the language of a contract—its intrinsic evidence—serves as the primary guide to its meaning, courts frequently turn to extrinsic evidence when ambiguity persists or when the contract's terms require additional context to be fully understood. Extrinsic evidence includes any information outside the written document that sheds light on the parties' intent, such as their prior dealings, conduct under the agreement, or the customs and practices of their trade.

This chapter examines the role of extrinsic evidence in contract interpretation, focusing on the principles that govern its admissibility and use. UCC § 1-303 provides a structured framework for incorporating extrinsic evidence, prioritizing course of performance, course of dealing, and usage of trade to resolve ambiguities and give meaning to contractual terms. The common law similarly acknowledges the value of external context, particularly when the contract language leaves room for reasonable differences in interpretation.

Extrinsic evidence serves two primary purposes. First, it can help courts to resolve disputes by clarifying contract terms that are unclear on their face or which become ambiguous in application. Second, it can supplement or qualify the written agreement by filling gaps or providing interpretive nuance that the text alone does not offer. However, courts approach extrinsic evidence with more caution than intrinsic evidence because information external to the written contract can complicate enforcement by reducing predictability and increasing the risk of subjective interpretation.

Building on the discussion of intrinsic evidence in Chapter 15, this chapter situates extrinsic evidence within the broader framework of contract interpretation. It also introduces the boundaries between extrinsic and parol evidence, which will be explored in greater depth in Chapter 17. By examining the tools and principles that govern extrinsic evidence, this chapter provides a roadmap for understanding how courts navigate the tension between the written contract and the external world in which it operates.

Rules

A. Course of Performance

Course of performance refers to the way the parties have behaved during the execution of the contract at issue. This type of extrinsic evidence provides a powerful indicator of the parties' intent, particularly when their ongoing conduct reflects how they understood and applied the terms of the agreement. Courts prioritize course of performance as the most persuasive form of extrinsic evidence because it demonstrates the parties' actual behavior under the contract, often providing more reliable insights than pre-contractual negotiations or general industry practices.

A “course of performance” is a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection. NH UCC § 1-303(a).

This definition establishes two conjunctive requirements for an evidentiary sequence of conduct: (1) the transaction must involve repeated occasions for performance, and (2) the conduct must be accepted or acquiesced to without objection. Contracts involving only a single instance of performance cannot give rise to course of performance evidence.

Imagine a customer orders a single box of groceries from Blue Apron. The contract specifies that “ingredients will be delivered fresh to the customer’s home.” Blue Apron delivers the box to a neighbor’s address due to a delivery error, and the customer retrieves it without raising objections. While this action demonstrates that the customer accepted this specific delivery, it cannot establish course of performance because there is only one occasion for performance under this one-time order.

Contrast this with a Blue Apron subscription service where groceries are delivered weekly for six months. If the subscription agreement ambiguously specifies “delivery to customer’s location,” and Blue Apron consistently delivers to the neighbor’s address without objection from the customer, this pattern of behavior could establish course of performance. The repeated nature of the deliveries (weekly) and the customer’s ongoing acceptance without objection satisfy the definition of course of performance.

Once established, course of performance serves as a powerful form of evidence in interpreting contracts. Courts use this evidence to clarify ambiguities, supplement missing terms, and resolve disputes about the meaning of contractual language. The weight given to course of performance reflects its unique ability to reveal how the parties themselves understood and carried out their agreement in practice.

Course of performance is particularly persuasive when resolving ambiguities in the written terms of a contract. For example, if a contract ambiguously states that “delivery must occur at the customer’s facility,” and the supplier consistently delivers to a nearby warehouse with the customer’s acceptance, this behavior clarifies the intended meaning of “facility.” The repeated conduct demonstrates a shared understanding of the term, which courts treat as the parties’ implicit agreement.

Consider a service contract that requires “timely maintenance of equipment” but does not define “timely.” If the service provider regularly performs maintenance within 30 days of the customer’s request, and the customer accepts this practice without objection, the court may interpret “timely maintenance” to mean a 30-day period based on the established course of performance.

Course of performance can also fill gaps in a contract where essential terms are absent. For instance, a lease agreement might specify that rent is due but omit the payment method. If the tenant consistently pays by check, and the landlord accepts these payments without objection, this course of performance supplements the agreement to specify payment by check.

Consider a long-term supply contract where the parties fail to specify whether goods will be delivered on pallets or in bulk. If the supplier consistently delivers on pallets, and the buyer accepts without objection, the court may treat pallet delivery as an implied term of the contract.

When two provisions within a contract appear to conflict, course of performance may guide courts in determining which provision reflects the parties’ true intent. For example, if a contract contains both a general delivery term and a more specific schedule, the parties’ conduct in adhering to the specific schedule without objection may resolve the conflict in favor of the detailed provision.

Courts give course of performance significant weight because it demonstrates how the parties interpreted and applied the contract in practice. Unlike course of dealing or usage of trade, course of performance reflects the parties’ actual behavior under the current agreement. This immediacy and specificity make it one of the most reliable forms of extrinsic evidence. However, its evidentiary value is limited by consistency, contradiction, and reasonableness. The course of performance must be consistent and repeated to establish a clear pattern of behavior. Course of performance cannot override express terms in the contract; it can only clarify or supplement them. And courts assess whether the course of performance is reasonable in light of the contract as a whole.

B. Course of Dealing

Course of dealing provides insight into the parties’ intent by examining how they interacted in prior transactions. It is distinct from course of performance, which focuses on behavior under the current contract. Instead, course of dealing reflects

the shared understanding that has developed over a history of agreements, offering evidence of how the parties have consistently interpreted terms in their business relationship.

A course of dealing is a sequence of previous conduct between the parties to an agreement which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct. R2d § 223(1); NH UCC § 1-303(b).

This definition establishes two key elements: (1) a sequence conduct in prior transactions that (2) provided a common basis of understanding. Course of dealing applies only to prior agreements or transactions between the same parties. It does not include interactions with third parties or hypothetical industry norms. And the prior conduct must demonstrate a shared interpretation or mutual expectation that can reasonably inform the terms of the current contract.

For example, a food supplier and a restaurant have engaged in monthly supply contracts for fresh produce. In every prior transaction, the supplier delivered goods on Monday mornings, and the restaurant paid by the end of the week. If their latest contract fails to specify a delivery schedule or payment terms, the court can look to their course of dealing to infer these terms, as the prior transactions establish a common basis of understanding.

Once established, course of dealing serves as a useful form of extrinsic evidence to clarify ambiguities, fill gaps, and resolve conflicts in the current contract. Courts rely on the parties' prior interactions to infer their intent and provide meaning to terms that might otherwise remain unclear. However, as with all extrinsic evidence, course of dealing is used to supplement or clarify the agreement, not to contradict express terms. Intrinsic evidence is weighted more heavily than extrinsic evidence.

Compared to other forms of extrinsic evidence, such as course of performance or usage of trade, course of dealing is particularly valuable for understanding how the parties themselves historically viewed their relationship. However, course of dealing is generally given less weight than course of performance because it does not reflect behavior under the current contract.

C. Usage and Trade Usage

Usage refers to habitual or customary practices that provide context for interpreting agreements.

Usage is habitual or customary practice. R2d § 219.

Usage, generally, need not be tied to any specific trade or industry. Usage provides insight into how terms are generally understood in practice, and it can clarify ambiguity or fill gaps in a contract. For example, it is common business practice to treat

contracts signed on a holiday as effective on the next business day. If a dispute arises over a contract signed on New Year's Day, a court may apply this usage to determine the agreement's effective date. This usage applies regardless of whether both parties are in the same trade or industry.

Usage of trade, in contrast, refers to practices specific to a particular trade, vocation, or industry.

A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law. NH UCC § 1-303(c).

R2d uses the term similarly:

A usage of trade is a usage having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement. It may include a system of rules regularly observed even though particular rules are changed from time to time. R2d § 222(1).

For instance, in the lumber industry, a "two-by-four" is universally understood to mean a board measuring 1.5 by 3.5 inches, and this trade usage would govern a contract referring to that term. This is true regardless of whether the contract is for goods (e.g., sale of a dozen two-by-fours) or for services (e.g., construction of a shed using two-by-fours).

Usage of trade, once established, provides valuable extrinsic evidence for interpreting ambiguous terms or filling gaps in a contract. Unlike dictionary usage, which relies on plain or technical definitions intrinsic to the agreement, trade usage reflects external norms specific to an industry. However, both usage and trade usage must be proven as a matter of fact unless they are so widely recognized that courts can take judicial notice of them. Judicial notice allows courts to accept well-known or codified practices without requiring formal proof. For example, the universally recognized meaning of "case" as twelve bottles in the wine industry may be judicially noticed. By contrast, a regional agricultural market practice of treating "a dozen" as thirteen items would require evidence, such as testimony from trade participants or reference to historical agreements.

Usage of trade is most frequently used to clarify ambiguous terms. For instance, in the construction industry, the term "final completion" is widely understood to include site cleanup, even if the contract does not explicitly state this requirement. Courts would interpret the term consistent with this trade usage, provided it aligns with the contract's overall purpose and does not conflict with its express terms. Similarly, if a

contract for the sale of commodities refers to “market price” without specifying how the price will be determined, trade usage in the relevant industry may establish the appropriate pricing source, such as a particular index or publication.

Trade usage can also supplement contracts by implying terms that are so commonly observed in the trade that the parties are presumed to have included them implicitly. For example, in a contract for custom furniture manufacturing, it is standard trade practice for delivery to include assembly at the customer’s site. If the agreement is silent on this point, courts may infer the obligation based on trade usage in order to ensure that the contract reflects the reasonable expectations of the parties.

Contract law limits the application of trade usage to ensure it does not undermine the written terms of the contract. Trade usage cannot contradict express terms, and courts must ensure that its application aligns with the intent of the agreement. Additionally, the party asserting trade usage bears the burden of proving its existence and scope. This requires evidence of regularity and consistency, such as testimony from industry experts, trade publications, or established customs documented in prior agreements.

By incorporating usage and trade usage into contract interpretation, courts bridge the gap between written agreements and the practical realities of the industries in which they operate. These tools allow contracts to reflect shared norms and expectations, thus promoting efficiency, fairness, and reliance in commercial relationships. At the same time, judicial safeguards ensure that trade usage is applied responsibly, preserving the integrity of the contract’s written terms.

D. Implied Terms

Contracts often omit essential provisions, leaving gaps that courts must fill to ensure they function as intended. Parties can introduce evidence that implied terms address these gaps, either by drawing on the parties’ conduct and industry practices (implied-in-fact terms) or by applying universal legal principles (implied-in-law terms). The distinction lies in the sources that courts use: implied-in-fact terms depend on extrinsic evidence, while implied-in-law terms reflect judicially imposed norms.

Implied-in-fact terms arise from the circumstances surrounding the contract, including the conduct of the parties, their prior dealings, or the practices of the relevant industry. In *Pacific Grape Products Co. v. Commissioner*,¹ the dispute involved a sale of bulk grape concentrate under an industry-standard contract that was silent about when title to the goods transferred. The buyer had agreed to the sale, the seller billed the goods, and the buyer paid for them, but the goods remained undelivered at the time of the seller’s bankruptcy. The Ninth Circuit examined industry practices

1. 219 F.2d 862 (9th Cir. 1955).

and testimony showing that in the grape concentrate trade, title typically passed to the buyer at the time of billing. This evidence established an implied term that title transferred at billing, consistent with the intent of the parties and the expectations of the industry.

In *Fisher v. Congregation B’Nai Yitzhok*, a synagogue hired a part-time rabbi to lead religious services during the Jewish holiday season. Their written agreement was silent on seating arrangements, but the synagogue had historically followed Orthodox tradition, including separate seating for men and women. After the contract was signed, the rabbi (who was Orthodox) learned the synagogue planned to introduce mixed seating and refused to officiate. The synagogue refused to pay him. The court examined extrinsic evidence—such as the synagogue’s religious character, past practice, and prior statements—and found that both parties had implicitly understood the agreement to preserve traditional seating. Because this shared understanding existed at the time of contracting, the court enforced an implied-in-fact term requiring separate seating. The case illustrates that implied terms may arise not from what is written, but from what both parties assumed to be true when they made the deal.

Implied-in-law terms, by contrast, do not depend on the parties’ intent but are imposed by courts to ensure fairness and enforceability. In *Southern Bell Telephone & Telegraph Co. v. Florida East Coast Railway Co.*,² the dispute concerned a contract allowing telephone lines to cross over railroad tracks. The agreement did not specify a duration, and the railroad later sought to terminate it. The court held that contracts without a stated duration are terminable at will upon reasonable notice, unless evidence suggests otherwise. This implied-in-law term ensured that the contract would not result in perpetual obligations while preserving fairness by requiring reasonable notice.

The evidentiary requirements for these implied terms differ. Implied-in-fact terms require proof, such as testimony, trade norms, or prior dealings. In *Pacific Grape*, testimony about trade practices provided the factual basis for inferring the title transfer term. In *Fisher*, the synagogue’s historical seating arrangements served as evidence of the parties’ intent. By contrast, implied-in-law terms like the reasonable termination rule in *Southern Bell* apply universally and do not require extrinsic evidence, as they are rooted in legal principles rather than party-specific behavior.

Implied terms allow courts to address omissions in contracts while balancing the autonomy of the parties with principles of fairness and practicality. Implied-in-fact terms ensure that agreements reflect the intent of the parties as demonstrated by extrinsic evidence, while implied-in-law terms uphold broader legal norms to make contracts complete and enforceable. These tools collectively preserve the functionality of agreements in diverse contexts.

2. 399 F.2d 854 (5th Cir. 1968).

E. Reflections on Evaluating Extrinsic Evidence

The evaluation of extrinsic evidence underscores the dynamic relationship between the written terms of a contract and the broader context in which it operates. While intrinsic evidence serves as the primary guide, extrinsic evidence allows courts to bridge gaps, clarify ambiguities, and bring agreements into alignment with the parties' lived realities. This interplay reflects the law's adaptability and its commitment to balancing textual integrity with practical functionality.

Extrinsic evidence can both promote and complicate efficiency in contract enforcement. On the one hand, it helps to clarify ambiguous terms and resolve disputes in a way that reflects established practices, such as course of performance and trade usage. These tools allow courts to align the agreement with the practical expectations of the parties, particularly in complex or long-standing relationships. On the other hand, reliance on extrinsic evidence can introduce procedural inefficiencies, as courts may need to weigh competing narratives, interpret extensive external data, or navigate disagreements about which evidence should control. This duality highlights the importance of careful drafting to reduce unnecessary reliance on external context and previews the challenges courts face when determining whether extrinsic evidence is admissible under the parol evidence rule.

Beyond efficiency, extrinsic evidence supports the principle of reliance. Contracts do not arise in a vacuum; they are built on expectations shaped by prior dealings, shared practices, and the customs of the trade. By incorporating these elements into interpretation, courts reinforce the stability of agreements and protect the reasonable expectations of the parties. The extent to which these external contexts are permitted to supplement or vary written terms, however, is a central question that the parol evidence rule seeks to address.

Fairness also lies at the heart of extrinsic evidence. Courts use it to address omissions, prevent opportunistic behavior, and incorporate implied terms that reflect equitable outcomes. Doing so ensures that contracts are not static documents, but instead functioning as dynamic instruments that can adapt to the realities of performance. Yet the use of extrinsic evidence must also be balanced against the need for certainty in written agreements, a tension that the parol evidence rule is designed to resolve by delineating the boundaries of admissibility.

Extrinsic evidence highlights both the complexity and flexibility of contract law. It reveals the limits of relying exclusively on written terms while also demonstrating how interpretive tools ensure that agreements are enforceable and equitable. By integrating external context into interpretation, courts ensure that contracts fulfill their intended purposes, harmonizing the letter of the agreement with the practicalities of real-world application. The next chapter explores how the parol evidence rule serves as a gatekeeper for extrinsic evidence by distinguishing between permissible supplementation and impermissible contradiction of the written contract.

Hierarchy of Contractual Meaning

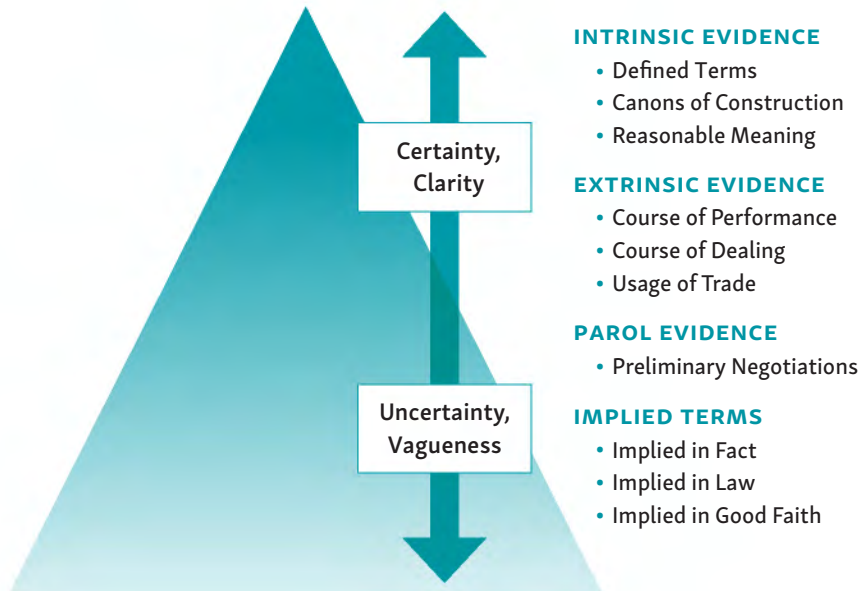


Figure 16.1. Illustration of the hierarchy of evidence used to determine contractual meaning. Credit: Seth C. Oranburg.

Cases

Reading *Wood v. Lucy, Lady Duff-Gordon*. Before you begin to read this case, note that it can be hard to read if you do not understand the procedural posture, which is admittedly a bit confusing. In this case, the plaintiff, Otis F. Wood, has sued the defendant, Lady Duff-Gordon, on the grounds of breach of contract. Duff-Gordon defends by arguing that there was no contract at all. Her argument is that the promises were illusory, and therefore, there was no consideration. As you learned in the module on contract formation, without consideration, there can be no contract-at-law; therefore, Duff-Gordon argues, since there was no contract, there can be no breach of contract.

Cardozo finds Duff-Gordon liable for breach of contract; therefore, he must have found that some contract existed. Although he could have found there was an enforceable agreement without consideration due to promissory estoppel or some other equitable approach to contract formation, he does not make that argument. Instead, he finds that there is a contract as a matter of law, and therefore, he must have found there was some consideration.

Recall that consideration is a bargained-for exchange, or, as Cardozo puts it, some mutuality of agreement. To find consideration, Cardozo must find that

Duff-Gordon and Wood made mutual promises to each other. This requires Cardozo to imply a key term that created this mutual obligation. As you read this case, pay careful attention to how Cardozo finds that the parties created a mutual obligation by virtue of the implied term of good faith.

Wood v. Lucy, Lady Duff-Gordon

222 N.Y. 88 (1917)

CARDOZO, J.

The defendant styles herself “a creator of fashions.” Her favor helps a sale. Manufacturers of dresses, millinery and like articles are glad to pay for a certificate of her approval. The things which she designs, fabrics, parasols and what not, have a new value in the public mind when issued in her name.

She employed the plaintiff to help her to turn this vogue into money. He was to have the exclusive right, subject always to her approval, to place her indorsements on the designs of others. He was also to have the exclusive right to place her own designs on sale, or to license others to market them. In return, she was to have one-half of “all profits and revenues” derived from any contracts he might make. The exclusive right was to last at least one year from April 1, 1915, and thereafter from year to year unless terminated by notice of ninety days. The plaintiff says that he kept the contract on his part, and that the defendant broke it. She placed her indorsement on fabrics, dresses and millinery without his knowledge, and withheld the profits.

He sues her for the damages, and the case comes here on demurrer.

The agreement of employment is signed by both parties. It has a wealth of recitals. The defendant insists, however, that it lacks the elements of a contract. She says that the plaintiff does not bind himself to anything. It is true that he does not promise in so many words that he will use reasonable efforts to place the defendant’s indorsements and market her designs.

We think, however, that such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view to-day. A promise may be lacking, and yet the whole writing may be “instinct with an obligation,” imperfectly expressed. If that is so, there is a contract.

The implication of a promise here finds support in many circumstances. The defendant gave an exclusive privilege. She was to have no right for at least a year to place her own indorsements or market her own designs except through the agency of the plaintiff. The acceptance of the exclusive agency was an assumption of its duties. We are not to suppose that one party was to be placed at the mercy of the other.

Many other terms of the agreement point the same way. We are told at the outset by way of recital that “the said Otis F. Wood possesses a business organization

adapted to the placing of such indorsements as the said Lucy, Lady Duff-Gordon has approved.”

The implication is that the plaintiff’s business organization will be used for the purpose for which it is adapted. But the terms of the defendant’s compensation are even more significant. Her sole compensation for the grant of an exclusive agency is to be one-half of all the profits resulting from the plaintiff’s efforts. Unless he gave his efforts, she could never get anything. Without an implied promise, the transaction cannot have such business “efficacy as both parties must have intended that at all events it should have.”

But the contract does not stop there. The plaintiff goes on to promise that he will account monthly for all moneys received by him, and that he will take out all such patents and copyrights and trademarks as may in his judgment be necessary to protect the rights and articles affected by the agreement.

It is true, of course, as the Appellate Division has said, that if he was under no duty to try to market designs or to place certificates of indorsement, his promise to account for profits or take out copyrights would be valueless. But in determining the intention of the parties, the promise has a value. It helps to enforce the conclusion that the plaintiff had some duties. His promise to pay the defendant one-half of the profits and revenues resulting from the exclusive agency and to render accounts monthly, was a promise to use reasonable efforts to bring profits and revenues into existence. For this conclusion, the authorities are ample.

The judgment of the Appellate Division should be reversed, and the order of the Special Term affirmed, with costs in the Appellate Division and in this court.

Reflection

Cardozo’s famous opinion effectively establishes the doctrine of good faith. Cardozo used this doctrine to create an enforceable obligation on the part of Lady Duff-Gordon when her promise to grant exclusivity to Wood would otherwise be unenforceable for his lack of consideration. But not every jurist would so willingly imply terms of good faith and thereby create a contract from them. For example, in *Goldstick v. ICM Realty*, 788 F.2d 456 (7th Cir. 1986), Judge Posner ignored any obligation of good faith (the term never even appears in his opinion) and instead declares a promise enforceable due to estoppel but not due to contract.

The dispute in *Goldstick* regarded a pair of out-of-luck attorneys who could not collect on a bill for a year’s worth of legal services; as a cautionary tale in professional responsibility, it is worth reading in full. As to the contract points, the facts can be summarized. ICM owned some property on which back taxes were owed. ICM leased the property to John Kusmiersky, who agreed to pay the back taxes in exchange for the rights to operate the property. Kusmiersky hired the law firm of Goldstick & Smith to reduce the back taxes. The lawyers succeeded in reducing the taxes by \$870,000 and billed Kusmiersky \$290,000, which he refused to pay. The

lawyers then entered into a settlement agreement with Kusmiersky and ICM under which ICM agreed to pay the lawyers \$250,000 out of any profits ICM made if the property were sold.

ICM sold the property at a loss and refused to pay the lawyers, who sued in the Northern District of Illinois. Defendants moved for summary judgment, and the trial court granted judgment as a matter of law to ICM, on the grounds that ICM did not promise to pay Goldstick & Smith unless it sold the property for a profit, and it did not sell the property for a profit, so ICM had no legal liability to Goldstick & Smith.

The Seventh Circuit reversed and remanded the case because Goldstick & Smith may have detrimentally relied on ICM. Although the appellate court could have read some duty of good faith and fair dealing into ICM's promise to Goldstick & Smith, such as an implied promise to make reasonable efforts to sell the property at a profit, the court did not even seem to entertain this idea. Rather, it employed the well-established doctrine of detrimental reliance.

The *Goldstick* case shows that Cardozo's imposition of good faith is not strictly necessary to do justice. Instead of finding a contract where the parties may not have actually promised to perform some bargained-for exchange, a judge could have found that Lady Duff-Gordon's promise to grant exclusive rights to Wood was enforceable because Wood reasonably and detrimentally relied on that promise. See R2d §90.

The fact that Posner and Cardozo take such different approaches to this central issue in contract law indicates there is a deep tension between implying terms in good faith and respecting the express intent of the parties. In *Wood*, Cardozo seems quite willing to imply terms in this contract. He seems to be focused on achieving a fair result for the parties in the case before him; after all, that is the hallmark of his equity-focused approach to judicial decision-making.

Discussion

1. Equitable remedies are supposed to prevent courts and legal arrangements, like contracts, from becoming tools of injustice. However, allowing judicial discretion for equity creates a great deal of uncertainty. Thus, equity creates an unfairness of its own, as parties to a contract cannot easily predict how a court will re-interpret a written agreement in hindsight. In other words, judicial power to correct things in hindsight obscures parties' ability to negotiate contracts with foresight. What is the appropriate balance? How much discretion should courts have to award equitable remedies "as justice requires"?
2. If courts are free to add, change, and modify terms, what use is the parol evidence rule? Whence comes the objective theory of contract interpretation? How can lawyers help businesses plan for an uncertain legal future?

3. Is there another way to resolve *Wood* in favor of the plaintiff without implying a duty of good faith as a contractual term? For example, could the doctrine of promissory estoppel (detrimental reliance) be employed to reach the same result of liability upon Lady-Duff Gordon without implying legal terms that the parties did not actually use?

Reading Fisher v. Congregation B’Nai Yitzhok. *Congregation B’Nai Yitzhok* is such a classic illustration of the concept of terms implied in fact that it is actually featured as an illustration in the R2d itself:

Illustration 221.2. A, an ordained rabbi, is employed by B, an Orthodox Jewish congregation, to officiate as cantor at specified religious services. At the time the contract is made, it is the practice of such congregations to seat men and women separately at services, and a contrary practice would violate A’s religious beliefs. At a time when it is too late for A to obtain substitute employment, B adopts a contrary practice. A refuses to officiate. The practice is part of the contract, and A is entitled to the agreed compensation.

The illustration, however, oversimplifies the complex factual analysis the court took on in this case. As you read this case, highlight the facts that are relevant to the court’s decision and annotate each highlight you make with a comment on why that fact is relevant. This exercise will elevate your understanding of when courts will imply terms in fact.

You should also pay attention to the court’s explanation for why the parol evidence rule does not apply.

Fisher v. Congregation B’Nai Yitzhok

177 Pa. Super. 359 (1955)

HIRT, J.

Plaintiff is an ordained rabbi of the orthodox Hebrew faith. He however does not officiate except on occasion as a professional rabbi-cantor in the liturgical service of a synagogue. The defendant is an incorporated Hebrew congregation with a synagogue in Philadelphia.

Plaintiff, in response to defendant’s advertisement in a Yiddish newspaper, appeared in Philadelphia for an audition before a committee representing the congregation. As a result, a written contract was entered into on June 26, 1950, under the terms of which plaintiff agreed to officiate as cantor at the synagogue of the defendant

congregation “for the High Holiday Season of 1950”, at six specified services during the month of September 1950. As full compensation for the above services the defendant agreed to pay plaintiff the sum of \$1,200.

The purpose upon which the defendant congregation was incorporated is thus stated in its charter: “The worship of Almighty God according to the faith, discipline, forms and rites of the orthodox Jewish religion.” And up to the time of the execution of the contract the defendant congregation conducted its religious services in accordance with the practices of the orthodox Hebrew faith.

On behalf of the plaintiff there is evidence that under the law of the Torah and other binding authority of the Jewish law, men and women may not sit together at services in the synagogue. In the orthodox synagogue, where the practice is observed, the women sit apart from the men in a gallery, or they are separated from the men by means of a partition [a “mechitza”] between the two groups.

The contract in this case is entirely silent as to the character of the defendant as an orthodox Hebrew congregation and the practices observed by it as to the seating at the services in the synagogue.

At a general meeting of the congregation on July 12, 1950, on the eve of moving into a new synagogue, the practice of separate seating by the defendant formerly observed was modified and for the future the first four rows of seats during religious services were set aside exclusively for the men, and the next four rows for the women, and the remainder for mixed seating of both men and women.

When plaintiff was informed of the action of the defendant congregation in deviating from the traditional practice as to separate seating, he through his attorney notified the defendant that he, a rabbi of the orthodox faith, would be unable to officiate as cantor because “this would be a violation of his beliefs.” Plaintiff persisted in the stand taken that he would not under any circumstances serve as cantor for defendant as long as men and women were not seated separately. And when defendant failed to rescind its action permitting men and women to sit together during services, plaintiff refused to officiate. It then was too late for him to secure other employment as cantor during the 1950 Holiday season except for one service which paid him \$100, and he brought suit for the balance of the contract price.

The action was tried before the late Judge Fenerty, without a jury, who died before deciding the issue. By agreement the case was disposed of by the late President Judge Frank Smith “on the notes of testimony taken before Judge Fenerty.” At the conclusion of the trial, counsel had stipulated that the judge need not make specific findings of fact in his decision. This waiver applied to the disposition of the case by Judge Smith.

Nevertheless Judge Smith did specifically find that defendant, at the time the contract was entered into, “Was conducting its services according to the Orthodox Hebrew Faith.” Judge Smith accepted the testimony of three rabbis learned in Hebrew law, who appeared for plaintiff, to the effect: “That Orthodox Judaism required a definite and physical separation of the sexes in the synagogue.” And he also considered it

established by the testimony that an orthodox rabbi-cantor “could not conscientiously officiate in a ‘trefah’ synagogue, that is, one that violates Jewish law”; and it was specifically found that the old building which the congregation left, “had separation in accordance with Jewish orthodoxy.”

The ultimate finding was for the plaintiff in the sum of \$1,100 plus interest. And the court entered judgment for the plaintiff on the finding.

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

The finding for the plaintiff in this trial without a jury has the force and effect of a verdict of a jury and in support of the judgment entered by the lower court, the plaintiff is entitled to the benefit of the most favorable inferences from the evidence. Findings of fact by a trial judge, sitting without a jury, which are supported by competent substantial evidence are conclusive on appeal.

Although the contract is silent as to the nature of the defendant congregation, there is no ambiguity in the writing on that score and certainly nothing was omitted from its terms by fraud, accident or mistake. The terms of the contract therefore could not be varied under the parol evidence rule. Another principle controls the interpretation of this contract.

There is sufficient competent evidence in support of the finding that this defendant was an orthodox congregation, which observed the rule of the ancient Hebrew law as to separate seating during the services of the High Holiday Season; and also to the effect that the rule had been observed immemorially and invariably by the defendant in these services, without exception.

As bearing on plaintiff’s bona fide belief that such was the fact, at the time he contracted with the defendant, plaintiff was permitted to introduce in evidence the declarations of Rabbi Ebert, the rabbi of the defendant congregation, made to him prior to signing of the contract, in which the rabbi said: “There always was a separation between men and women” and “there is going to be strict separation between men and women,” referring to the seating in the new synagogue.

Rabbi Lipschitz, who was present, testified that Rabbi Ebert, in response to plaintiff’s question “Will services be conducted as in the old Congregation?” replied “Sure. There is no question about that,” referring to the prior practice of separate seating.

The relationship of rabbi to the congregation which he serves does not create the legal relationship of principal and agent. And Rabbi Ebert in the absence of special authority to speak for the congregation could not legally bind the defendant by his declarations to the plaintiff prior to the execution of the contract. But while the declarations of Rabbi Ebert, above referred to would have been inadmissible hearsay as proof of the truth of what was said, yet his declarations were properly admissible as bearing upon plaintiff’s state of mind and his intent in entering into the contract.

In determining the right of recovery in this case the question is to be determined under the rules of our civil law, and the ancient provision of the Hebrew law relating

to separate seating is read into the contract only because implicit in the writing as to the basis—according to the evidence—upon which the parties dealt.

In our law the provision became a part of the written contract under a principle analogous to the rule applicable to the construction of contracts in the light of custom or immemorial and invariable usage. It has been said that: “When a custom or usage is once established, in absence of express provision to the contrary it is considered a part of a contract and binding on the parties though not mentioned therein, the presumption being that they knew of and contracted with reference to it.”

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

Judgment affirmed.

Reflection

The *Congregation B’Nai Yitzhok* appeal was decided in 1955, and the trial court below it had rendered its opinion in 1950. To really understand what was happening in this case, consider some parol evidence (i.e., context) about what was happening in the Jewish-American world at the time.

Congregation B’Nai Yitzhok appears to be a snapshot of great change in social history. In this case, we see an Orthodox rabbi cleaving to tradition while congregations in the Philadelphia suburbs modernized their practices. Perhaps the congregation’s members were more inclined toward egalitarianism than its clergy were. In any event, when the Congregation B’Nai Yitzhok adopted the practice of mixed seating for its High Holiday services in September 1950, that was a major event that is best understood through the lens of its historical context.

Throughout the nineteenth century, American Judaism featured two prominent movements. The Orthodox movement, discussed in *Congregation B’Nai Yitzhok*, above, generally held that the Torah (also known as the five books of Moses, the Pentateuch, or the first five books of the Bible) contains the true and original words of God, and that the “revealed laws” therein and described by accepted oral tradition were binding and immutable. In this tradition, each year takes mankind further away from the revelation of the Torah at Mount Sinai, which the movement places at 1313 B.C.E. Under this theology, change is antithetical to core beliefs. Therefore, ancient practices, including dietary laws, separation of the sexes, Hebrew language prayer, and resting on the Jewish Sabbath, must be maintained.

The Reform movement, with foundations related to the German Enlightenment, generally held that theology is a continuous revelation. Many Reform Jews believe

that man, not God, wrote the Bible, so critical research can lead to new insights such that each generation can build upon the past to get closer and closer to a true understanding of God. Under this movement, change is necessary for the religion to remain relevant in a modern world. Therefore, changes to ancient practices are necessary so that Jews can eat in restaurants, achieve equality of the sexes, pray in English, and work and drive on Saturdays.

The differences between these schools of thought are quite vast, and the rift between the members of these movements was vastly widened by an event called the Trefa Banquet. (Recall from the *Congregation B’Nai Yitzhok* case above that “trefa” (or “trefah,” as it appears in the case) means ritually unclean or impure under Orthodox Jewish law.) On July 11, 1883, at the Highland House Restaurant in Cincinnati, Ohio, a Reform seminary held a dinner to commemorate the graduation of its first class of rabbis. Whether by the organizers’ intentions or negligence, the banquet featured many foods that are considered trefa under Orthodox Jewish law. This caused great offense among the Orthodox community and may have sparked the creation of a third, middle way in Jewish theology.

Members of the Reform movement who were offended by the brash disregard for the revealed laws broke away to form a new movement that would become Conservative Judaism. The Jewish Theological Seminary (JTS) was founded in 1886 to advance this middle way. Conservative Jewish theology, as expressed by JTS, seeks to combine commitment to traditional beliefs and practices with full engagement with modern society.

The pressure to modernize Judaism while cleaving to its traditions may have been amplified by the events of World War II (1939–1945) and the Holocaust, in which six million European Jews were murdered by Nazis. This event had a profound impact on the American Jewish conscience. For some, it drove them toward assimilation into American society. For others, it demanded a return to traditional practices. For all, it was a time of great upheaval and change.

Discussion

1. Given this history, do you think the court was correct in determining that separate seating was an implied term in Rabbi Fisher’s contract? Was the court correct in only seeking the opinion of Orthodox rabbis? Should the court have also taken testimony from Conservative or Reform rabbis on what Jewish law requires?
 2. If this case were to occur today—when 35% of American Jews identify as Reform, 18% identify as Conservative, and 10% identify as Orthodox—should the court arrive at a different result? Should a court generally be willing to hear evidence about the historical and social context of contract formation?
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Reading Nānākuli Paving & Rock Co. v. Shell Oil Co. *Nānākuli* is a difficult case to read for the same reason that so many contracts cases are difficult: because the subject matter of these cases are commercial transactions that are foreign to most law students. The parties—and the opinions resolving their disputes—tend to use specific and technical terms that have special meaning for those in the field.

While this may be frustrating, it is also necessary. To many judges, contract interpretation is the art and science of determining what the parties actually intended when they entered into an agreement. Courts use the language of the parties and their trade to understand what intentions they had when they formed their agreement. To do this requires judges, attorneys, and law students to understand language and terminology that is sometimes unfamiliar to them.

The key term in this case is “price protection.” This means that the seller will not raise the price for some period of time. Generally, price protection benefits a buyer. This concept is not as strange as it might seem. Some credit cards offer price protection, which means that if the price of an item drops within some period of time (usually 90 days) after a purchase, the buyer can get the lower price.



Figure 16.2. Roads are often paved with refined bitumen, which is derived from crude oil. Thus, the cost of paving roads varies with the price of oil, and the short-term volatility of oil prices presents challenges for pricing contracts for long-term construction projects such as paving roads.

Photo credit Seth C. Oranburg.

Does the nature of the parties matter when interpreting a contract? Should it? Consider the commercial context in *Nānākuli*. *Nānākuli* is one of two local road-paving companies on the island of Honolulu. It buys asphalt from Shell Oil, one of the largest corporations on earth. *Nānākuli* argues that it is entitled to price protection for its asphalt purchases—not because of any power imbalance, but because Shell had honored such protections in past dealings. Specifically, *Nānākuli* claims that the price should be based on Shell's posted rate at the time the buyer committed to a paving project, not the higher rate Shell charged at delivery. It contends that this understanding reflects the parties' course of performance and local industry practice.

The contract, however, says otherwise. The seller, Shell—a corporation that is now worth over \$200 billion—argues that the court should interpret its agreement with *Nānākuli* according to the plain meaning of their agreement. The parties' written contract clearly states in the writing that the contract price shall be "Shell's Posted Price at time of delivery." This is not ambiguous. Posted price means the price that Shell is charging on that day. The posted price can change, either up or down.

Nānākuli attempts to enter two types of evidence in support of its claim: trade usage and course of performance. As you read this case, pay attention to the arguments each party uses to argue for or against the admission of this evidence. Those are the same kinds of arguments that law students and lawyers might make. Also, consider why the court accepted *Nānākuli*'s argument in the end. Why did this court ignore the plain meaning of the contract? How might this reasoning impact whether courts are likely to accept extrinsic evidence that changes the meaning of written terms?

Nānākuli Paving & Rock Co. v. Shell Oil Co.

664 F.2d 772 (9th Cir. 1981)

HOFFAN, J.

Appellant [Plaintiff] *Nānākuli Paving and Rock Company* (*Nānākuli*) initially filed this breach of contract action against appellee [Defendant] *Shell Oil Company* (*Shell*) in Hawaiian State Court in February, 1976.

Nānākuli, 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 *Nānākuli* on its first claim, which is that *Shell* breached the 1969 contract in January, 1974, by failing to price protect *Nānākuli* on 7200 tons of asphalt at the time *Shell* raised the price for asphalt from \$44 to \$76.

Nānākuli'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 [of asphalt] Nānākuli had already committed [to use in performance of government paving contracts] because Nānākuli 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 notwithstanding the verdict of the jury, 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 Nānākuli in 1974. We do not believe the evidence in this case was such that, giving Nānākuli the benefit of all inferences fairly supported by the evidence and without weighing the credibility of the witnesses, only one reasonable conclusion could have been reached by the jury.

Nānākuli offers two theories for why Shell's failure to offer price protection in 1974 was a breach of the 1969 contract. First, it 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, Nānākuli continues, even though the written contract provided for price to be "Shell's Posted Price at time of delivery," free on board (F.O.B.) Honolulu [meaning that buyer accepts and takes legal responsibility for the asphalt when it arrives at port in 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 Nānākuli on the island of Oahu, whereby the expansion of Shell on the island was intimately connected to the business growth of Nānākuli. 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. Nānākuli 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 Nānākuli's to "chew up" tonnage already committed at Shell's old price.

Nānākuli's second theory for price protection is that Shell was obliged to price protect Nānākuli, even if price protection was not incorporated into their contract, because price protection was the commercially reasonable standard for fair dealing in the asphaltic paving trade in Hawaii in 1974. Observance of those standards is part of the good-faith requirement that the Code imposes on merchants in performing a

sales contract. Shell was obliged to price protect Nānākuli in order to act in good faith, Nānākuli argues, because such a practice was universal in that trade in that locality.

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.

Shell's second complaint is that the two prior occasions on which it price protected Nānākuli, 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 Nānākuli'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 Nānākuli'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 tremendous losses on price increases if all their material suppliers did not routinely offer them price protection; and
- Shell's determination to build Nānākuli 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 Nānākuli.

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 Nānākuli were not ambiguous and therefore indicated Shell's understanding of the terms of the agreement with Nānākuli 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 Nānākuli’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 Nānākuli.

I. History of Nānākuli-Shell Relations Before 1973

[This section may be summarized as follows: Nānākuli and Shell had been working together closely since the early 1960s. In fact, Nānākuli painted its trucks “Shell white” and placed the Shell logo on its trucks and its stationery to symbolize the closeness of their relationship. In 1969, the parties signed a long-term (seven-year) supply agreement. That agreement is the subject of this case.]

II. Trade Usage Before and After 1969

[This section may be summarized as follows: In 1969 in Oahu, Hawaii, the majority of paving contracts were between a few paving companies like Nānākuli on the one hand and government agencies on the other. None of the agencies allowed escalation clauses—which would increase the amount paid to paving companies if the price of input materials like asphalt goes up. Without price protection, paving companies could find themselves paying more for asphalt than they would receive under the government contracts for paving. Therefore, price protection was an economic necessity and a nearly universal practice.]

III. Shell’s Course of Performance of the 1969 Contract

[This section may be summarized as follows: Nānākuli made several orders of asphalt from Shell under their 1969 contract. The original price was \$35 per ton of asphalt. From the inception of that agreement until the events that gave rise to this lawsuit, Shell raised its price of asphalt only two times: in 1970 and 1971, Shell raised its price to \$40 and \$44. Both times, Nānākuli complained about the price increase, and after negotiations with Shell’s Hawaiian Representative, Bohner, Shell price protected Nānākuli by holding its price constant for several months after announcing a price increase. Shell argued that this evidenced its good faith under the contract, but Nānākuli argued this evidenced that Nānākuli reasonably relied on Shell’s price protection.]

[Shell sent its customers, including Nānākuli, a] November 25, 1970, letter setting out “Shell’s New Pricing Policy” at its Honolulu and Hilo terminals. The letter explained the elimination of price protection: “In other words, we will no longer

guarantee asphalt prices for the duration of any particular construction projects or for the specific lengths of time. We will, of course, honor any existing prices which have been committed for specific projects for which we have firm contractual commitments.” The letter requested a supply contract be signed with Shell within fifteen days of the receipt of an award by a customer.

[Nānākuli’s Vice President] Smith’s reading of this was that Nānākuli’s supply contract with Shell was a firm contractual commitment by Shell and that no further contract was needed. “We felt that this letter was unapplicable (sic) to our supply contract, that we already had a contractual commitment with Shell Oil Company which was not to end before 1975.” [Nānākuli did not comply with the letter.]

IV. Shell-Nānākuli Relations, 1973-74

Two important factors form the backdrop for the 1974 failure by Shell to price protect Nānākuli: the Arab oil embargo and a complete change of command and policy in Shell’s asphalt management. . . .

[Shell’s Hawaiian Representative] Bohner testified to a big organizational change at Shell in 1973 when asphalt sales were moved from the construction sales to the commercial sales department. In addition, by 1973 the top echelon of Shell’s asphalt sales had retired. Lewis and Blee, who had negotiated the 1969 contract with Nānākuli, were both gone. Their duties were taken over by three men: Fuller in San Mateo, California, District Manager for Shell Sales, Lawson, and Chippendale, who was Shell’s regional asphalt manager in Houston. When the philosophy toward asphalt pricing changed, apparently no one was left who was knowledgeable about the peculiarities of the Hawaiian market or about Shell’s long-time relations with Nānākuli or its 1969 agreement, beyond the printed contract.

[On December 31, 1973, Shell informed Nānākuli of a price increase to \$76 per ton of asphalt.] On January 4, 1974, [Nānākuli’s Vice President] Smith called [Shell’s Hawaiian representative] Bohner, as he had done before at times of price increases, to ask for price protection, this time on 7200 tons. Bohner told Smith that he would have to get in touch with the mainland, but he expected that the response would be negative. . . . Smith wrote several letters in January and February asking for price protection. After getting no satisfaction, he finally flew to California to meet with Lawson, Fuller, and Chippendale. Chippendale, from the Houston office, was acknowledged by the other two to be the only person with authority to grant price protection. All three Shell officials lacked any understanding of Nānākuli and Shell’s long, unique relationship or of the asphaltic trade in Oahu. They had never even seen Shell’s contracts with Nānākuli before the meeting. When apprised of the three and their seven-year duration, Fuller remarked on the unusual nature of Nānākuli’s relations with Shell, at least within his district. Chippendale felt it was probably unique for Shell anywhere. Smith testified that Fuller admitted to knowing nothing, beyond the printed page of Nānākuli’s agreement with Shell, of the background negotiation or Shell’s past pricing policies toward Nānākuli. . . . Fuller testified that Shell would not act without written proof of Shell’s past price protection of Nānākuli.

We conclude that the decision to deny Nānākuli price protection was made by new Houston management without a full understanding of Shell's 1969 agreement with Nānākuli or any knowledge of its past pricing practices toward Nānākuli. If Shell did commit itself in 1969 to price protect Nānākuli, the Shell officials who made the decisions affecting Nānākuli in 1974 knew nothing about that commitment. Nor did they make any effective effort to find out. They acted instead solely in reliance on the 1969 contract's express price term, devoid of the commercial context that the Code says is necessary to an understanding of the meaning of the written word. Whatever the legal enforceability of Nānākuli's right, Nānākuli officials seem to have acted in good faith reliance on its right, as they understood it, to price protection and rightfully felt betrayed by Shell's failure to act with any understanding of its past practices toward Nānākuli.

V. Scope of Trade Usage

The validity of the jury verdict in this case depends on four legal questions. First, how broad was the trade to whose usages Shell was bound under its 1969 agreement with Nānākuli: did it extend to the Hawaiian asphaltic paving trade or was it limited merely to the purchase and sale of asphalt, which would only include evidence of practices by Shell and Chevron? Second, were the two instances of price protection of Nānākuli by Shell in 1970 and 1971 waivers of the 1969 contract as a matter of law or was the jury entitled to find that they constituted a course of performance of the contract? Third, could the jury have construed an express contract term of Shell's posted price at delivery as reasonably consistent with a trade usage and Shell's course of performance of the 1969 contract of price protection, which consisted of charging the old price at times of price increases, either for a period of time or for specific tonnage committed at a fixed price in non-escalating contracts? Fourth, could the jury have found that good faith obliged Shell to at least give advance notice of a \$32 increase in 1974, that is, could they have found that the commercially reasonable standards of fair dealing in the trade in Hawaii in 1974 were to give some form of price protection?

We approach the first issue in this case mindful that an underlying purpose of the U.C.C. as enacted in Hawaii is to allow for liberal interpretation of commercial usages. The Code provides, "This chapter shall be liberally construed and applied to promote its underlying purposes and policies."

No U.C.C. cases have been found on this point, but the court's reading of the Code language is similar to that of two of the best-known commentators on the U.C.C.:

Under pre-Code law, a trade usage was not operative against a party who was not a member of the trade unless he actually knew of it or the other party could reasonably believe he knew of it.

White and Summers add:

This view has been carried forward by 1-205(3) . . . [U]sage of the trade is only binding on members of the trade involved or persons who know or

should know about it. Persons who should be aware of the trade usage doubtless include those who regularly deal with members of the relevant trade, and also members of a second trade that commonly deals with members of a relevant trade (for example, farmers should know something of seed selling).

Using that analogy, even if Shell did not “regularly deal” with aggregate supplies, it did deal constantly and almost exclusively on Oahu with one asphalt paver. It therefore should have been aware of the usage of Nānākuli and other asphaltic pavers to bid at fixed prices and therefore receive price protection from their materials suppliers due to the refusal by government agencies to accept escalation clauses. . . .

The Comment explains:

The ancient English tests for “custom” are abandoned in this connection. Therefore, it is not required that a usage of trade be “ancient or immemorial,” “universal” or the like. . . . [F]ull recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree.

The Comment’s demand that “not universality but only the described ‘regularity of observance’” is required reinforces the provision only giving “effect to usages of which the parties ‘are or should be aware.’” A “regularly observed” practice of protection, of which Shell “should have been aware,” was enough to constitute a usage that Nānākuli had reason to believe was incorporated into the agreement.

Nānākuli went beyond proof of a regular observance. It proved and offered to prove that price protection was probably a universal practice by suppliers to the asphaltic paving trade in 1969. It had been practiced by H.C. & D. since at least 1962, by P.C. & A. since well before 1960, and by Chevron routinely for years, with the last specific instance before the contract being March, 1969, as shown by documentary evidence. . . .

VI. Waiver of Course of Performance

. . . Shell protested that the jury could not have found that those two instances of price protection [in 1970 and 1971] amounted to a course of performance of its 1969 contract, relying on two Code comments. First, one instance does not constitute a course of performance. “A single occasion of conduct does not fall within the language of this section. . . .”

Although the Comment rules out one instance, it does not further delineate how many acts are needed to form a course of performance. The prior occasions here were only two, but they constituted the only occasions before 1974 that would call for such conduct. In addition, the language used by a top asphalt official of Shell in connection with the first price protection of Nānākuli indicated that Shell felt that Nānākuli was entitled to some form of price protection. . . .

Shell’s second defense is that the Comment expresses a preference for an interpretation of waiver. . . . The preference for waiver only applies, however, where acts are

ambiguous. . . . The jury's interpretation of those acts as a course of performance was bolstered by evidence offered by Shell that it again price protected Nānākuli on the only two occasions of post-1974 price increases, in 1977 and 1978.

VII. Express Terms as Reasonably Consistent with Usage in Course of Performance

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 [UCC §§ 1-205 and 2-208]." 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.

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." 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." Much of the evidence of prior dealings between Shell and Nānākuli 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." 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."

Of these three, then, the most important evidence of the agreement of the parties is their actual performance of the contract. 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." "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 [Section 2-208] make it clear that a sequence of conduct after or under the agreement may have equivalent meaning." 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.'" "Under this section a course of performance is always relevant to determine the meaning of the agreement."

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.

[Extensive analysis of case law omitted.]

"Astonishing as it will seem to most practicing attorneys, under the Code it will be possible in some cases to use custom to contradict the written agreement. . . . Therefore usage may be used to 'qualify' the agreement, which presumably means to 'cut down' express terms although not to negate them entirely."

Here, the 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 Nānākuli and Shell and that price protection was reasonably consistent with the express term of seller's posted price at delivery.

VIII. Good Faith in Setting Price

... The Code provides, “A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.” ...

Nānākuli presented evidence that Chevron, in raising its price to \$76, gave at least six weeks’ advance notice, in accord with the long-time usage of the asphaltic paving trade. Shell, on the other hand, gave absolutely no notice, from which the jury could have concluded that Shell’s manner of carrying out the price increase of 1974 did not conform to commercially reasonable standards.

In both the timing of the announcement and its refusal to protect work already bid at the old price, Shell could be found to have breached the obligation of good faith imposed by the Code on all merchants. “Every contract or duty within this chapter imposes an obligation of good faith in its performance or enforcement,” *id.* § 490:1-203, which for merchants entails the observance of commercially reasonable standards of fair dealing in the trade. The Comment to 1-203 reads:

This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act. . . . It is further implemented by Section 1-205 on course of dealing and usage of trade.

Chevron’s conduct in 1974 offered enough relevant evidence of commercially reasonable standards of fair dealing in the asphalt trade in Hawaii in 1974 for the jury to find that Shell’s failure to give sufficient advance notice and price protect Nānākuli after the imposition of the new price did not conform to good faith dealings in Hawaii at that time.

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

REVERSED AND REMANDED WITH DIRECTIONS TO ENTER FINAL JUDGMENT.

Reflection

University of Virginia School of Law professors Charles J. Goetz and Robert E. Scott reflect extensively on *Nānākuli* in their seminal law review article on the interaction between express and implied contract terms. The article notes:

At first glance, Nānākuli seems to be a perfectly correct application of the rules of interpretation. . . . The court applied a presumption of consistency to the extrinsic evidence submitted by the buyer, holding that the express price term supplemented, rather than trumped, the price protection usage. The presumption was not overcome by the inclusion of a standard merger clause, which

the court characterized as boilerplate rather than as an invoked term of art. The Limits of Expanded Choice: An Analysis of the Interactions between Express and Implied Contract Terms, 73 Calif. L. Rev. 261, 318 n.154 (1985).

But the court's strict prioritization of extrinsic evidence over express terms is actually an oversimplification of how contracts should be interpreted:

Further reflection, however, reveals an underlying conceptual problem. The court in Nānākuli framed the interpretive issue as a choice between supplementary expressions and trumps. This requires a binary resolution: either the express price term trumps the context or the price protection usage fully applies.

Professors Goetz and Scott argue that this binary does not reflect how parties actually think and behave, especially with regard to long-term contracts. Remember that Nānākuli and Shell had a longstanding close relationship.

In such relationships, it is equally plausible to assume that the apparent conflict between the express price term and the custom of price-protection could not have been "solved" by the parties when they crafted their agreement.

In other words, shouldn't the Nānākuli court have recognized that parties don't really have an understanding at the time of contracting about all circumstances that will occur in the future? Aren't these long-term relational contracts more about a framework under which to work things out, and less about a set of rules courts will apply to every future circumstance?

This hypothesis [that the parties had no mutual assent regarding price protection] is supported by evidence that the price-protection issue first arose in 1970, seven years after the supply contract was negotiated and following major changes in Shell's management. If the formulations in Nānākuli were indeterminate rather than apparently inconsistent, then neither the outcome endorsed by the court nor the result urged by Shell would represent the optimal interpretive solution. Instead, an equitable adjustment of price would have been more consistent with the contractual instructions of the parties.

In addition to this theoretical contribution, Goetz and Scott succinctly summarize the material facts and holdings of the case. It might be useful for law students to compare the professors' approach to this case with their own notes of key facts and holdings:

Nānākuli, a paving contractor, negotiated a long-term contract with Shell in which Shell agreed to supply and Nānākuli agreed to purchase all its asphalt requirements. After extensive negotiations and drafting, a written contract was signed providing that the contract price for asphalt ordered and supplied was to be determined by Shell's "posted price at the time of delivery." The written contract contained a standard merger clause. Some ten years after the original agreement was concluded, Shell increased the price on a delivery of

7,200 tons of asphalt from the \$44 per ton price prevailing at the time of the order to [\$76] per ton, its posted price at the time of delivery. Subsequently, Nānākuli sought \$220,800 in damages for breach of the contract, alleging that the paving trade in Hawaii followed a practice of “price protection” by extending the old price for a period of time after a new one became effective. . . .

Nānākuli claimed that Shell had protected it from price increases in two previous instances. In response, Shell argued that if the relevant market were narrowed to the supply of asphalt alone, the usage was not clearly established. Shell further claimed that the two instances of price protection were isolated waivers, not a course of performance. Finally, it said that in any event the extrinsic evidence was clearly inconsistent with the express price term in the contract and thus the price term was controlling under U.C.C. § 1-205(4).

In reinstating the jury’s verdict for Nānākuli, the Ninth Circuit held that the jury could properly have found a relevant usage and course of performance, and that this extrinsic evidence was not inconsistent with the express price term in the written contract.

The above summary of the facts and holding of *Nānākuli* may therefore be a useful guide to law students on how to accurately and briefly summarize such a complex case.

Discussion

1. Is there tension between the goals of effectuating the parties’ intentions and enforcing the plain meaning of written terms, or are these both means to the same ends?
2. Do you think the *Nānākuli* court correctly interpreted the contract to include price protection? Why or why not?
3. In *Nānākuli*, Shell may have gone above and beyond its contractual obligations by giving price protection to Nānākuli two times in the past. If going above and beyond in the past obligates a party to continue acting in that manner going forward, how might that impact contractual parties’ willingness to do favors for each other?

Reading First National Bank of Lawrence v. Methodist Home for the Aged. The *Congregation B’Nai Yitzhok* case above illustrates how courts can use factual evidence, such as parties’ testimonies, to determine whether terms should be implied in fact. But what if the parties are not available?

In *First National Bank of Lawrence v. Methodist Home for the Aged*, 181 Kan. 100 (1957), the plaintiff is the administrator of a decedent's estate. In other words, one of the parties to the contract is dead. Since dead people cannot give testimony—and at least one court, *Baiul v. William Morris Agency, LLC*, 2014 U.S. Dist. LEXIS 14977, ruled that “evidence of deceased's wishes via Ouija board is not admissible in federal court”—courts will have to look to other sources of evidence to determine whether implied terms existed.

Methodist Home concerns an agreement for lifetime tenancy in a retirement home. This lifetime membership was subject to a probationary period, during which either side could cancel the agreement. The written contract did not discuss what would happen if the tenant died during the probationary period. When such a death occurred, the estate sought to cancel the agreement and receive a refund of the lifetime tenancy fee. The court then had to determine whether such a term should be implied in this contract—but it could not call upon the decedent to determine her actual intentions at the time of contracting.

Before reading the case, consider why the parties may have omitted this term. Do you think the omission was deliberate or negligent on the part of the retirement home, which drafted the written contract? Why didn't Ms. Ellsworth insist that the contract stipulate what would happen if she died during the probationary period? Would the court really be able to determine if the parties actually discussed this term? Even if they discussed it, would the parol evidence rule bar admission of that discussion?

The court states that the written contract in question is ambiguous, but it does not explain its reasoning. Do you think the contract is ambiguous? How does this finding of ambiguity impact the application of the parol evidence rule?

You may also note that this court helpfully outlines the rules of interpreting an ambiguous contract. It phrases these rules a bit differently from the R2d—which is not surprising, given that the R2d was not yet published—but effectively goes through a similar process to the one you already learned. In fact, this court does a rather thorough job of reviewing the rules of contract interpretation in general. Highlight where the court discusses these rules. Annotate your highlights with a reference to the corresponding section in the R2d and note any discrepancies you notice between how the R2d and this court frame the rules.

Noting that the retirement home drafted the contract, do you think that the policy canon of construction against the drafter, R2d § 206, plays a role in the court's analysis? Should it?

**First National Bank of Lawrence v. Methodist
Home for the Aged**

181 Kan. 100 (1957)

PARKER, Chief Justice.

Plaintiff is a banking corporation with its place of business at Lawrence, Kansas, and the duly appointed administrator, with the will annexed, of the will of Bertha C. Ellsworth, deceased. Defendant is the Methodist Home For the Aged, a corporation, with its principal place of business at Topeka, Kansas, where it operates a home for the aged.

The events leading up to the institution of this litigation are not in controversy and should be stated at the outset in order to insure a proper understanding of the appellate issues involved.

On September 13, 1953, Bertha C. Ellsworth, who desired to be admitted to the defendant's home and was then single and more than seventy-one years of age, made a written application for admission to such home. Thereafter, having been advised her application had been approved, she was admitted to the home on May 10, 1954, and on the same date entered into the written agreement with defendant which is actually the subject of this litigation. Pertinent portions of such agreement, which we pause to note had been prepared by defendant on one of its standard forms, used for admission of members, read:

This Agreement, made and entered into this 10th day of May, 1954, by and between The Methodist Home for the Aged, a Corporation, of Topeka, Kansas, Party of the First Part and Bertha C. Ellsworth, of Lawrence, Kansas, Party of the Second Part, Witnesseth:

Party of the Second Part having this day given Party of the First Part, without reservation, the sum of \$10,779.60 to be used and disposed of in the furtherance of its benevolence and charitable work as it may deem best, Party of the First Part admits Party of the Second Part into its Home as a member thereof during the period of her natural life, and agrees to furnish: . . .

Fifth: It is clearly understood that Party of the Second Part has been received in accordance with the new regulations on a probation period of two months in which time she has the opportunity of finding out whether she desires to remain in the Home; and also find out whether the Home is able to satisfy the requirements. If it should be found advisable to discontinue her stay in the Home, then her gift, with the exception of \$80.00 per month shall be refunded.

The rules and regulations and bylaws of the Home as they now are and as they from time to time may be adopted and promulgated by the Board of Directors of said Party of the First Part are hereby referred to and made a part hereof and the Party of the Second Part hereby agrees to be bound by same. It is especially understood and agreed that in case of serious mental illness

requiring hospital care and attention, that the First Party shall have the right to make proper arrangements for the treatment and care of the Second Party in a lawful manner in a proper State Institution, provided that if Second Party is discharged as completely cured to admit Second Party into the Home without further financial requirements. (Emphasis supplied.)

The parties concede that defendant's bylaw, article 12, was in full force and effect on the date of the execution of the agreement and therefore, according to the terms of that agreement, is a part of the contract. It reads:

Probationary membership means a short trial period while the member becomes adjusted to the life of the Home. The probationary membership shall not continue for a longer period than two consecutive months. If for any reason the trial member does not desire to remain in the Home he or she shall have the privilege of leaving. On the other hand, if the Home for any reason does not desire to continue the membership then the member shall be notified in writing and leave the Home within a week after such notice is given. Only members who do not have the money or securities to pay for their life Membership shall be granted the privilege of paying by the month. (Emphasis supplied.)

After execution of the May 10, 1954, agreement Bertha C. Ellsworth remained in the home until she died on June 10, 1954. At that time neither she nor the home had made an election as to whether she was to leave the home or remain therein after the expiration of the probationary period specified by its terms. However, it is conceded that during the interim, and on June 4, 1954, the plaintiff bank in its capacity as trustee had paid the defendant the sum of \$10,799.60 by a check, which defendant had cashed, specifying that such check was "In Payment of Life Membership for Bertha C. Ellsworth in the Methodist Home for the Aged, as specified in Agreement dated May 10, 1954", and that defendant had acknowledged payment of that sum by a receipt of like import.

Upon the death of Bertha Ellsworth plaintiff was appointed by the probate court of Douglas County, Kansas, as Administrator CTA of such decedent. Thereafter it made written demand on defendant for performance under the agreement, including pertinent by-laws, and demanded that defendant refund the estate of its decedent the amount paid pursuant thereto, less any amounts due the Home under its terms, particularly the fifth clause thereof. When this demand was refused plaintiff procured authority from the probate court to institute the instant action to recover such amount as an asset of the estate of Bertha C. Ellsworth, deceased.

Following action as above indicated plaintiff commenced this lawsuit by filing a petition which, it may be stated, recites in a general way that under the more important facts, conditions and circumstances, heretofore outlined, the defendant had never attained a life membership in the home by reason of her death prior to the expiration of the probationary membership period prescribed by the contract, hence

the contract should be construed as contemplating her estate was entitled to a return of the money paid by her to defendant for such a membership.

When a demurrer to this pleading, based on the ground it failed to state a cause of action, was overruled by the trial court defendant filed an answer alleging in substance that under the same facts, conditions and circumstances the contract between it and the decedent is to be construed as warranting its retention of the sum paid by such decedent for the life membership even though, prior to her death, such decedent neither indicated that she did not desire to remain in the Home nor that she desired the privilege of leaving it.

It should perhaps be added that such answer contains an allegation that on May 10, 1954, decedent was permitted to enter the home without having paid her life membership; admits subsequent payment of such membership in the manner heretofore indicated; and makes decedent's application for admission to the home a part of such pleading.

With issues joined, as heretofore related, the cause came on for trial by the court.

During the trial facts, as heretofore related, were established by evidence and at the conclusion thereof the trial court, after holding that the salient question in the case was purely a question of law involving the interpretation of the contract, rendered judgment decreeing that plaintiff was entitled to recover the amount paid by Bertha C. Ellsworth to the Home, less \$235 paid by the Home for her funeral expenses and less the sum of \$80 provided for in the contract in the event she had elected not to remain in the Home.

Thereupon defendant perfected this appeal wherein under proper specification of errors it charges the trial court erred in overruling the demurrer to the petition; in rendering judgment for plaintiff and against defendant, wholly contrary to the law and the terms of the agreement; and in overruling its motion for a new trial.

In a preliminary way it can be said a careful examination of the record leads to the inescapable conclusion the trial court was eminently correct in holding that the all decisive question involved in this case is purely a question of law involving the interpretation of the contract entered into between the appellant and Bertha C. Ellsworth, deceased. Indeed the parties make no serious contention to the contrary.

For that reason, and others to be presently disclosed, we turn directly to appellant's claim the trial court's judgment was contrary to the terms of the agreement and to the law, mindful as we do so that where—as here—the terms of a contract are ambiguous, obscure or susceptible of more than one meaning there are certain well defined rules to which courts must adhere in construing its provisions. Four of such rules, which we believe have special application here, can be stated as follows:

1. *That doubtful language in a contract is construed most strongly against the party preparing the instrument or employing the words concerning which doubt arises.*

2. That where a contract is susceptible of more than one construction its terms and provisions must, if possible, be construed in such manner as to give effect to the intention of the parties at the time of its execution.

3. That in determining intention of the parties where ambiguity exists in a contract the test is not what the party preparing the instrument intended its doubtful or ambiguous words to mean but what a reasonable person, in the position of the other party to the agreement, would have understood them to mean under the existing conditions and circumstances.

4. That the intent and purpose of a contract is not to be determined by considering one isolated sentence or provision thereof but by considering and construing the instrument in its entirety.

Stated, substantially in its own language, the principal contention advanced by appellant as grounds for reversal of the judgment is that the membership agreement between it and the involved decedent was fully executed inasmuch as decedent had been admitted to the Home as a life member on May 10, 1954, and thereafter caused her life membership to be paid; hence, since nothing further needed to be done by the parties to make the portion of the agreement relating to life membership binding, provisions of the contract with respect thereto had become fully executed and title to the fee paid for such membership had vested in appellant.

If we could limit our construction of the contract to its first two paragraphs, as heretofore quoted, we might well conclude that appellant's views respecting the status of the agreement and the gift therein mentioned could be upheld. However, as has been previously demonstrated, our obligation is not to consider isolated provisions of the contract but to consider and construe such instrument in its entirety. When succeeding paragraphs of the agreement, and the incorporated by-laws, particularly portions thereof which we have heretofore italicized for purposes of emphasis, are reviewed in the light of the rule to which we have just referred, as well as others heretofore mentioned, we have little difficulty in concurring in the views expressed by the trial court in rendering its judgment that the contract had never become executed and that title to the gift paid by the decedent for a life membership had not vested in the Home.

In fact, and without repeating the emphasized portions of the agreement on which we base our conclusion, we go further and hold that, under the clear import and meaning of such emphasized provisions, Bertha C. Ellsworth, because of her untimely death during the probationary and/or trial period expressly required by their terms, never attained a life membership status in the Home. Indeed to hold otherwise would not only do violence to the language of the contract but read into it something that is not there.

One question remains in this lawsuit. Who, the Home or the decedent's estate, is entitled to the life membership fee paid by decedent to appellant? In this connection it is interesting to note that the money was paid by decedent by a check and receipted for by appellant in writing, each of which instruments contain a recital "In

Payment of Life Membership for Bertha C. Ellsworth in the Methodist Home for the Aged, as specified in Agreement dated May 10, 1954.” So, since it cannot be denied the contract contains no express provisions relating to where the money was to go if Bertha Ellsworth died during the probationary and/or trial period prescribed by its terms, it appears we are faced with the obligation of determining what was intended by the parties at the time of the execution of the agreement in the event of such a contingency.

Strange as it may seem, the question thus presented has been before the Courts on but few occasions. However, it has been decided under similar circumstances. An interesting discussion on the subject appears in 10 A.L.R.2d., Annotation, pp. 874, 875, § 12. It reads:

Many entrance contracts provide for a probationary period during which the applicant for admission to the charitable home as well as the home itself can dissolve the agreement without cause. In case the applicant is refused permanent admission at the end of the trial period or withdraws during the period of his own volition, all payments made, less a fixed weekly charge for the time he stayed at the home, are refunded to him and his property rights are restored.

An interesting situation arises if the applicant dies during the probationary period without having been either accepted or rejected as a permanent inmate. The legal question then is whether or not the charitable home may retain the applicant's property on the ground that the agreement had not been dissolved by either party.

In a majority of cases this question has been answered in the negative and it has been held that the home may not claim or retain the applicant's property, on the ground that the death of the applicant has made it impossible to determine whether he would have become a permanent inmate at the end of the probationary period.

In connection with the foregoing quotation the author cites [sources] as supporting the conclusion reached by him in the concluding paragraph of his discussion and one case only as holding to the contrary. We may add our somewhat extended research of the books, including our own reports, discloses no other cases which can be regarded as decisive of the question presented under similar facts, conditions and circumstances.

Again reviewing the contract in the light of the heretofore stated rules, and mindful that appellant, not the decedent, prepared the involved contract, we are impelled to the view that a reasonable person, in the position of the decedent at the time of the execution of the contract, would have understood the provisions of that instrument to mean that unless and until she attained the status of a life member in the appellant's home she, or her estate would be entitled to a return of the money paid by her for that right, less amounts specified in the agreement.

Moreover we are convinced, that having prepared the contract, appellant's failure to make express provision therein for retaining the money paid by Bertha C. Ellsworth as a life membership fee, in the event of her death during the period of her probationary and/or trial membership status, precludes any construction of that agreement which would warrant its retention of such money upon the happening of that contingency.

After careful consideration of the decisions last above cited we have concluded those having the effect of holding, under similar circumstances, that the appellant cannot claim or retain Bertha Ellsworth's lifetime payment for the reason her death made it impossible for her to determine whether she was to become a permanent inmate of the Home at the end of the probation period, are more sound in principle and better reasoned than the one case holding to the contrary.

Therefore, based on the conclusions heretofore announced and on what is said and held in such decisions, we hold that the trial court did not err in rendering the judgment from which the Home has appealed.

Lest we be charged with overlooking it, we pause here to note, we regard *Old Peoples Home, etc. v. Miltner*, relied on by each of the parties in support of respective claims regarding the propriety of the judgment, as clearly distinguishable and hence of no value as a precedent controlling issues involved in the case at bar.

Contentions advanced by appellant in connection with the overruling of its demurrer to appellee's evidence and the overruling of its motion for a new trial are the same as those heretofore considered, discussed and determined. For that reason further discussion of the propriety of such rulings is neither necessary nor required.

The judgment is affirmed.

Reflection

In *Methodist Home*, the court is unable to call upon the decedent to ascertain her intentions for the obvious reason that she is dead. So, the court takes the next best approach and tries to determine what a reasonable person in the place of the decedent would have intended.

To determine the intention of a reasonable person, the court looks to case law. Fortunately for the disposition of this case, the exact matter had been litigated several times before. The court then, effectively, tallies up the number of analogous cases that found for the estate of the decedent versus the number of analogous cases that found for the old-age home, and it rules in favor of the decedent seemingly based on the sheer number of cases.

Fairness considerations will come to the forefront in the next section, where we consider terms implied from the duty of good faith and fair dealing.

Discussion

1. Are you comfortable with the court's approach in *Methodist Home*? Does its empirical approach approximate what a "reasonable" old-age home and its resident would intend? If the actual intention of the parties is the polestar of contract interpretation, has the court reasonably approximated that with its reasonable person approach?
 2. Consider your answer to the previous question in light of the reflections on *Congregation B'Nai Yitzhok*. If Rabbi Fisher were unavailable for testimony, could the court have determined his reasonable intentions by looking at other contracts for rabbinical services?
 3. One issue with looking at precedent is that, by its very nature, it looks backward, at what has been done in the past. At times of great social, technological, industrial, or political change, does looking at precedent to determine the intentions of a reasonable person still come close enough to the actual intentions of the parties to be a valid means of determining whether to add terms to an agreement?
 4. Another issue to consider is fairness. Do you think the court arrived at the correct result by refunding the decedent's money to the estate?
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-

Problems

Problem 16.1. Output of Toasted Bread

Plaintiff Henry S. Levy & Sons, Inc., popularly known as Levy's, is a bakery, located first at Moore Street and Graham Avenue in Brooklyn, New York, and later on Park Avenue and 115 Thames Street, New York, NY. Levy's was famous for its cheesy bread and its rye bread, which was the subject of an offbeat advertisement campaign.

Defendant Crushed Toast Co. manufactures breadcrumbs. Interestingly, the term "breadcrumbs" does not refer to crumbs that may flake off bread. Rather, breadcrumbs are a manufactured item that starts with stale or imperfectly appearing loaves, followed by removal of labels, processing through two grinders, the second of which effects a finer granulation, insertion into a drum in an oven for toasting and, finally, bagging of the finished product.

Levy's agreed to purchase "all breadcrumbs produced by Crushed Toast Co." Over the next several years, Crushed Toast Co. sold over 250 tons of breadcrumbs to Levy's.

But on May 15, 1969, the main oven at Crushed Toast Co. suddenly imploded, and the company thereafter stopped production of breadcrumbs.



Figure 16.3. Levy's "You don't have to be Jewish" campaign was considered zany yet effective.

Levy's brought suit, alleging that Crushed Toast Co. had a duty in good faith to repair its oven and to continue producing breadcrumbs for Levy's.

Crushed Toast Co. defended, alleging that the contract did not require it to manufacture breadcrumbs but merely to sell those it did. Since none were produced after the demise of the oven, there was no duty to deliver, and, consequently, from then on, no liability on its part.

Analyze both claims and discuss whether either party should prevail upon a court and, if so, what remedies that court should award the prevailing party.

See Feld v. Levy and Sons, 37 N.Y.2d 466 (1975).

Problem 16.2. Requirements for Corrugated Paper Boxes

Plaintiff Fort Wayne Corrugated Paper Co. (Fort Wayne Paper) is a paper manufacturer that sells corrugated paper boxes.

Defendant Anchor Hocking Glass Corp. (Anchor Glass) is a glass manufacturer that purchases and uses corrugated paper boxes to package and ship its glassware.

Defendant Anchor Glass, as buyer, entered into a written contract with Plaintiff Fort Wayne Paper, as seller, in which it was agreed that the buyer would buy not less than 90% of its entire needs of corrugated paper and solid fiber products from Fort Wayne Paper as seller.

The buyer's needs were estimated to be 500 carloads of boxes per year.

The seller agreed to reserve production space for the manufacture of the buyer's requirements and not to make contracts for more than 50% of its production capacity. The contract was to continue for five years and thereafter until written notice of

annulment was given by either party. During the first two years following the making of this contract, the amount purchased by the buyer increased from year to year.

In the third year, the contract was amended to change the proportion of requirements which Anchor Glass agreed to buy from Fort Wayne Paper to not less than 75% of its needs. These needs were re-estimated to be approximately 800 carloads a year.

The parties did business under this arrangement satisfactorily up to the latter part of the fourth year. During the last few months of that year, there was a sudden recession of business so that the demand for glass containers fell off sharply, and from the combination of this and labor trouble at the Anchor Glass plant, there was a marked reduction in the business done there at the close of that year. It is found as a fact that the president and general manager concluded that Anchor Glass could not hope for any substantial increase of business within a reasonably brief period of time.

In the fourth year, it was directed by resolution that operations at the plant should be suspended indefinitely. This direction was put into effect immediately. Anchor Glass promptly notified Fort Wayne Paper of its intention not to purchase any corrugated paper boxes in the fifth year of the contract.

The plaintiff, Fort Wayne Paper, brings the case upon its argument to the effect that Anchor Glass, as buyer of the plaintiff's product, was required as a matter of good faith under the contract to continue purchasing a similar amount of corrugated paper boxes in the fifth year as it had in the first four years. Defendant Anchor Glass contends that it is under no liability; that the contract was a requirements contract; and, having ceased having any requirements for plaintiff's paper boxes, they were under no obligation to take and pay for any of them.

Analyze both claims and discuss whether either party should prevail upon a court, and if so, what remedies that court should award the prevailing party.

See Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp., 130 F.2d 471 (3d Cir. 1942).

Chapter 17

The Parol Evidence Rule

The parol evidence rule (PER) governs whether evidence of prior discussions, agreements, or promises can be used to interpret or add to a written contract. At its core, the PER is straightforward: once parties enter into a final written agreement intended to reflect their contract's terms, called an **integration**, the rule excludes evidence of prior or contemporaneous agreements that fall outside the written document. This excluded evidence, known as **parol evidence**, is considered **extrinsic** to the finalized terms. By enforcing this rule, courts ensure that the written contract serves as the definitive expression of the parties' intentions.

The PER serves important policy goals in contract law. Written contracts reduce misunderstandings by providing a shared, objective record of the parties' agreement. By prioritizing the written terms and excluding extrinsic evidence, the PER creates clarity and certainty in contractual relationships that protects the parties from later disputes over unrecorded or ambiguous terms. Furthermore, because it takes parol evidence away from the jury or fact-finder, the rule safeguards the integrity of written agreements against speculative or unreliable claims that could undermine the written contract.

Despite its simplicity, the PER is not absolute. Courts must first determine whether the parties created an integration, which is a written document representing the final expression of one or more terms of their agreement. This step is critical because the PER applies only when there is such a final writing.

Second, courts assess the **degree of integration**. A **complete integration** captures all the terms of the agreement and excludes any additional evidence. By contrast, a **partial integration** may leave room for consistent additional terms from outside the written contract. The degree of integration directly impacts whether parol evidence is admissible.

Finally, even if the court finds that the writing is a complete integration, certain exceptions may still allow for the admission of parol evidence. For example, parol evidence can be admitted to resolve ambiguities, prove fraud or mistake, or address other specific procedural issues. These exceptions ensure that the rule balances the value of written agreements with fairness in addressing the realities of contractual relationships.

Understanding the PER requires more than knowing the rule itself. It demands a grasp of how courts apply these principles in practice, particularly when resolving disputes over integration, consistency, and exceptions. This chapter examines the PER's general rule, its exceptions, and the practical ways courts use it to resolve disputes. By analyzing cases and real-world scenarios, we will explore how the rule balances two fundamental goals of contract law: preserving the integrity of written agreements while addressing fairness and practical realities in enforcement.

Rules

A. Introducing the Parol Evidence Rule

The PER controls whether evidence of prior discussions, agreements, or promises can be used to interpret or add to a written contract. The rule assumes that once the parties memorialize their contract in a final writing, this written version of the contract represents the final version of their agreement. All prior discussions, agreements, or promises are excluded from the evidence and indeed **discharged** by the final writing, meaning that they lose their legal effect.

The famous case *Mitchill v. Lath*, 247 N.Y. 377, 160 N.E. 646 (1928), provides a basic illustration of how the PER works in practice. The buyer, Mrs. Mitchill, bought a property from the sellers, the Laths. During negotiations, Mr. Lath allegedly made Mrs. Mitchill an oral promise to remove an unsightly “icehouse” from a neighboring property which was not a part of the sale to Mrs. Mitchell. However, the written contract memorializing the property sale made no mention of this oral promise. After the sale, Mr. Lath refused to remove the icehouse, prompting Mrs. Mitchill to take legal action and sue the Laths for breach of contract, based on Mr. Lath's oral promise to remove the icehouse.

Mrs. Mitchill argued that Mr. Lath's oral promise to remove the icehouse was part of their agreement and should be enforced. She claimed that, although the promise was not included in the final written contract, the promise was very important in her decision to buy the property, and that enforcing the promise would not change or contradict the terms of the final written contract because it dealt with an issue outside the land sale itself. In legal terms, she argued that the oral promise was a **collateral agreement**, which should not be excluded by the PER. (As you will learn, a collateral agreement is an exception to the PER).

Mr. Lath, on the other hand, contended that the written contract was the complete and final record of their agreement. He argued that if the oral promise to remove the icehouse was truly part of their deal, it would have been included in the written document. Allowing Mrs. Mitchill to introduce evidence of the oral promise, he

asserted, would undermine the reliability of the written contract as the definitive statement of their agreement.

The court had to decide whether the written contract was intended to be the final and exclusive agreement between the parties, or whether it left room for promises made outside the written document. The court ultimately concluded that the PER barred admission of Mr. Lath's oral promise to remove the icehouse. To make this determination, the court asked three questions:

1. Was the promise to remove the icehouse a collateral agreement, meaning a totally separate "side deal" between the parties, which was not a part of the written contract and not covered by its terms?
2. Was the promise consistent with the terms of the written contract, or did it contradict the terms of the written contract?
3. Was the promise the type of term that the parties "would not ordinarily be expected to embody in the writing," or was it instead "part and parcel" of their land sale transaction?

"An inspection of this contract," the court wrote, "shows a full and complete agreement, setting forth in detail the obligations of each party." If it were true that the oral promise was made, the court wrote, "it would seem most natural that the inquirer should find it in the contract." Yet the promise was not contained in the contract at all, and there was nothing to suggest any exceptions applied that might permit the court to admit evidence of the promise into the record.

To answer the three questions it posed, the court first determined that the alleged promise was not truly collateral; it was closely connected to the subject matter of the written contract and could not reasonably be considered a separate "side deal." Second, the promise contradicted the completeness of the written agreement, which the court found was intended to capture the entirety of the parties' obligations. Third, the court found that the type of term at issue—a promise to remove a structure from the land—was significant enough that the parties would ordinarily include it in their final written agreement if it were part of their understanding. These findings collectively led the court to conclude that admitting evidence of the oral promise would undermine the integrity of the written agreement.

At a high level, the *Mitchill* court's analysis was similar to the way most courts would assess a PER issue today. The R2d and the UCC both provide versions of the PER that are, at their core, similar to the rule applied in *Mitchill*. Both frameworks emphasize evaluating the completeness and intent of the written agreement, the relationship of the oral term to the written agreement, and whether the term is of the type typically included in a formal writing. There are, however, many nuances that you need to understand in order to correctly apply the rule. The rest of the chapter explains how to thoroughly conduct a PER analysis. We start with a statement of the general rule before moving to specific details of the analysis and exceptions to the rule.

B. The General Rule

The PER establishes a default rule for how courts should treat prior or contemporaneous agreements in relation to a written contract. If a written contract is deemed to be the final expression of the parties' agreement, called an "integration," then the PER generally excludes evidence of any prior written or oral agreements, or contemporaneous oral agreements discussed during the time the writing was entered, which are not contained in the final writing.

The PER does not typically apply to contemporaneous written agreements. Written agreements from the time of the writing are likely to be deemed integrated into the final writing, assuming they are clearly referenced in the writing. The PER also does not apply to future modifications or later agreements. Rather, the PER only applies to prior agreements, made before the writing was finalized, or contemporaneous oral agreements, made during the time of the writing.

The common law, as represented by the R2d, provides the general rule as follows:

A binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them. R2d §213(1).

"Discharge" comes from the Old French *deschargier*, meaning "to unload," as in unloading a wagon or cart. In fact, in Latin, *carrus* means "wagon," and *dis* means "do the opposite," such that *dis-carrus* means to unload or disburden. In the legal sense, "discharge" refers to releasing, or unloading, one from a legal obligation or duty. In this context, the effect of the PER is that any prior obligations are discharged—they are released—once the PER is triggered by a final integration.

The UCC announces a very similar version of the PER, indicating that once the parties have entered a final written agreement, this writing cannot be contradicted by evidence of prior agreements or contemporaneous oral agreements.

[t]erms . . . set forth in a writing intended by the parties as a complete and exclusive statement of the terms of the agreement may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement. NH UCC §2-202(b).

The purpose of the PER is to protect the integrity of the written document and reduce uncertainty by preventing disputes over what was said or agreed upon during negotiations. The PER can be quite dramatic in its effect. For example, in *Mitchill*, the court found the parties entered a final and complete integration, which the parties intended to encompass all the terms of their land sale. Absent any exception(s) to the PER, the alleged oral promise by Mr. Lath to remove the icehouse simply could not be admitted into evidence. It did not matter whether Mr. Lath made the promise or not. The evidence could not be considered at all.

The *Mitchill* court's reasoning aligns with the PER's general rule: written contracts supersede and discharge all prior agreements, discussions, or promises the parties might have made to each other, in order to ensure the reliability and enforceability of

the document as the definitive expression of the parties' agreement. This general rule applies broadly but is subject to nuances and exceptions which allow courts to admit extrinsic evidence in limited circumstances. We explore these in the next sections.

C. Determining Whether There Is an Integration

The first step in addressing any PER scenario requires asking whether there is an **integrated agreement**, or integration. "Integrated" just means "final." You can use the terms "integrated" and "final" synonymously. Thus, an integrated agreement is just a final writing.

An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement. R2d § 209(1).

In deciding whether there is an integration, the focal point of the analysis is the intent of the parties, as seen through an objective lens. Courts ask whether it reasonably appears that the parties intended a writing to be the final expression of one or more terms of their agreement.

Sometimes this question is easily answered. For example, in *Mitchill*, the court found that the parties had an integration because they entered a written contract for Mrs. Mitchill to purchase Mr. Lath's property. The writing delineated the key terms, like the price, the subject matter, and various other terms relating to the sale, such as how the purchase would be financed. The writing looked final, and so it was.

That said, while courts often find that a writing is an integration, this is not always the case. For example, in *Sierra Diesel Injection Service, Inc. v. Burroughs Corp.*, 874 F.2d 653 (9th Cir. 1989), below, the court assessed whether a contract for the sale of a computer resulted in a final integration. The court found that it did not. The parties' negotiations resulted in "at least four different kinds of writings. . . . No one writing stands alone, each must be read with reference to another document." This case illustrates that just because a writing memorializing some terms of the agreement exists, this does not necessarily mean that the parties intended this writing to represent the final terms of their contract.

If the parties never finalized their contract in any writing, then the PER does not apply. But assuming there is an integration, as is often the case, the next question is: what is the degree of integration?

D. Determining the Degree of Integration

The next question to consider is the degree of integration. Is the integration partial, meaning that it captures only some of the agreed terms, or is it complete, meaning that it includes all the terms the parties intended to agree upon?

This distinction is critical. If an agreement is partially integrated, then the court may admit consistent additional terms. In contrast, if the agreement is completely integrated, the court will generally exclude any and all prior discussions, promises, or agreements that are not reflected in the writing.

The R2d states the distinction as follows:

- (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. R2d § 210.*

To draw the distinction between a complete and a partial integration, courts must evaluate the content of the written document, the circumstances surrounding its creation, and the nature of the parol evidence and additional term(s) that a party seeks to admit.

1. Partially Integrated Agreements

A partially integrated agreement is a written contract that represents the final expression of some, but not all, of the terms of the parties' agreement. In these cases, the PER allows evidence of consistent additional terms to supplement the written agreement. As long as the extrinsic evidence does not contradict the written terms, it can be admitted.

This approach recognizes that the parties may intend a writing to memorialize certain aspects of their agreement while leaving other consistent terms unwritten.

R2d § 216(1) states that evidence of a "consistent additional term" is admissible, unless the writing was intended as a complete and exclusive statement of the agreement. In other words, so long as the integration is only partial, consistent additional terms are admissible.

Evidence of a consistent additional term is admissible to supplement an integrated agreement unless the court finds that the agreement was completely integrated. R2d § 216(1).

UCC § 2-202(b), while it uses different terminology, similarly indicates that so long as a writing was not "intended . . . as a complete and exclusive statement of the terms," then it may be supplemented by "evidence of consistent additional terms[.]"

This analysis will become clearer with the help of an example. Imagine a written contract for the sale of goods that specifies the price and the basic delivery terms but does not address the timing of payment. Imagine that the buyer and seller orally agreed that payment would be due thirty days after delivery, but this oral agreement

did not appear in the final writing. This fact pattern would trigger the parol evidence rule. The court would ask whether the sales contract was an integration—which it likely was—and then ask the degree of integration. If the court finds the writing was only partially integrated, then the additional term regarding the due date for payment will be admissible, so long as it is consistent with the final writing.

What, then, does it mean for a term to be “consistent”? Consistent terms are generally regarded as are those that are “in reasonable harmony” with the final writing or at least do not “negate” any term in the final writing. (Ironically, courts are not consistent in defining what “consistent” means.) For example, if one party in a land sale contract alleges that, during negotiations, the parties agreed to a different price than is reflected in the final written contract, this would not be admissible (absent egregious facts like fraud) because the oral price term clearly negates the price term in the final writing. In contrast, in *Mitchill*, Mr. Lath’s alleged promise to remove the icehouse did not negate any term in the final writing and was in reasonable harmony with the terms of the land sale.

2. Completely Integrated Agreements

A completely integrated agreement is a written document that represents the complete and *exclusive* statement of the terms of the parties’ contract. When a court determines that a contract is completely integrated, the PER excludes all prior written and oral agreements, terms, or promises, regardless of whether they contradict the final writing or not.

If an integration is complete, then the presumption is that all terms related to the agreement are contained within the document. No other evidence can be included, so long as the evidence relates to the same general agreement as the final written integration. R2d § 213(2) states this rule as follows.

A binding completely integrated agreement discharges prior agreements to the extent that they are within its scope. R2d § 213(2).

UCC § 2-202(b), similarly indicates that if a writing is deemed the “complete and exclusive statement of the terms of the agreement,” then even “evidence of consistent additional terms” is excluded.

Completely integrated agreements reflect the PER’s core purpose of ensuring that written contracts provide a reliable and enforceable record of the parties’ intentions. By excluding essentially all extrinsic evidence, courts uphold the integrity of the writing and promote certainty in contractual relationships.

3. Distinguishing Complete from Partial Integrations

How, then, do courts decide whether a writing is a partial integration or a complete integration? There are numerous approaches, and jurisdictions adopt different rules, with some being more favorable to admitting parol evidence than others. Here we

provide a generalizable approach that aligns with the R2d's. But in practice, be sure to look up case law in the relevant jurisdiction.

Under the R2d, a written contract is partially integrated if it reasonably appears that the parties intended it to be the final expression of some, but not all, of the terms agreed upon. These agreements often leave certain terms unstated or incomplete, reflecting the parties' intent to address specific aspects of their agreement in writing while reserving other matters for additional evidence. In contrast, a contract is completely integrated if it reasonably appears that the parties intended the written contract to be the exclusive statement of all the terms.

In applying this rule, courts look at the language of the contract itself. They look at the length of the contract, and they look for phrases indicating finality and completeness. Courts also ask whether the contract addresses key terms of the agreement in detail, such as price, payment, delivery, or other terms like warranties. If so, this is more likely to be viewed as completely integrated. In contrast, if a document appears incomplete, contains "blanks" to be filled in, or omits terms that are commonly included in similar agreements, this suggests only a partial integration.

Most courts look for the presence, or absence, of a merger clause. A merger clause, also called an "integration clause," explicitly states that it is intention of the parties for the contract to be completely integrated. Here is an example of a typical integration clause:

This Agreement constitutes the complete, exclusive, and entire agreement between A and B regarding the Subject; all prior communications verbal or written between A and B shall be of no further effect or evidentiary value.

Such language is often dispositive. Courts usually find this language shows that the parties intended the agreement to be completely integrated. That said, courts do not always treat a merger clause as dispositive. Courts have found that agreements lacking such language were completely integrated and that agreements possessing such language were not. You will see an example of this in *Gianni v. R. Russell & Co.*, 281 Pa. 320 (1924), below, where the court finds that an agreement was completely integrated even though it lacked a merger clause.

The R2d indicates two very specific reasons that a court might find a writing to be only partially integrated, such that consistent additional terms can be admitted into evidence.

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. R2d § 216(2).

Under this approach, which is adopted by some courts, deciding whether a writing is only partially integrated requires examining the parol evidence term itself and asking whether this term was either (1) "agreed to for separate consideration," or (2) a term that "might naturally be omitted from the writing."

A parol evidence term is agreed to for separate consideration if the parties agreed that one of them would take on an additional obligation in exchange for separate consideration, above and beyond any consideration encompassed in the final writing. If so, evidence of this term can be admitted, despite the PER. For example, in *Mitchill*, imagine that Mrs. Mitchill and Mr. Lath agreed that Mr. Lath would demolish the icehouse in exchange for a separate agreed sum of \$3000, above and beyond the purchase price for the property? If so, the final written sales contract would *not* have been integrated with respect to this term. The agreement to remove the icehouse for \$3000 would have been admissible; a jury could at least consider this evidence.

Identifying “naturally omitted terms” is trickier. This generally requires comparing the asserted parol evidence term to the terms contained in the final writing and considering the overall context and circumstances of the parties’ dealings, in order to decide whether there was some reason the term might “naturally have been omitted” from the final writing.

A classic example of this type of analysis can be found in *Gianni v. R. Russell & Co.*, below. Frank Gianni rented a room in R. Russell & Co.’s office building, from where he operated a store selling tobacco, fruit, candy, and soft drinks. After some time, the parties entered into a written lease agreement, for a three-year term, which contained the following provision:

*Lessee should use the premises only for the sale of fruit, candy, soda water, etc.
It is expressly understood that the tenant is not allowed to sell tobacco in any
form, under penalty of instant forfeiture of this lease.*

Under this lease agreement, Gianni agreed to pay rent, and he also gave up his right to sell tobacco in the building, in exchange for Russell’s continued permission to let him lease the office space.

Shortly after signing, the lessor, Russell, rented another space in his building to a drug store. The drug store also sold soda. Gianni protested that his contract gave him the exclusive right to sell soda in the office building. He claimed Russell had promised exclusivity to him *orally* before signing and that his agreement not to sell tobacco was part of the consideration for this exclusive right. But the final lease agreement was silent regarding this provision.

The court had to decide whether the parties intended the written lease contract to be the exclusive statement of their agreement—in which case, Gianni’s evidence of a prior oral promise of exclusivity would be excluded and discharged—or whether the writing was susceptible to additional consistent terms. In other words, the court was effectively asking whether the agreement was a complete or a partial integration.

The court found that Gianni and Russell intended their writing to be the complete and exclusive list of terms. The reason was two-fold. First, even though the written agreement lacked an integration clause, the agreement otherwise appeared quite comprehensive on its face. Second, a comparison of the written terms to the oral term that Gianni alleged the parties agreed to suggested that the parties “would naturally

and normally” have included the oral term in the final writing. Indeed, “the written contract stipulated for the very sort of thing which plaintiff claims has no place in it. It covers the use to which the storeroom was to be put by plaintiff and what he was and what he was not to sell therein.” If the parties had orally agreed Gianni would have the exclusive right to sell soda in the building, this would have been in the final writing. “Nothing can be imagined more pertinent to these provisions[.]”

E. Identifying Exceptions

The final step is to ask whether there are exceptions to the PER which might permit admitting parol evidence. While the PER generally excludes evidence of prior or contemporaneous agreements that contradict or vary the terms of a written contract, exceptions allow extrinsic evidence to be admitted under specific circumstances. These exceptions ensure that courts can address fairness and practical realities, thus preventing the rule from being applied rigidly in ways that would produce unjust outcomes.

1. *Fraud, Duress, or Mistake*

The PER does not bar evidence that challenges the validity of the written contract itself. When a party alleges fraud, duress, or mistake, the focus shifts from enforcing the written terms to determining whether the contract should be enforced at all. These exceptions ensure that the rule is not applied rigidly in ways that allow unfair or deceptive practices to prevail.

Evidence of fraud is admissible to show that one party was induced into the contract through intentional misrepresentation or deceit. The PER cannot be used as a shield for dishonest conduct. Fraud can take various forms, including fraudulent inducement (when a party is tricked into entering the agreement based on false statements or promises) and fraudulent concealment (when a party deliberately withholds material information that affects the agreement). For instance, in a contract for the sale of a home, the seller verbally assures the buyer that the basement is free of water damage, but the buyer later discovers significant flooding issues. Even if the written contract includes an “as is” clause, the buyer may introduce evidence of the seller’s statements to show fraud. Courts will consider whether the misrepresentation was material and whether it induced the buyer to enter the agreement.

Evidence of duress is admissible to demonstrate that a party was coerced into signing the contract under unlawful or unfair pressure. Duress undermines the voluntariness of consent, a fundamental principle of contract formation. For example, a supplier threatens to stop all shipments to a retailer unless the retailer immediately signs a long-term exclusivity agreement. If the retailer claims they signed under economic duress, they may introduce evidence of the threat to challenge the validity of the contract. Courts will evaluate whether the supplier’s conduct left the retailer with no reasonable alternative.

Evidence of mistake is admissible to correct errors in the contract that do not reflect the parties' true intent. Mistakes can be unilateral (made by one party) or mutual (shared by both parties). Mutual mistakes are more likely to justify admitting extrinsic evidence, as they reveal a shared misunderstanding.

Consider a situation where two parties agree on the sale of one hundred shares of stock for \$10 per share, but the written contract mistakenly states a total price of \$10,000 instead of \$1,000. Evidence of the mistake is admissible to correct the error and ensure that the written contract aligns with the parties' intended terms.

These exceptions reflect the principle that contracts must be both fair and enforceable. The fraud exception prevents parties from benefiting from deceptive practices. The duress exception ensures that contracts are entered into voluntarily, preserving the autonomy of the parties. The mistake exception allows courts to correct unintended errors that would otherwise lead to unjust outcomes.

Unlike other exceptions to the PER, these focus on the formation of the contract itself rather than its interpretation. Evidence admitted under these exceptions does not supplement or contradict the written terms but instead calls into question the validity of the contract as a whole.

The fraud, duress, and mistake exceptions highlight the PER's balance between textual certainty and fairness. While the rule prioritizes the written contract, these exceptions recognize that enforcing a flawed agreement undermines the principles of justice and equitable outcomes. Courts use these exceptions to ensure that written contracts reflect genuine assent and honest dealings.

2. Ambiguity

The ambiguity exception to the PER allows extrinsic evidence to clarify the meaning of ambiguous language in a written contract. Ambiguity arises when a term or provision is susceptible to more than one reasonable interpretation. In these cases, courts admit evidence from preliminary negotiations or oral agreements to uncover the parties' intent.

Some courts conduct a preliminary review of parol evidence to determine whether it reveals a **latent ambiguity**, which is not obvious from the face of the contract. This approach focuses on whether the extrinsic evidence shows that the written terms can reasonably bear more than one interpretation. If so, the evidence is admitted to clarify the ambiguity. For example, in *Pacific Gas & Electric Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33 (1968), the court examined parol evidence to determine whether the term "indemnify" referred to indemnification against damages caused by a third party or by the contracting party. The court admitted the evidence after finding the term was susceptible to both interpretations, illustrating how extrinsic evidence can reveal ambiguities not apparent on the face of the contract.

Unlike course of performance, course of dealing, and usage of trade—tools focused on the behavior of the parties or industry norms—parol evidence introduces prior

statements or agreements as a lens for interpreting written terms. This distinction highlights the unique role parol evidence plays in uncovering latent ambiguity.

While parol evidence can reveal a latent ambiguity, courts are cautious not to use it to fabricate ambiguity in an otherwise clear contract. Evidence is admissible only if it genuinely demonstrates that the written terms are reasonably susceptible to alternative meanings. If a contract states payment is due “within thirty days of delivery,” parol evidence cannot be introduced to argue that “thirty days” means “thirty business days,” as the term is clear on its face and not susceptible to a reasonable alternative interpretation.

The ambiguity exception balances textual certainty and interpretive flexibility. By allowing parol evidence to be used to uncover latent ambiguities, courts respect the parties’ intent while ensuring contracts are not enforced based on rigid, incomplete interpretations. This exception acknowledges the limits of language and the need for context in understanding contractual terms.

3. Collateral Agreements

Many courts recognize a separate exception to the PER for so-called “collateral agreements.” A collateral agreement is a separate agreement that is related to but distinct from the written contract. A collateral agreement is admissible only if it satisfies *all three* of the following requirements:

- (1) The agreement is independent and separate from the written contract;
- (2) The agreement is consistent with the written terms and does not conflict with them; and
- (3) The agreement is of a type that would not naturally be included in the written contract.

This conjunctive requirement ensures that the PER does not unfairly exclude terms that the parties intended to remain outside the primary written agreement, while maintaining the integrity of fully integrated contracts.

Suppose a written contract for the sale of a house includes detailed terms about price, payment schedules, and property disclosures but makes no mention of the seller’s agreement to leave a particular piece of furniture. The buyer claims that during negotiations, the seller promised to leave a family heirloom piano as part of the deal. If this promise does not conflict with the terms of the written contract and is independent of the house sale terms, it may qualify as a collateral agreement. A court would evaluate whether such a promise meets all three requirements: independence, consistency, and whether it would naturally have been included in the written contract.

We have already seen this rule at play to some extent. Courts adopting the R2d’s approach perform a very similar analysis when determining whether an agreement is only partially integrated. Recall that R2d § 216(2)(b) provides that parol evidence is admissible if it is either (1) supported by “separate consideration,” or (2) “such a term

as in the circumstances might naturally be omitted from the writing.” This analysis is quite similar to the collateral agreement exception. However, because a collateral agreement is an exception to the PER, this means courts may consider evidence of a collateral agreement even with respect to completely integrated written agreements.

For example, in *Mitchill*, the court conceded that, even if the parties’ purchase agreement was a complete and final integration, Mr. Lath’s promise to remove the icehouse would not have been excluded by the PER if it qualified as a collateral agreement. Mrs. Mitchill argued that Mr. Lath’s oral promise to remove the icehouse from neighboring land was a separate agreement, collateral to the written contract for the sale of the property. The court, however, rejected this argument, reasoning that the alleged promise was so closely related to the property sale that it would naturally have been included in the written agreement if it had been intended as part of the deal. The court’s decision underscores the importance of the third criterion: collateral agreements must concern terms that the written contract would not be expected to address.

The application of this exception is further illustrated in *Lee v. Joseph E. Seagram & Sons, Inc.*, 413 F. Supp. 693 (S.D.N.Y. 1976). In this case, the plaintiffs wanted to evidence an oral agreement under which Seagram promised to relocate them to a new liquor distributorship after the sale of their current business. Although the written contract detailed the sale’s terms, the relocation promise was found to be independent and separate from the written agreement. The court determined that the oral promise did not contradict the sale’s written terms and concerned a matter—relocation—that would not naturally have been included in the contract for the sale of assets. This case demonstrates how the exception can preserve oral agreements that complement but do not alter or contradict a written contract.

In contrast, *Miller v. Hekimian Laboratories, Inc.*, 257 F. Supp. 2d 506 (N.D.N.Y. 2003), provides an example of a court rejecting a claim that an agreement was collateral. The plaintiff argued that a pre-employment document outlining commissions was a collateral agreement separate from his employment contract. However, the court found that the alleged agreement conflicted with the written employment contract, which specifically gave discretion over incentive payments to the employer. Additionally, commission terms were considered central to the employment relationship and thus naturally included in the written contract. The court’s refusal to admit the alleged collateral agreement highlights how closely related terms and integration clauses can block such claims.

The collateral agreements exception balances the integrity of written contracts with the parties’ freedom to structure their agreements as they see fit. By allowing evidence of separate agreements that meet all three criteria, courts preserve the flexibility needed to address the realities of complex transactions. At the same time, the requirement that collateral agreements satisfy all three elements prevents misuse of the exception to undermine fully integrated contracts. These cases illustrate the nuanced approach courts take to ensure fairness while upholding the written word.

4. *Conditions Precedent*

The PER allows extrinsic evidence to prove the existence of a condition precedent—a fact or event that must occur before a contract, or a particular contractual promise, takes effect. You will learn more about conditions precedent in Chapter 19. For now, it is sufficient to understand that conditions are not promises; rather, conditions are events whose occurrence (or non-occurrence) turns a contractual duty on or off. If a contractual duty is limited by a condition precedent, then the duty is not activated unless the condition is met.

Conditions are everywhere in contract law. For example, a job offer may be contingent upon the candidate's passing a drug test. A real estate purchase agreement may depend on the buyer's obtaining financing. Evidence of such conditions are admissible under the PER, so long as the condition does not alter the written terms but merely clarifies the prerequisites for the contract's enforceability.

For example, consider a signed contract for the sale of a commercial building. During negotiations, the buyer and seller agreed orally that the contract would not take effect unless the buyer first obtained zoning approval for their intended use of the property. The written contract is silent on this condition. If the buyer fails to obtain zoning approval and refuses to complete the sale, the buyer will likely seek to introduce evidence of the oral agreement to show that the contract never became binding upon the buyer, since a condition was not met. This condition does not contradict the written terms; instead, it clarifies that the agreement was contingent on the buyer's obtaining zoning approval.

If the seller tries to exclude evidence of the condition under the PER, a court would likely admit this evidence under the exception for conditions precedent. This exception is important. Without it, parties might be bound to promises or entire contracts that they never intended to be binding, merely because they failed to insert the condition term in their final written agreement.

R2d § 217 addresses this exception, providing that evidence of a condition precedent to the effectiveness of a written agreement is generally admissible despite the PER.

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. R2d § 217.

The condition precedent exception may seem esoteric, but it can be broadly applicable. A party wishing to admit parol evidence can employ this exception strategically. Returning once again to the *Mitchill* case, what if Mrs. Mitchill had argued that the removal of the icehouse was a condition precedent to her performance under the property sale agreement? If so, the court might have admitted evidence of the oral agreement, assuming it did not directly conflict with the written terms. But in the actual case, Mrs. Mitchill used a different strategy. She tried to frame the alleged icehouse promise as a collateral agreement, which was totally separate from the land sale,

rather than a prerequisite for the sale. Her strategy was unsuccessful, and the court excluded the evidence under the PER.

In sum, the condition precedent exception ensures that contracts are not enforced when the parties intended them to depend on unfulfilled conditions. This exception respects the intent of the parties while preserving the integrity of written agreements by focusing only on prerequisites to enforceability, not on altering the substance of the written terms.

F. Reflections on the Parol Evidence Rule

The PER embodies a fundamental tension in contract law: preserving the integrity of written agreements while accommodating the realities of negotiation, performance, and enforcement. By prioritizing written contracts as the definitive expression of the parties' intent, the PER promotes certainty, predictability, and efficiency. These qualities reduce transaction costs and reinforce reliance, enabling parties to negotiate and finalize agreements with the assurance that their written terms will govern future disputes.

At the same time, the PER recognizes that written agreements are not infallible. Contracting parties may omit key terms, fail to address ambiguities, or succumb to fraud or coercion during negotiations. The rule's carefully delineated exceptions—such as fraud, ambiguity, collateral agreements, and conditions precedent—ensure that courts can address these imperfections without undermining the general primacy of written agreements. By admitting extrinsic evidence in narrowly defined circumstances, the PER balances textual certainty with contextual fairness.

This balance reflects broader themes of contract law. By ensuring that a contract's terms are enforced as intended, the PER respects the parties' choice to memorialize their agreement in writing, and, in doing so, supports autonomy. Simultaneously, the rule protects reliance by allowing courts to intervene when written contracts fail to reflect the parties' true commitments due to fraud, mistake, or ambiguity. The resulting framework not only strengthens the enforceability of contracts but also mitigates the risk of injustice in specific cases.

The flexibility of the PER does not weaken its principles but enhances its effectiveness. For example, the fraud exception prevents dishonest parties from exploiting the PER to enforce agreements procured through deception, thereby maintaining fairness. Similarly, the ambiguity exception ensures that courts can resolve disputes by interpreting terms in ways consistent with the parties' shared intent. These exceptions highlight how the PER operates not as an absolute barrier but as a tool for achieving both reliability and equity in contract enforcement.

The *Mitchill* case illustrates this dynamic. By excluding evidence of the alleged promise to remove the icehouse, the court reinforced the primacy of the written agreement and ensured that the contract's terms were definitive and enforceable. However, the court's reasoning also acknowledged the need for careful criteria, such as whether the oral promise was collateral or naturally included in the writing, to

ensure fairness in its application. This dual focus underscores how the PER provides a structured framework for evaluating extrinsic evidence that preserves the integrity of written contracts while accounting for the complexities of real-world agreements.

In the end, the PER is more than a rule of exclusion; it is a reflection of contract law's broader commitment to balancing efficiency, reliance, and fairness. By harmonizing the written word with contextual realities, it enables courts to uphold the parties' intentions while safeguarding the principles of justice and predictability that underlie all contractual relationships.

Cases

Reading Gianni v. R. Russell & Co. *Gianni* demonstrates the objective approach to contract interpretation. Under the strict form of the objective approach, the express terms in the written agreement (i.e., intrinsic evidence) take absolute priority over extrinsic evidence. When the written agreement appears to be “a contract complete within itself,” the presumption is even stronger: the court will not admit extrinsic evidence that is within the scope of the written agreement.

Gianni v. R. Russell & Co.

281 Pa. 320 (1924)

SCHAFFER, J.

The Plaintiff had been a tenant of a room in an office building in Pittsburgh wherein he conducted a store, selling tobacco, fruit, candy and soft drinks. Defendant acquired the entire property in which the storeroom was located, and its agent negotiated with plaintiff for a further leasing of the room. A lease for three years was signed. It contained a provision that the lessee should “use the premises only for the sale of fruit, candy, soda water,” etc., with the further stipulation that “it is expressly understood that the tenant is not allowed to sell tobacco in any form, under penalty of instant forfeiture of this lease.” The document was prepared following a discussion about renting the room between the parties and after an agreement to lease had been reached. It was signed after it had been left in plaintiff's hands and admittedly had been read over to him by two persons, one of whom was his daughter.

Plaintiff sets up that in the course of his dealings with defendant's agent it was agreed that, in consideration of his promises not to sell tobacco and to pay an increased rent, and for entering into the agreement as a whole, he should have the exclusive right to sell soft drinks in the building. No such stipulation is contained in the written lease. Shortly after it was signed defendant demised the adjoining room in the building to a drug company without restricting the latter's right to sell soda water and soft drinks.

Alleging that this was in violation of the contract which defendant had made with him, and that the sale of these beverages by the drug company had greatly reduced his receipts and profits, plaintiff brought this action for damages for breach of the alleged oral contract, and was permitted to recover. Defendant has appealed.

Plaintiff's evidence was to the effect that the oral agreement had been made at least two days, possibly longer, before the signing of the instrument, and that it was repeated at the time he signed; that, relying upon it, he executed the lease. Plaintiff called one witness who said he heard defendant's agent say to plaintiff at a time admittedly several days before the execution of the lease that he would have the exclusive right to sell soda water and soft drinks, to which the latter replied if that was the case he accepted the tenancy. Plaintiff produced no witness who was present when the contract was executed to corroborate his statement as to what then occurred. Defendant's agent denied that any such agreement was made, either preliminary to or at the time of the execution of the lease.

Appellee's counsel argues this is not a case in which an endeavor is being made to reform a written instrument because of something omitted as a result of fraud, accident, or mistake, but is one involving the breach of an independent oral agreement which does not belong in the writing at all and is not germane to its provisions. We are unable to reach this conclusion.

Where parties, without any fraud or mistake, have deliberately put their engagements in writing, the law declares the writing to be not only the best, but the only evidence of their agreement.

"All preliminary negotiations, conversations and verbal agreements are merged in and superseded by the subsequent written contract . . . and unless fraud, accident, or mistake be averred, the writing constitutes the agreement between the parties, and its terms cannot be added to nor subtracted from by parol evidence."

The writing must be the entire contract between the parties if parol evidence is to be excluded, and to determine whether it is or not the writing will be looked at, and if it appears to be a contract complete within itself, "couched in such terms as import a complete legal obligation without any uncertainty as to the object or extent of the engagement, it is conclusively presumed that the whole engagement of the parties, and the extent and manner of their undertaking, were reduced to writing."

When does the oral agreement come within the field embraced by the written one? This can be answered by comparing the two, and determining whether parties, situated as were the ones to the contract, would naturally and normally include the one in the other if it were made. If they relate to the same subject-matter, and are so interrelated that both would be executed at the same time and in the same contract, the scope of the subsidiary agreement must be taken to be covered by the writing. This question must be determined by the court.

In the case at bar the written contract stipulated for the very sort of thing which plaintiff claims has no place in it. It covers the use to which the storeroom was to be

put by plaintiff and what he was and what he was not to sell therein. He was “to use the premises only for the sale of fruit, candy, soda water,” etc., and was not “allowed to sell tobacco in any form.” Plaintiff claims his agreement not to sell tobacco was part of the consideration for the exclusive right to sell soft drinks. Since his promise to refrain was included in the writing, it would be the natural thing to have included the promise of exclusive rights. Nothing can be imagined more pertinent to these provisions which were included than the one appellee avers.

In cases of this kind, where the cause of action rests entirely on an alleged oral understanding concerning a subject which is dealt with in a written contract it is presumed that the writing was intended to set forth the entire agreement as to that particular subject. “In deciding upon this intent [as to whether a certain subject was intended to be embodied by the writing], the chief and most satisfactory index . . . is found in the circumstance whether or not the particular element of the alleged extrinsic negotiation is dealt with at all in the writing. If it is mentioned, covered, or dealt with in the writing, then presumably the writing was meant to represent all of the transaction on that element, if it is not, then probably the writing was not intended to embody that element of the negotiation.”

As the written lease is the complete contract of the parties, and since it embraces the field of the alleged oral contract, evidence of the latter is inadmissible under the parol evidence rule. “The [parol evidence] rule also denies validity to a subsidiary agreement within [the] scope [of the written contract] if sued on as a separate contract, although except for [that rule], the agreement fulfills all the requisites of valid contract.”

There are, of course, certain exceptions to the parol evidence rule, but this case does not fall within any of them. Plaintiff expressly rejects any idea of fraud, accident, or mistake, and they are the foundation upon which any basis for admitting parol evidence to set up an entirely separate agreement within the scope of a written contract must be built. The evidence must be such as would cause a chancellor to reform the instrument, and that would be done only for these reasons and this holds true where this essentially equitable relief is being given, in our Pennsylvania fashion, through common law forms.

We have stated on several occasions recently that we propose to stand for the integrity of written contracts. We reiterate our position in this regard.

The judgment of the court below is reversed, and is here entered for defendant.

Reflection

Gianni makes the parol evidence rule seem quite black and white. But as you have probably already realized, the law is usually some shade of gray. After all, it is hard to craft a clear, strict rule that produces the correct result in all circumstances. Broad, vague standards give judges the discretion to provide a fair result in the instant case. But broad, vague standards create problems, too, especially in commercial law fields, where people are planning business decisions. It is hard to know in advance how a

random judge will rule under a broad standard. This uncertainty creates risk. Risk creates cost. Cost kills deals, since no good businessperson would engage in a deal that has a negative expected value. When dealing with a commercial law subject such as contract law, therefore, courts must maintain the delicate balance between certainty in advance (so people can plan accordingly) and fairness after the fact (so the law does not become a tool to perpetuate injustice).

You will next read how the R2d and the UCC complicate the rule. Before moving on, pause and think about whether you understood the *Gianni* opinion. Was the rule stated clearly? Would you be able to counsel a client based on the parol evidence rule presented in *Gianni*? If you disagreed with the *Gianni* opinion—or found it too vague to apply with confidence—make a note of that. It may suggest a preference for objective standards, bright-line tests, and clearer doctrinal rules.

Next, speculate on the reason the bright-line rule in *Gianni* could result in unfair decisions. What kind of circumstances might make the rule in *Gianni* unfair? Does the bright-line, objective approach articulated in *Gianni* conflict with deeper principles of contract law? One way to explore these questions is to imagine how the *Gianni* court itself might have come to a different conclusion if the facts were different. Why did the court mention that the written agreement in *Gianni* was read over to him by two people? If the agreement had not been read to him by anyone, would that change your opinion of whether Gianni should be bound by it? Do you think he could have read it himself? Does that change your opinion of whether he should be bound by it? If the agreement did not prohibit Gianni from selling tobacco, would that make his argument that he was entitled to exclusive rights to sell soft drinks stronger or weaker?

After you read the next set of rules and cases, you will see that the parol evidence rule is trying to balance objectivity and certainty on the one hand and subjective intent and fairness on the other. Which approach, objective or subjective, is the right one?

Discussion

1. What kind of intrinsic evidence would make a written agreement appear to be “a contract complete within itself”?
2. Can extrinsic evidence be used to show that a written agreement is complete within itself?
3. Can extrinsic evidence be used to show that a written agreement is not complete within itself, where the written agreement itself taken alone appears to be complete?
4. How does a court determine the scope of a written agreement in general? How does the *Gianni* court specifically determine that Gianni’s purported consideration (the exclusive right to sell soft drinks) is within the scope of this agreement allowing him to sell soft drinks and forbidding him from selling tobacco?

5. What is the purpose of, or reasoning for, refusing to consider extrinsic evidence about preliminary negotiations where the intrinsic evidence appears to be the complete and exclusive statement of the parties' agreement?

Reading UAW-GM Human Resource Center v. KSL Recreation Corp. The next case involves a lawsuit about whether a hotel promised to staff an event using only union employees. The hotel's client, United Auto Workers-General Motors (UAW), is a labor union, so it may make sense why it wanted to vote with its dollars by hiring union staff for its event. But the legal question is whether UAW is entitled to present evidence that the parties agreed to staff the event with union workers, even though the written agreement does not mention this provision.

You should read this case for three reasons. First, this case illustrates a critical concept under the parol evidence rule: a merger clause. Also known as an integration clause, the merger clause is a written term in the agreement that effectively says (to put this in the *Gianni* court's terms) that the written agreement is a contract complete within itself. After reading this case, you should be able to identify the merger clause in an agreement—and you might be able to begin analyzing whether a potential merger clause is effective at declaring that the written agreement is a complete and exclusive statement of the parties' agreement.

Second, the majority takes an approach similar to the *Gianni* court's by refusing to admit extrinsic evidence of preliminary negotiations where the written agreement itself seemed to be complete within itself. The *UAW* court provides some additional reasoning and support for this objective approach to contract interpretation. Think about why *Gianni*, which did not have a merger clause, arrived at the same result (the exclusion of extrinsic evidence of preliminary negotiations) as *UAW*.

Third, the dissent in *UAW* provides your first introduction to the reasons why the objective standard can lead to unfair results. The dissent provides reasoning in support of a subjective approach that would more readily admit extrinsic evidence. Take special note of the dissent's reasoning and see whether the case that follows *UAW*, *Sierra Diesel*, applies the same logic for its selection of the subjective approach.

Although the following cases are edited, they are nevertheless lengthy. That is because your humble author felt that Professors Williston and Corbin explain competing rationales for objective and subjective approaches to the parol evidence rule better than he could, so he included many full paragraph quotations of their law treatises.

**UAW-GM Human Resource Center v. KSL
Recreation Corp.**

228 Mich. App. 498 (1998)

MARKMAN, J.

Defendants appeal as of right a trial court order granting summary disposition to plaintiff on its claims of breach of contract, conversion, and fraud. Defendants also appeal as of right the trial court's denial of their motion for summary disposition. We reverse and remand for determination of damages pursuant to the liquidated damages formula set forth in the contract.

Facts

In December 1993, plaintiff entered into a contract with Carol Management Corporation (CMC) for the use of its property, Doral Resort and Country Club, for a convention scheduled in October 1994. The "letter of agreement" included a merger clause that stated that such agreement constituted "a merger of all proposals, negotiations and representations with reference to the subject matter and provisions." The letter of agreement did not contain any provision requiring that Doral Resort employees be union-represented. However, plaintiff contends in its appellate brief that it signed the letter of agreement in reliance on an "independent, collateral promise to provide [plaintiff] with a union-represented hotel." Plaintiff provided the affidavits of Herschel Nix, plaintiff's agent, and Barbara Roush, CMC's agent, who negotiated the contract. In his affidavit, Nix states that during the contract negotiation he and Roush discussed plaintiff's requirement that the hotel employees be union-represented and that Roush agreed to this requirement. In her affidavit, Roush states that "prior to and at the time" the contract at issue was negotiated she "was well aware" of plaintiff's requirement that the hotel employees be union-represented and that "that there is no doubt that I agreed on behalf of the Doral Resort to provide a union hotel." The letter of agreement also included a liquidated damages clause in the event plaintiff canceled the reservation "for any reason other than the following: Acts of God, Government Regulation, Disaster, Civil Disorders or other emergencies making it illegal to hold the meeting/convention."

Later in December 1993, the hotel was sold to defendants, who subsequently replaced the resort's union employees with a nonunionized work force. In June 1994, when plaintiff learned that the hotel no longer had union employees, it canceled the contract and demanded a refund of its down payment. Defendants refused to refund the down payment, retaining it as a portion of the liquidated damages allegedly owed to them pursuant to the contract.

[Facts regarding the procedural history and standard of review for summary judgment are omitted.]

Merger Clause

Defendants claim that the trial court erred in granting plaintiff's motion for summary disposition and in denying defendant's motion for summary disposition.

Regarding the breach of contract count, they specifically contend that parol evidence of a separate agreement providing that the hotel would have union employees at the time of the convention was inadmissible because the letter of agreement included an express merger clause.

We begin by reiterating the basic rules regarding contract interpretation. “The primary goal in the construction or interpretation of any contract is to honor the intent of the parties.”

“We must look for the intent of the parties in the words used in the instrument. This court does not have the right to make a different contract for the parties or to look to extrinsic testimony to determine their intent when the words used by them are clear and unambiguous and have a definite meaning.”

In *Port Huron Ed Ass’n v Port Huron Area School Dist.*, 452 Mich. 309 (1996), the Court stated:

The initial question whether contract language is ambiguous is a question of law. If the contract language is clear and unambiguous, its meaning is a question of law. Where the contract language is unclear or susceptible to multiple meanings, interpretation becomes a question of fact.

A contract is ambiguous if “its words may reasonably be understood in different ways.” Courts are not to create ambiguity where none exists. “Contractual language is construed according to its plain and ordinary meaning, and technical or constrained constructions are to be avoided.” If the meaning of an agreement is ambiguous or unclear, the trier of fact is to determine the intent of the parties.

The parol evidence rule may be summarized as follows: “[p]arol evidence of contract negotiations, or of prior or contemporaneous agreements that contradict or vary the written contract, is not admissible to vary the terms of a contract which is clear and unambiguous.” This rule recognizes that in “[b]lack of nearly every written instrument lies a parol agreement, merged therein.”

“The practical justification for the rule lies in the stability that it gives to written contracts; for otherwise either party might avoid his obligation by testifying that a contemporaneous oral agreement released him from the duties that he had simultaneously assumed in writing.” 4 Williston, Contracts, § 631. In other words, the parol evidence rule addresses the fact that “disappointed parties will have a great incentive to describe circumstances in ways that escape the explicit terms of their contracts.” Fried, *Contract as Promise* (Cambridge: Harvard University Press, 1981) at 60.

However, parol evidence of prior or contemporaneous agreements or negotiations is admissible on the threshold question whether a written contract is an integrated instrument that is a complete expression of the parties’ agreement. *In re Skotzke Estate*, 216 Mich. App. 247 (1996); *NAG Enterprises, Inc v All State Industries, Inc*, 407 Mich. 407 (1979). The NAG Court noted four exceptions to the parol evidence rule, stating that extrinsic evidence is admissible to show (1) that the writing was a sham, not intended to create legal relations, (2) that the contract has no efficacy or

effect because of fraud, illegality, or mistake, (3) that the parties did not integrate their agreement or assent to it as the final embodiment of their understanding, or (4) that the agreement was only partially integrated because essential elements were not reduced to writing. Importantly, neither *NAG* nor *Skotzke* involved a contract with an explicit integration clause.

The first issue before us is whether parol evidence is admissible with regard to the threshold question of integration even when the written agreement includes an explicit merger or integration clause. In other words, the issue is whether *NAG* applies to allow parol evidence regarding this threshold issue when a contract includes an explicit merger clause. While this issue is one of first impression, its answer turns on well-established principles of contract law. Williston on Contracts and Corbin on Contracts offer specific guidance regarding this issue. 4 Williston, Contracts, § 633, p. 1014 states in pertinent part:

Since it is only the intention of the parties to adopt a writing as a memorial which makes that writing an integration of the contract, and makes the parol evidence rule applicable, any expression of their intention in the writing in regard to the matter will be given effect. If they provide in terms that the writing shall be a complete integration of their agreement . . . the expressed intention will be effectuated.

3 Corbin, Contracts, § 578, pp. 402-411 states in pertinent part:

If a written document, mutually assented to, declares in express terms that it contains the entire agreement of the parties . . . this declaration is conclusive as long as it has itself not been set aside by a court on grounds of fraud or mistake, or on some ground that is sufficient for setting aside other contracts. . . . It is just like a general release of all antecedent claims. . . . An agreement that we do now discharge and nullify all previous agreements and warranties is effective, so long as it is not itself avoided. . . . By limiting the contract to the provisions that are in writing, the parties are definitely expressing an intention to nullify antecedent understandings or agreements. They are making the document a complete integration. Therefore, even if there had in fact been an antecedent warranty or other provision, it is discharged by the written agreement.

Thus, both Corbin and Williston indicate that an explicit integration clause is conclusive and that parol evidence is not admissible to determine whether a contract is integrated when a written contract contains such a clause. In the context of an explicit integration clause, Corbin recognizes exceptions to the barring of parol evidence only for fraud (or other grounds sufficient to set aside a contract) and for the rare situation when the written document is obviously incomplete “on its face” and, therefore, parol evidence is necessary “for the filling of gaps.” The conclusion that parol evidence is not admissible to show that a written agreement is not integrated when the agreement itself includes an integration clause is consistent with the general contract principles

of honoring parties' agreements as expressed in their written contracts and not creating ambiguities where none exist. This conclusion accords respect to the rules that the parties themselves have set forth to resolve controversies arising under the contract. The parties are bound by the contract because they have chosen to be so bound.

Further, and most fundamentally, if parol evidence were admissible with regard to the threshold issue whether the written agreement was integrated despite the existence of an integration clause, there would be little distinction between contracts that include an integration clause and those that do not. When the parties choose to include an integration clause, they clearly indicate that the written agreement is integrated; accordingly, there is no longer any "threshold issue" whether the agreement is integrated and, correspondingly, no need to resort to parol evidence to resolve this issue. Thus *NAG*, which allows resort to parol evidence to resolve this "threshold issue," does not control when a contract includes a valid merger clause.

3 Corbin, Contracts, § 577, p. 401 states in pertinent part:

A finding that the parties had assented to a writing as the complete integration of their then existing agreement is necessarily a finding that there is no simultaneous oral addition. On such a finding of fact, we are no longer required to decide whether proof of simultaneous oral agreement is admissible, for we have just found that there was no such oral agreement.

The conclusion that parol evidence is not admissible regarding this "threshold issue" when there is an explicit integration clause honors the parties' decision to include such a clause in their written agreement. It gives effect to their decision to establish a written agreement as the exclusive basis for determining their intentions concerning the subject matter of the contract.

This rule is especially compelling in cases such as the present one, where defendants, successor corporations, assumed performance of another corporation's obligations under a letter of agreement. Because defendants were not parties to the negotiations resulting in the letter of agreement, they would obviously be unaware of any oral representations made by CMC's agent to plaintiff's agent in the course of those negotiations. Defendants assumed CMC's obligations under the letter of agreement, which included an explicit merger clause. Defendants could not reasonably have been expected to discuss with every party to every contract with CMC whether any parol agreements existed that would place further burdens upon defendants in the context of a contract with an explicit merger clause. Under these circumstances, it would be fundamentally unfair to hold defendants to oral representations allegedly made by CMC's agent. Of the participants involved in this controversy, defendants are clearly the least blameworthy and the least able to protect themselves. Unlike plaintiff, which could have addressed its concerns by including appropriate language in the contract, and unlike CMC, which allegedly agreed to carry out obligations not included within the contract, defendants did nothing more than rely upon the express language of the instant contract, to wit, that the letter of agreement represented the

full understanding between plaintiff and CMC. We believe that defendants acted reasonably in their reliance and that the contract should be interpreted in accordance with its express provisions.

[Citations to and discussion of Michigan law omitted.]

For these reasons, we hold that when the parties include an integration clause in their written contract, it is conclusive and parol evidence is not admissible to show that the agreement is not integrated except in cases of fraud that invalidate the integration clause or where an agreement is obviously incomplete “on its face” and, therefore, parol evidence is necessary for the “filling of gaps.” 3 Corbin, Contracts, § 578, p. 411.

Fraud

[Discussion on invalidity of the contract for fraud or misrepresentation omitted. Misrepresentation is discussed in Module IV.]

Liquidated Damages

[Discussion on enforceability of liquidated damages provision omitted. Liquidated damages (which are enforceable) and penalties (which are unenforceable) will be discussed in Module VI.]

Finally, we will briefly respond to the dissenting opinion. The dissenting opinion indicates that no contract existed between plaintiff and defendants. Initially, we note that the parties themselves, unlike the dissent, have not suggested that no contract existed between plaintiff and defendants. In fact, the parties clearly assume that the letter of agreement is binding on them; they only disagree regarding its meaning and the effect of the alleged oral representations regarding union representation of the staff. While this Court may, of course, address essential issues not raised by the parties, we are perplexed by the dissent’s reliance upon an argument that is inconsistent with the parties’ positions to dispose of this matter.

[Discussion on delegation of duties omitted. Assignment and delegation will be discussed in Module VI.]

Reversed and remanded for proceedings consistent with this opinion. We do not retain jurisdiction.

HOLBROOK, J., dissenting

I respectfully dissent.

The event that precipitated this legal dispute was Carol Management’s sale of the resort to defendants, without informing plaintiff during contract negotiations that the resort was for sale or that a sale was pending, and defendants’ subsequent firing of the resort’s union staff, less than one month after the contract with plaintiff was negotiated and signed. The contract—drafted by Carol Management—included a standardized integration or merger clause, but was silent regarding plaintiff’s acknowledged requirement that the resort employ a union-represented staff. Attempts to pigeonhole these unusual facts into established black-letter rules of contract law led to harsh and unintended results. Hard cases do, indeed, make bad law.

The contract's merger clause—"a merger of all proposals, negotiations and representations with reference to the subject matter and provisions"—appears plain and unambiguous. While it is often stated that courts may not create an ambiguity in a contract where none exists, and that parol evidence is generally not admissible to vary or contradict the terms of a written contract, Professor Corbin acknowledges that strict adherence to these rules can be problematic:

The fact that the [parol evidence] rule has been stated in such a definite and dogmatic form as a rule of admissibility is unfortunate. It has an air of authority and certainty that has grown with much repetition. Without doubt, it has deterred counsel from making an adequate analysis and research and from offering parol testimony that was admissible for many purposes. Without doubt, also it has caused a court to refuse to hear testimony that ought to have been heard. The mystery of the written word is still such that a paper document may close the door to a showing that it was never assented to as a complete integration.

No injustice is done by exclusion of the testimony if the written integration is in fact what the court assumes or decides that it is.

The trouble is that the court's assumption or decision as to the completeness and accuracy of the integration may be quite erroneous. The writing cannot prove its own completeness and accuracy. Even though it contains an express statement to that effect, the assent of the parties thereto must still be proved. Proof of its completeness and accuracy, discharging all antecedent agreements, must be made in large part by the oral testimony of parties and other witnesses. The very testimony that the "parol evidence rule" is supposed to exclude is frequently, if not always, necessary before the court can determine that the parties have agreed upon the writing as a complete and accurate statement of terms. The evidence that the rule seems to exclude must sometimes be heard and weighed before it can be excluded by the rule. This is one reason why the working of this rule has been so inconsistent and unsatisfactory. This is why so many exceptions and limitations to the supposed rule of evidence have been recognized by various courts.

There is ample judicial authority showing that, in determining the issue of completeness of the integration in writing, evidence extrinsic to the writing itself is admissible. The oral admissions of the plaintiff that the agreement included matters not contained in the writing may be proved to show that it was not assented to as a complete integration, however complete it may look on its face. On this issue, parol testimony is certainly admissible to show the circumstances under which the agreement was made and the purposes for which the instrument was executed.

And, in § 583 of his treatise, Professor Corbin continues:

No written document can prove its own execution or that it was ever assented to as a complete integration, supplanting and discharging what preceded

it. . . . There are plenty of decisions that additional terms and provisions can be proved by parol evidence, thereby showing that the written document in court is not a complete integration. This is true, even though it is clear that the additional terms form a part of one contractual transaction along with the writing. [3 Corbin on Contracts, § 583, pp. 465–467.]

Accord *Stimac v Wissman*, 342 Mich. 20 (1955); Restatement Contracts, 2d, § 216, comment e, p. 140 (observing that a merger “clause does not control the question of whether the writing was assented to as an integrated agreement”).

The fact that plaintiff’s representative read and signed the contract does not obviate the applicability of the principles outlined in Corbin, §§ 582 and 583. Indeed, Professor Corbin illustrates the principles of the section by analyzing the case of *Int’l Milling Co v Hachmeister, Inc*, 380 Pa. 407 (1955), in which the parties entered into a contract for the sale and purchase of flour. During negotiations, buyer insisted that each shipment of flour meet certain established specifications and that such a provision be included in the contract. Seller refused to put the provision in the contract, but agreed to write a confirmation letter to buyer tying in the required specifications. Buyer placed a written order, indicating that the flour must meet the required specifications. Seller sent to buyer a printed contract form, which contained none of the specifications, but did contain an express integration clause. Seller also sent a separate letter assuring delivery in accordance with the required specifications. Buyer signed the written contract form. When a subsequent shipment of flour failed to meet the specifications, buyer rejected it and canceled all other orders. The Pennsylvania Supreme Court held that extrinsic evidence of the parties’ negotiations and antecedent agreements was admissible with regard to the issue whether buyer had assented to the printed contract form as a complete and accurate integration of the contract, notwithstanding its express provision to the contrary. Corbin, *supra* at 458. Professor Corbin notes that the court’s decision was fully supported by § 582, and explained at p. 459:

It appears that in the instant case the buyer’s evidence was very strong, so strong that it would be a travesty on justice to keep it from the jury. This is not because the express provision of integration was concealed from the buyer; he was familiar with the printed contract form and knew that the provision was in it and the specifications were not. The court rightly refuses to deprive him of the opportunity to prove that its statement was untrue. . . . Bear in mind, however, that throughout the chapter the author has warned against the acceptance of flimsy and implausible assertions by parties to what has turned out to be a losing contract.

Section 582 of Corbin, allowing admission of extrinsic evidence with regard to the threshold question whether in fact the parties mutually assented to the written document as a completely integrated contract, does not contradict, but rather dovetails with, § 578, on which the lead opinion relies. Indeed, in § 578, p. 402, Professor Corbin hinges a finding of conclusiveness of an express integration clause on whether

the written document was “mutually assented to.” Further, in language excerpted out of the lead opinion’s quotation of § 578, Professor Corbin observes:

The fact that a written document contains one of these express provisions does not prove that the document itself was ever assented to or ever became operative as a contract. Neither does it exclude evidence that the document was not in fact assented to and therefore never became operative . . . [P]aper and ink possess no magic power to cause statements of fact to be true when they are actually untrue. Written admissions are evidential; but they are not conclusive. [Id. at 405, 407 (emphasis added).]

Thus, examination of the written document alone is insufficient to determine its completeness; extrinsic evidence that is neither flimsy nor implausible is admissible to establish whether the writing was in fact intended by the parties as a completely integrated contract.

The cardinal rule in the interpretation of contracts is to ascertain the intention of the parties. To this rule all others are subordinate.

It is undisputed in this case that plaintiff’s decision to hold its convention at the resort was predicated on the understanding of the representatives for both defendants’ predecessor and plaintiff that the resort employed a unionized staff. Had plaintiff been made aware that the resort was for sale or that a sale was pending, I believe it is reasonable to assume that plaintiff’s representative would have insisted that such a clause be incorporated into the agreement. Courts should not require that contracting parties include provisions in their agreement contemplating every conceivable, but highly improbable, manner of breach. In my opinion, the circumstances surrounding execution of the contract, as well as the material change in circumstance that occurred when the resort was sold and the union staff fired, establishes as a matter of law that plaintiff did not assent to a completely integrated agreement. Corbin’s warning against the admission of “flimsy and implausible” evidence is not implicated here.

Accordingly, I would affirm the trial court’s order granting summary disposition in favor of plaintiff pursuant to MCR 2.116(C)(10).

Reflection

The UAW case had particular facts that may have led the court to its result. The fact the parties to this lawsuit were not the original parties to the contract may have encouraged the use of Williston’s objectivist approach. UAW-GW had originally contracted with CMC. KSL only learned about this contractual obligation after purchasing CMC’s hotel properties. The court may have held KSL to a lower standard than CMC with regard to extrinsic evidence, since KSL had no way to know what CMC and UAW discussed in preliminary negotiations.

Discussion

1. Note that the *UAW* majority cites mainly to Professor Williston, while the *UAW* dissent cites to Professor Corbin. What is the difference between these two perspectives?
 2. Do you agree with the majority (who gave effect to the plain meaning merger clause) or to the dissent (who would have disregarded the merger clause based on extrinsic evidence)?
 3. Does the majority or the dissent more closely follow the R2d?
 4. Based on your reading of this case and the R2d rules, can you articulate a general rule on when merger clauses should be enforced and when they should be disregarded?
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Reading *Sierra Diesel Injection Service, Inc. v. Burroughs Corp.* *Sierra Diesel* juxtaposes *UAW*: whereas the *UAW* court took a strict constructionist approach to the merger clause in its agreement, *Sierra Diesel* disregards a similarly clear and plain integration clause. Why would two courts arrive at such different conclusions when reviewing similar intrinsic evidence?

As you read *Sierra Diesel*, think about whether the court uses the objective approach (the plain meaning and four corners rules) or a subjective approach (meeting of the minds) to determine whether the sales contract in this case was integrated. Consider which approach is the right one for this case and in general.

Sierra Diesel Injection Service, Inc. v. Burroughs Corp.

874 F.2d 653 (9th Cir. 1989)

STEPHENS, J.

Sierra Diesel Injection Service, Inc. (Sierra Diesel) is a family owned and operated business that services the fuel injection portions of diesel engines and sells related diesel engine parts. In September 1977, 19-year-old Caroline Cathey, the daughter-in-law of the Sierra Diesel's owner and operator James Cathey, worked as the company bookkeeper. She went to the Reno, Nevada branch office of the Burroughs Corporation (Burroughs) to purchase a posting machine to speed up Sierra Diesel's invoicing and accounting. The salespeople at Burroughs told Caroline Cathey that Sierra Diesel

should buy a B-80 computer (B-80) instead of a posting machine. Caroline and James Cathey attended a demonstration of the B-80 at the Burroughs office. After the demonstration, Burroughs' sales staff sent a letter to Mr. Cathey which said that the B-80 "can put your inventory, receivables, and invoicing under complete control." The letter also informed Mr. Cathey that the information in the letter was "preliminary" and that "the order when issued shall constitute the only legally binding commitment of the parties."

In October 1977, Mr. Cathey decided to purchase the B-80. Sierra Diesel and Burroughs signed various contracts for the sale of hardware and software and for maintenance service. Mr. Cathey's highest level of formal education was a high school degree. At the time he bought the B-80 he was not knowledgeable about computers. He had a general knowledge of warranties and their limitations from the warranty service work Sierra Diesel did for diesel component parts manufacturers, but he did not understand the meaning of "merchantability." He read the contracts from Burroughs to see that they contained the correct price information and product description and he glanced at the back of the contract to see, as he put it, that "I'm not actually signing away the deed to my home or something of this nature."

The B-80 computer did not perform the invoicing and accounting functions for which it had been purchased. It experienced basic equipment breakdowns and was unable to "multi-program." Sierra Diesel personnel complained to the Burroughs service personnel. Burroughs responded to these complaints and its staff attempted to solve the problems and also attempted to repair the system during their regularly scheduled visits under the Maintenance Agreement. Eventually, the Burroughs staff recommended to Sierra Diesel that it purchase a different Burroughs computer (B-91) to remedy the problems. Sierra Diesel purchased the B-91 and took delivery in February 1981. The B-91 computer was no better able to perform the invoicing and accounting functions than the B-80. After additional unsuccessful attempts by Burroughs employees to correct the problems, Sierra Diesel employed an independent computer consultant who concluded that the Burroughs computers would never perform the functions for which they had been purchased. Sierra Diesel bought another computer from a different company. In 1984, Sierra Diesel initiated the present litigation.

[Procedural history omitted. The key point is the trial court determined that the contract was not completely integrated, despite its integration clause.]

After the trial court's ruling, Sierra Diesel and Burroughs entered into a settlement in which the court dismissed with prejudice all of Sierra Diesel's claims as to the B-91 and to most of the claims as to the B-80. The parties stipulated that Burroughs had breached its contracts with Sierra Diesel by failing to put Sierra Diesel's inventory, receivables, and invoicing under complete control and that the B-80 was not merchantable. The trial court awarded Sierra Diesel \$44,000 in damages. The judgment reserved to Burroughs a right to appeal the court's integration and conspicuousness rulings. Burroughs timely appealed.

[Jurisdictional discussion omitted.]

I. Integration

The trial court found that the printed form contracts supplied by Burroughs did not represent a final integrated contract. The court considered the September 27 letter and found that the representations in the letter were part of the agreement between the parties.

Nevada has adopted the Uniform Commercial Code's parol evidence rule in NRS § 104.2202. Under the code, a trial court must make an initial determination that a writing was "intended by the parties as a final expression of their agreement." This is a question of fact and the trial court's findings are reviewed for substantial error.

In deciding whether a writing is final the most important issue is the intent of the parties. One factor is the sophistication of the parties. The trial court found that Mr. Cathey was not a sophisticated businessman, that he had little knowledge of computers or of contract terms, and that he fully expected that the representations made to him by Burroughs' representatives were part of the contract. The trial court also found that Burroughs knew of Mr. Cathey's computer needs and knew that his sole purpose for buying the computer was to get Sierra Diesel's inventory, receiving, and invoicing under control and that Mr. Cathey would not have purchased the B-80 if it were not capable of putting his inventory, receiving, and invoicing under control. The trial court's findings are supported by the record.

Burroughs argues that the presence of a merger clause should, as a matter of law, determine that the contract was integrated, and some courts have so held. However other courts and commentators have rejected this view, especially when the contract is a pre-printed form drawn by a sophisticated seller and presented to the buyer without any real negotiation. Whether several documents are integrated to form one contract is a factual question and the presence of a merger clause while often taken as a strong sign of the parties' intent is not conclusive in all cases.

The agreement between Burroughs and Sierra Diesel involved at least four different kinds of writings: the contract for the sale of the hardware, the contracts for the sale of the software, the contract to finance the transaction through what was on its face a lease, and the contract for service and maintenance. No one writing stands alone, each must be read with reference to another document. The description of the computer components does not lead to recognition of how they relate to one another without additional explanation. The hardware could not function without the software. The lease appears on its face to be inconsistent with a sale. It is not possible to understand what the basic transaction was intended to be without some coordinating explanation. It is understandable that Mr. Cathey believed that he was justified in looking beyond the four corners of anyone writing for the meaning of his agreement with Burroughs.

Additionally, the trial court found that Burroughs' efforts to repair the B-80 showed that Burroughs intended to live up to the representations made in the September 27 letter. Burroughs did not advise Sierra Diesel that the repairs were undertaken without prejudice to Burroughs' contention that there were no warranties. Burroughs'

efforts are also evidence of Burroughs' knowledge of Mr. Cathey's expectations as to the scope and terms of their agreement.

[Discussion on implied warranties omitted. Implied warranties of merchantability and fitness for a particular purpose are discussed in courses focusing on the law of Sales.]

[Discussion on effect of lend-lease agreement omitted.]

Conclusion

The trial court's judgment is AFFIRMED.

Reflection

Sierra Diesel reflects Corbin's subjectivist philosophy. In this case, a clear and unequivocal formal agreement is nevertheless interpreted based on testimony of what the parties thought but did not express in writing. This is anathema to the objectivist philosophy preferred by Williston. And it reflects a general trend in the law at the time away from objectivism and toward subjectivism.

The successors of Corbin furthered the R2d's push toward subjective standards over objective, formalistic rules. One of those successors was John E. Murray Jr., chancellor and a professor of law at Duquesne University, who authored the treatise *Murray on Contracts*. His treatise summarizes what is common about the approaches you have seen so far and functions as a brief but complete statement of the essential features of the parol evidence rule:

(1) [I]f the parties intend their written expression of agreement to be merely final, the terms of that final agreement may not be contradicted by any prior or contemporaneous oral agreement. (2) Such terms in a final writing may, however, be explained or supplemented by evidence of consistent additional terms or by evidence of course of dealing, usage of trade or course of performance. (3) If the parties intended their writing to be not merely final but also a complete and exclusive statement of the terms of their agreement, evidence of consistent additional terms is excluded, but even with respect to such a complete and exclusive expression of agreement, evidence of trade usage, course of dealing, and course of performance is admissible. There is, therefore, no presumption that the writing is the complete and exclusive expression of the parties' agreement. Rather, the opposite is assumed, i.e., the writing will not be viewed as complete and exclusive unless the court finds that the parties intended it to be complete and exclusive.

As mentioned above, it is ironic that Murray was following in Corbin's subjectivist footsteps in his role in Pittsburgh while the Pennsylvania courts continued to advance the objectivist approach. The cleft between the bench and the bar show that Murray's and Corbin's efforts to reform the law have not always been well met. It is not clear whether the Restatements will continue to have so much influence over judicial

decision-making if they continue to be activist in trying to change the law instead of reacting to what the law currently is.

Instead of dwelling on the *Sierra Diesel* case at this point, let's move on to critically evaluate how the R2d instructs judges to interpret contracts. As you review the Restatement's approach, consider how it accords with the reasoning articulated in *Sierra Diesel*.

Discussion

1. Compare and contrast the *UAW* and *Sierra Diesel* cases. Are they based on the same rule and reasoning, or have the courts applied different rules?
 2. If the rules in *UAW* and *Sierra Diesel* are different, which rule is better and why? If the rules are the same, what are the dispositive facts that produce a different outcome in each case?
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Problems

Problem 17.1. Comparing the Common Law and the UCC

The parol evidence rule that has been enacted in each state as UCC § 2-202 is nearly identical to the parol evidence rule as it previously developed in the courts as part of the common law and as it is described in R2d §§ 213–216. There is, however, one subtle difference in the wording of the common law rule and the statutory rule.

a. The provisions are reproduced side by side below. In your opinion, is the difference substantive or merely semantic? In other words, is it real difference, or merely a distinction without a difference?

b. Describe how NH UCC § 2-202 and R2d § 216 are different and whether those differences matter.

Problem 17.2. Capitol City Liquor Company

Harold S., Lester, and Eric Lee (the Lees, or Plaintiffs) owned 50% of Capitol City Liquor Company Inc. (Capitol City). Seagram (or Defendant) is a distiller of alcoholic beverages. Capitol City is a wholesale liquor distributor located in Washington, D.C. Capitol City carries a wide variety of Seagram products, and a large portion of its sales were generated by Seagram lines, for many years.

In May 1970, then EVP, now President, of Seagram, Jack Yogman and Harold S. Lee discussed the sale of Capitol City to Seagram, conditioned on Seagram's offer to relocate the Lees to a new distributorship of their own (100% ownership) in a different

R2d. § 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.	NH UCC § 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.

Figure 17.1. R2d and UCC were drafted based on similar philosophies, but the specific language differs in material ways.

city. Yogman agreed, and the Lees trusted him based on their years of personal friendship and confidence.

About a month later, Seagram sent an officer to D.C., where the Lees negotiated and agreed to sell Capitol City. The Seagram officers prepared the paperwork (the Merger Agreement), which Harold signed on behalf of the Lees. The other 50% owners of Capitol City signed for themselves as well. The promise to relocate the Lees was never reduced to writing. The Merger Agreement does not have an integration clause.

Based on these facts, answer the following questions:

- a. **Is the Merger Agreement final? What evidence of finality is in these facts? For each piece of evidence, classify it as intrinsic or extrinsic.**
- b. **What is the effect of the Merger Agreement's lack of an integration clause?**
- c. **Is the promise to relocate the Lees within the scope of the Merger Agreement?**

- d. What do you think the parties to the oral agreement—Harold S. Lee and Jack Yogman—actually agreed to?
- e. If the Lees attempt to introduce evidence showing that Jack and Harold met and what they discussed, should a court take an objective or a subjective approach? Under that approach, how should a court rule?
- f. What do you think is a fair remedy (if any) for the Lees?

See *Lee v. Joseph E. Seagram & Sons, Inc.*, 552 F.2d 447 (2d Cir. 1977).

Problem 17.3. Middletown Concrete Products

Middletown Concrete Products, Inc. (MCP) manufactures precast concrete products. Hydrotile is a corporate division of Black Clawson Co. Hydrotile makes pipe-making systems.

In 1988, David Mack, Hydrotile's regional sales manager, visited MCP and gave one of its managers a promotional brochure for one of its products, the Neptune Multipak Pipe Machine (the Neptune). The Neptune only works in conjunction with the other half of its pipe-making system, the Rekers Off-Bearing Unit (Rekers).

The Neptune brochure contained a list of figures which included that the Neptune could produce round pipe at a rate of 54 pipes per hour.

After considering purchasing concrete pipe-making equipment from multiple suppliers, MCP focused on negotiations with Hydrotile. Representatives from both companies met and discussed terms including production rates. Although negotiations got heated, with MCP managers screaming, shouting, and demanding a warranty on production rates, Hydrotile never agreed orally or in writing to any particular production rate.

After about a week of negotiations, Hydrotile presented to MCP an "Acceptable Performance Letter," which contained a guaranteed round pipe production rate for the Neptune of 44 pipes per hour. The parties disagree on whether MCP orally made its payment to Hydrotile contingent on the system achieving Acceptable Performance.

After inspecting several locations where the Neptune was installed and operating, MCP agreed to purchase the machine. MCP signed two different contracts: a Neptune Sales Agreement and a Rekers Sales Agreement. Both agreements contained the following clauses:

There are no rights, warranties or conditions, express or implied, statutory or otherwise, other than those herein contained.

This agreement between Buyer and Seller can be modified or rescinded only by a writing signed by both parties.

No waiver of any provision of this agreement shall be binding unless in writing signed by an authorized representative of the party against whom the waiver is asserted and unless expressly made generally applicable shall only apply to the specific case for which the waiver is given.

MCP's Neptune was delivered piecemeal and installed on location starting in October 1989 and began production on March 21, 1990. MCP's Neptune produces round pipe at the rate of 34 pipes per hour. MCP sued Hydrotile, claiming that Hydrotile breached its promises that the Neptune would produce 54 pipes per hour.

Based on the above facts, what evidence should the court allow MCP to admit in support of this claim?

See Middletown Concrete Products, Inc. v. Black Clawson Co., 802 F. Supp. 1135 (D. Del. 1992).

To see how concrete pipe is manufactured, visit <https://www.youtube.com/watch?v=E6jITxhL8bg>.

Problem 17.4. Corn Delivery

Charles Campbell is a farmer in Adams County, Pennsylvania, who entered into a written contract with Hostetter Farms, Inc., to sell twenty thousand bushels of corn for \$1.70 per bushel. The written agreement is signed and dated, but it lacks a merger clause.

During preliminary negotiations, the parties calculated the quantity of corn to be sold based on probable yield of Campbell's farm. Campbell claims that the parties agreed to buy and sell only what Campbell could produce. Hostetter claims that Campbell agreed to sell the specified quantity at the specified price from whatever source. However, this term was not included in their final written agreement.

The prior year, the parties had previously done business for the purchase and sale of three thousand bushels of No. 2 wheat at \$2.15 a bushel. Pursuant to an oral agreement, Campbell delivered 1,534.88 bushels of wheat, but Campbell did not deliver the remaining 1,465.12 bushels. After a little grumbling about the wheat not delivered, Hostetter paid for the wheat delivered, and the matter was concluded.

The weather was especially wet this year, and Campbell's farm did not yield as much corn as he expected. Campbell delivered 10,417.77 bushels of corn to Hostetter, who refused to pay anything given the shortage. Hostetter then purchased twenty thousand bushels of corn on the open market for \$2.65 a bushel.

Hostetter sued Campbell for the extra he paid to purchase the corn on the open market instead of from Campbell. In his defense, Campbell seeks to introduce evidence that (a) he only produced 12,417.77 bushels of corn, (b) he retained 2,000 bushels of corn to feed his livestock, (c) the parties discussed that Campbell was only responsible for delivering the quantity he produced, and (d) it is very common for farmers in Adams County to retain about 10% of their crop yields to feed their livestock.

Hostetter seeks to introduce evidence that the parties discussed that Campbell was responsible for obtaining the corn from another source if his farming did not yield a sufficient quantity.

- a. Characterize each piece of evidence that Campbell and Hostetter seek to admit as intrinsic or extrinsic, and discuss what that evidence would be admitted to show or prove.
- b. Does the parol evidence rule apply to any of the evidence in this case? Should any evidence be excluded from the jury pursuant to the parol evidence rule?
- c. How should the court rule? Was Campbell responsible for delivering 20,000 bushels (the full amount under the contract), 12,417.77 bushels (the amount he actually produced), 10,417.77 bushels (the amount he actually delivered), or some other amount?

See *Campbell v. Hostetter Farms, Inc.*, 251 Pa. Super. 232 (1977).

Problem 17.5. Injury and Indemnity

DEFINITIONS: “Drayage” means shipping goods over a short distance, as compared with long-distance shipping. “Rigging” means attaching loads to cranes or structures. G.W.’s name implies it is in the trade of moving and transporting heavy equipment. Please look up any other industrial or technical terms that are not familiar to you.

Pacific Gas & Electric Company (PG&E), a producer of electrical power, hired G.W. Thomas Drayage & Rigging Company (G.W.) to remove and replace the metal cover of a steam turbine. Their written agreement, which was governed by California law, contained the following indemnity clause:

Contractor shall indemnify Company, its officers, agents, and employees, against all loss, damage, expense and liability resulting from injury to or death of person or injury to property, arising out of or in any way connected with the performance of this contract. Contractor shall, on Company’s request, defend any suit asserting a claim covered by this indemnity. Contractor shall pay any costs that may be incurred by Company in enforcing this indemnity.

During the work, the cover fell and damaged PG&E’s turbine. PG&E sued G.W. to recover the cost to repair the turbine.

PG&E presented evidence that the term “indemnity” has a plain meaning in the law of contracts. It is defined in California Civil Code § 2772 as follows: “Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person.”

G.W. responded by offering to admit evidence of (a) admissions of plaintiff’s agents that they actually knew G.W. did not intend to indemnify PG&E, (b) evidence of defendant’s conduct under similar contracts entered into with plaintiff, and (c) evidence that the trade usage of such indemnity clauses is meant to cover injury to property of third parties only and not to plaintiff’s own property.

- a. Characterize each piece of evidence that PG&E and G.W. seek to admit as intrinsic or extrinsic, and discuss what that evidence would be admitted to show or prove (i.e., Would that evidence add, modify, or explain a term? Is the evidence collateral or directly related to the writing? Etc.).
- b. Does the parol evidence rule apply to any of the evidence in this case? Should any evidence be excluded from the jury pursuant to the parol evidence rule?
- c. How should the court rule? Should G.W. be required to indemnify PG&E and pay for the damage to its turbine?

See Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 69 Cal. 2d 33 (1968).

Chapter 18

Warranties

Warranties are promises that goods or services will meet certain standards. Warranties clarify the obligations of sellers and the expectations of buyers, which builds trust and ensures accountability. Disputes about warranties often require courts to interpret the promises made, the terms of the contract, and the context of the transaction. This chapter examines warranties through the lens of interpretation, focusing on how courts determine the obligations the parties intended to create.

Interpretation is essential to the enforcement of warranties. Courts must decide whether a seller's statement is an enforceable express warranty or a mere opinion. Similarly, courts interpret whether implied warranties, such as merchantability or fitness for a particular purpose, apply based on the circumstances of the sale. These decisions hinge on the seller's language, the transaction's context, and whether the buyer reasonably relied on the promise.

Consider this scenario. A seller advertises a speedboat as "unsinkable" and "capable of withstanding any storm." A buyer purchases the boat based on these claims. When the boat takes on water during a moderate thunderstorm, the buyer sues for breach of warranty. The court must decide whether the seller's statements were factual promises creating enforceable warranties or mere puffery. Resolving this dispute requires interpreting the seller's language, the context of the sale, and the buyer's reasonable expectations.

Ambiguity frequently arises in warranty disputes. Sellers may make statements that buyers interpret as promises, even if the seller believes otherwise. For example, a description like "durable design" might seem like a guarantee to a buyer but a marketing phrase to the seller. Courts resolve such ambiguities using interpretive tools, including intrinsic evidence, like contract language, and extrinsic evidence, such as trade practices or prior dealings.

Disclaimers of warranties add complexity. Sellers may limit or exclude warranties with terms like "as is" or "no warranties, express or implied." Courts must interpret whether these disclaimers are clear, conspicuous, and consistent with the parties' agreement. This process balances freedom of contract with protecting buyers from unfair or hidden terms.

This chapter illustrates how interpretive tools are used to resolve specific contractual obligations. Warranties provide a practical context for understanding broader

concepts in contract law, including ambiguity, enforceability, and fairness. By studying warranties, students will learn how courts clarify rights and obligations and balance competing interests in commercial transactions. This chapter serves as a practical capstone to our module on interpretation.

Rules

A. Express Warranties

We begin with express warranties. “Express warranties” under the UCC are explicit promises made by a seller of goods to a buyer of goods about the quality, nature, longevity, or specific facts relating to the goods. Express warranties can arise in several different ways. UCC § 2-313 provides:

Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

NH UCC § 2-313(1).

Thus, a seller of goods can create an express warranty in three ways: (1) by making specific affirmations of fact about goods, which indicate that the goods will conform to the stated standard; (2) by providing a description of goods, which suggests the goods will conform to the description; or (3) by providing samples or models, which suggest the goods will be similar to the sample or model provided. Any of these methods can potentially create a legally enforceable promise that the goods will live up to the seller’s representations.

The main way a seller creates an express warranty is by directly promising the buyer that goods will perform a certain way in the future. Magic words like “I warrant” or “I guarantee” are not necessary, so long as the statement is definite and specific enough to become “part of the basis of the bargain.” The buyer must be aware of the statement and rely on it, to some extent, in their decision to purchase the goods. For example, a seller might say, “This car gets forty miles per gallon.” Even though the seller did not use magic words like “I promise,” if the buyer hears and relies on this factual assertion,

it becomes part of the basis of the bargain and creates an express warranty that the car will, in fact, get forty miles per gallon. (Note that this is very similar to the definition of a “promise” in R2d § 2—a statement of intention to do or not do something, so made as to justify the promisee in thinking a commitment has been made).

Express warranties can also arise from descriptions of the goods, such as on packaging. For example, a product label might say, “100% organic cotton.” This creates an express warranty that the goods meet that description. Sellers can also make express warranties by providing buyers with samples of goods, which suggest to the buyer that the goods will be similar to the sample. For example, if a seller gives a buyer a sample of their newest snack bar, this sample effectively generates a promise that the same brand of snack bar sold in stores will match the sample. These are all forms of express warranties.

Express warranties are very important to how commerce works today. They ensure that buyers can rely on sellers’ statements about goods in making their purchasing decisions, and they hold sellers accountable for their promises. Enforcing these promises promotes fairness and trust in transactions.

That said, not every statement a seller makes about goods creates an express warranty. Statements of opinion or mere “puffery” do not qualify as affirmations of fact which can form the basis of a warranty. An exaggerated claim like “this is the best TV on the market” or a salesperson’s statement that “this computer is my favorite” are not warranties. These are examples of exaggerated bluster or subjective opinion, which no buyer would be justified in relying upon. These types of statements cannot be enforced as warranties.

Express warranties rely on the seller’s explicit statements or actions to create enforceable promises. However, contracts also include implied warranties, which arise automatically under the UCC to protect buyers even when no explicit assurances are given. The next section examines these implied warranties, starting with the implied warranty of merchantability.

B. Implied Warranty of Merchantability

The implied warranty of merchantability ensures that goods meet basic quality standards. The implied warranty of merchantability arises automatically when a seller is a merchant who deals in goods of the kind involved in the transaction. In other words, the warranty of merchantability is implied only when the seller is a merchant in the narrow sense of being a dealer in this type of goods. A merchant in the broad sense—a person who “by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction”—will not meet this standard. *See* UCC § 2-104(1).

The implied warranty of merchantability does not guarantee perfection. Goods are merchantable if they meet the minimal standards outlined in NH UCC § 2-314(2):

Goods to be merchantable must be at least such as

- (a) pass without objection in the trade under the contract description; and*
- (b) in the case of fungible goods, are of fair average quality within the description; and*
- (c) are fit for the ordinary purposes for which such goods are used; and*
- (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and*
- (e) are adequately contained, packaged, and labeled as the agreement may require; and*
- (f) conform to the promise or affirmations of fact made on the container or label if any.*

For example, Lawrence, a law student, decides to sell his old bike to Medina, a medical student, for \$100, to raise money for his torts casebook. The bike looks fine, but when Medina takes it home and tries to ride it, she realizes the bike doesn't work. It won't pedal, the gears are jammed, and it's completely unusable.

Medina, upset that she can't use the bike as intended, decides to sue Lawrence. She brings a claim based on breach of the implied warranty of merchantability, arguing that the bike is not fit for its ordinary purpose (riding). What result?

When Lawrence, a law student, sells his old bike to Medina, a medical student, for \$100, the implied warranty of merchantability does not apply because Lawrence is not a merchant. Under UCC § 2-314, the implied warranty of merchantability arises only when the seller is a merchant dealing in goods of the kind sold. Lawrence is a private individual selling his personal bike, not someone engaged in the business of selling bicycles or holding himself out as an expert in this field. Therefore, Medina cannot bring a successful claim based on a breach of the implied warranty of merchantability.

Similarly, the implied warranty of fitness for a particular purpose, which is governed by UCC § 2-315, does not apply here. This warranty arises when the seller knows the buyer has a specific purpose for the goods, and the buyer relies on the seller's expertise to select goods suitable for that purpose. In this case, Medina did not communicate any particular purpose for the bike, nor did she rely on Lawrence's skill or judgment in selecting it. Thus, no implied warranty of fitness for a particular purpose was created.

If Lawrence had explicitly stated to Medina, "This bike works fine, I promise," the situation would be different. This statement would likely create an express warranty under UCC § 2-313. Express warranties arise when the seller makes a specific affirmation of fact or promise about the goods that becomes part of the basis of the bargain. By stating that the bike works fine, Lawrence promised a certain level of functionality. If Medina relied on this statement when purchasing the bike, and the bike turned out to be non-functional, Lawrence could be liable for breaching the express warranty.

If Lawrence were in the business of selling used bicycles, he would be considered a merchant under UCC § 2-104(1). As a merchant, Lawrence would be subject to

the implied warranty of merchantability, which requires that goods sold be fit for their ordinary purpose. If the bike failed to meet this standard—for example, if it was completely unusable for riding—Medina would have a valid claim for breach of the implied warranty of merchantability.

In the absence of any warranties, the principle of *caveat emptor* (“let the buyer beware”) applies. As a private sale between non-merchants, Medina bears the responsibility for inspecting the bike and assuming the risk of defects. Without an express or implied warranty, Medina likely has no legal recourse under the warranties doctrine. However, if Lawrence made explicit promises or were a merchant, Medina’s claim would stand on much stronger footing.

C. Implied Warranty of Fitness for a Particular Purpose

The implied warranty of fitness for a particular purpose ensures that goods meet the buyer’s specific needs when those needs are communicated to the seller. This warranty, governed by UCC § 2-315, arises when three conditions are met. These conditions establish a relationship of trust and accountability between the buyer and seller which ensures that the goods provided align with the buyer’s intended use.

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller’s skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose. NH UCC § 2-315

First, the seller must have reason to know the buyer’s particular purpose for the goods. A particular purpose refers to a use that goes beyond the goods’ ordinary or expected functions. For example, a buyer may need paint designed for use in a high-humidity environment or tires suitable for competitive racing rather than standard road use. To trigger this warranty, the buyer must clearly communicate this specific purpose to the seller during the transaction.

Second, the seller must have reason to know that the buyer is relying on the seller’s skill or judgment to select or provide suitable goods. This reliance occurs when the seller understands that the buyer is seeking advice or recommendations rather than acting based on their own expertise. For instance, if a buyer explains the need for pesticide to address a specific type of insect infestation, and the seller recommends a product that does not work for that purpose, the seller may be liable. Similarly, if a buyer requests paint suitable for outdoor use, and the seller provides paint intended only for interiors, the seller could be held accountable if the paint fails under weather exposure.

Third, the buyer must actually rely on the seller’s expertise or recommendations in selecting the goods. If the buyer independently chooses the goods or disregards the seller’s advice, the warranty does not apply. For example, if a buyer purchases

pesticide based solely on their own research and does not seek input from the seller, the warranty is not triggered even if the pesticide is ineffective. Courts assess reliance by examining the context of the transaction and whether the buyer reasonably trusted the seller's expertise to meet their specific needs.

These three conditions ensure that the implied warranty of fitness for a particular purpose applies only in situations where the seller's expertise is central to the transaction and the buyer reasonably depends on that expertise.

ILLUSTRATIONS OF THE FITNESS WARRANTY IN ACTION

The implied warranty of fitness for a particular purpose arises in transactions where the buyer communicates a specific need and the seller's expertise is central to meeting that need. Courts analyze whether the buyer's reliance on the seller's recommendation was reasonable and whether the seller's goods were suitable for the communicated purpose. The following examples illustrate common applications of this warranty:

A farmer explains to a seller that they need a pesticide to address a specific insect infestation. The seller recommends a product that ultimately proves ineffective against the pest. Because the farmer relied on the seller's recommendation, the seller has breached the implied warranty of fitness for a particular purpose.

A buyer informs a seller that they need paint for exterior use on a house and purchases paint based on the seller's recommendation. When the paint begins to peel and degrade after exposure to outdoor weather, the seller is liable under the warranty because their recommendation failed to meet the buyer's clearly stated need.

A hiker tells a seller that they need boots for trekking in extreme cold. The seller recommends boots that are not designed for such conditions, and the hiker suffers harm during their trip. Because the buyer relied on the seller's expertise, the seller has breached the warranty by providing unsuitable goods.

These examples demonstrate the warranty's application across a variety of contexts. In each case, the seller's recommendation was central to the transaction, and the buyer relied on the seller's expertise to meet a specific, non-ordinary need. The implied warranty of fitness ensures accountability and gives buyers confidence when seeking specialized goods or advice.

The implied warranty of fitness for a particular purpose complements the implied warranty of merchantability. While merchantability ensures that goods meet basic

quality standards for ordinary use, fitness for a particular purpose protects buyers in situations where their needs go beyond those ordinary purposes. For example, while a pair of boots might meet merchantable quality standards for casual walking, they might fail to satisfy the implied warranty of fitness if sold for extreme cold without adequate insulation.

Disputes over the implied warranty of fitness for a particular purpose often arise when the communication between buyer and seller is ambiguous or when the seller disputes the buyer's reliance. Courts must interpret the evidence to determine whether the buyer clearly expressed their needs and whether the seller's knowledge and recommendations justified reliance. By applying these principles, courts balance fairness and accountability in commercial transactions.

The implied warranty of fitness for a particular purpose ensures that buyers can trust sellers' expertise in specialized contexts while protecting sellers from liability where no reliance exists. It plays a vital role in fostering trust and confidence in transactions involving goods for unique or technical purposes.

D. Enforcement and Remedies

Warranties provide buyers with enforceable rights and expose sellers to liability when those rights are breached. Breach of a warranty occurs when goods fail to meet the seller's express or implied promises. In such cases, the UCC provides buyers with remedies that reflect the difference between the goods promised and those delivered.

Under NH UCC § 2-714, the default remedy for breach of warranty is money damages. The statute provides:

The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

For example, if a seller promises that a car has a new engine but delivers a car with a used and unreliable engine, the buyer can recover the diminished value of the car. If the car as promised would have been worth \$8,000, but the car delivered is worth only \$5,000, the buyer is entitled to \$3,000 in damages.

The UCC also allows parties to modify or limit remedies through their agreement. NH UCC § 2-719(1) states:

The agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts.

For instance, a seller might include a provision stating that their liability is limited to repairing defective goods or replacing non-conforming items. This flexibility allows parties to craft remedies tailored to their specific needs. However, limitations must comply with the UCC's requirements and cannot fail their essential purpose. If a repair or replacement clause cannot adequately resolve the defect, the buyer may revert to the default remedies under § 2-714.

It is also important to distinguish breach of warranty remedies from rescission. Rescission, which unwinds the contract and returns the parties to their pre-contract positions, is generally available in cases of fraud, mistake, or misrepresentation. In contrast, warranty remedies assume that the contract remains valid but breached. As a result, warranty remedies focus on compensating the buyer for defective performance rather than invalidating the agreement.

Enforcing warranties ensures that sellers are held accountable for their promises, and it provides buyers with reliable remedies when those promises are breached. By allowing parties to modify remedies under § 2-719, the UCC balances contractual flexibility with the protection of buyers' reasonable expectations.

E. Disclaimers of Warranties

The UCC permits sellers to disclaim warranties, either by limiting, altering, or excluding them entirely. These disclaimers are governed by UCC § 2-316, which establishes specific requirements for validity. While sellers can use disclaimers to protect themselves from liability, courts carefully scrutinize these provisions to ensure they are clear, conspicuous, and fair to buyers.

1. Disclaiming Implied Warranties

It is generally easier for sellers to disclaim implied warranties than express warranties. NH UCC § 2-316(2) provides:

Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

To exclude the implied warranty of merchantability, the disclaimer must specifically mention merchantability and, if written, must be conspicuous. For example, a contract stating, "The seller makes no warranties, including any warranty of merchantability," satisfies this requirement if presented in a way that attracts the buyer's

attention. Sellers often write disclaimers in all caps or bold font to make them more conspicuous and meet the UCC's standard.

For instance, a used car dealership might include the following language in its sales contract:

“THIS VEHICLE IS SOLD AS IS, WITH ALL FAULTS. THE SELLER MAKES NO WARRANTIES, INCLUDING ANY IMPLIED WARRANTY OF MERCHANTABILITY.”

This disclaimer, written in capital letters and prominently placed in the contract, would likely meet the UCC's requirements for clarity and conspicuousness. However, if the disclaimer were buried in fine print or located on the back of a receipt, a court might find it invalid because it does not reasonably attract the buyer's attention.

Similarly, to disclaim the implied warranty of fitness for a particular purpose, the disclaimer must use clear, conspicuous language, such as “There are no warranties that extend beyond the description of the goods.” In either case, courts evaluate whether the disclaimer meets the UCC's standards for conspicuousness by considering factors like font size, placement, and visibility in the contract.

Alternatively, sellers may use “catch-all” language to disclaim all implied warranties. UCC § 2-316(3) allows exclusions through phrases such as “as is” or “with all faults,” provided these terms are clear and readily understandable to buyers. However, even with valid disclaimers, courts may invalidate provisions that are deemed unconscionable under UCC § 2-302.

2. Disclaiming Express Warranties

Disclaiming express warranties is inherently difficult. An express warranty arises when a seller makes a specific promise or affirmation of fact about the goods that becomes part of the basis of the bargain. If a contract contains both an express warranty and a disclaimer of warranties, UCC § 2-316(1) directs courts to interpret these terms as consistent wherever reasonable. However, when the warranty and disclaimer are inherently contradictory, courts generally favor the warranty.

Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the [parol evidence rule] negation or limitation is inoperative to the extent that such construction is unreasonable. NH UCC § 2-316(1).

For example, imagine a seller provides a written express warranty stating, “This engine is guaranteed to run for 100,000 miles,” but the same contract includes a disclaimer stating, “The seller makes no warranties, express or implied.” These terms cannot reasonably be reconciled. Courts will generally prioritize the warranty because

it reflects the buyer's reasonable reliance on the seller's specific promise, especially when the warranty induced the buyer to enter the contract.

3. Parol Evidence Rule Implications

The interaction between oral warranties and written disclaimers introduces additional complexity because it implicates the parol evidence rule. When a seller makes an oral promise during negotiations (e.g., "This car will get 40 miles per gallon"), and the final written agreement contains a broad disclaimer of warranties, courts must determine whether the oral warranty can be admitted as evidence.

Under the parol evidence rule, prior or contemporaneous oral agreements that contradict the terms of a fully integrated written contract are generally excluded. For example, if a written contract contains a clause stating that "the seller makes no warranties, express or implied," evidence of an oral promise that contradicts this disclaimer would typically be barred. However, courts often scrutinize such disclaimers, particularly when the circumstances suggest unfairness, misrepresentation, or an imbalance in the bargaining process.

In *Sierra Diesel Injection Service v. Burroughs Corp.*, 890 F.2d 108 (9th Cir. 1989), the seller orally promised that its "B-80" computer would perform specific accounting functions. The written contract, however, included a broad disclaimer stating that the seller made "no warranties, express or implied." The court found that the disclaimer was not sufficiently conspicuous, and it also concluded that the written contract was not fully integrated. These findings allowed the court to admit evidence of the oral warranty. Importantly, the court emphasized that barring the oral warranty under the parol evidence rule would have unfairly shielded the seller from accountability for its misleading representations.

Courts are particularly likely to find ways around an integration clause when enforcing it would lead to an inequitable result. If a seller's oral promises induced a buyer to enter a contract, and the written agreement later contains an unexpected disclaimer, courts may admit the oral promise as evidence of fraud, misrepresentation, or a lack of genuine assent. This judicial flexibility helps to ensure fairness and protect buyers from deceptive practices.

MISREPRESENTATION, PAROL EVIDENCE, AND WARRANTIES

In addition to conflicts between warranties and disclaimers, sellers' statements during negotiations may give rise to claims of misrepresentation. A seller's false assertion about the quality or functionality of goods can lead to liability, even if the contract contains a valid disclaimer of warranties. This interaction highlights a key exception to the Parol Evidence Rule: fraud or misrepresentation.

For example, if a seller assures a buyer during negotiations that a product is “state-of-the-art,” and the buyer later discovers that the product is defective or outdated, the buyer may bring a claim for misrepresentation. Courts often allow evidence of the seller’s statement to establish fraud or misrepresentation, even when the Parol Evidence Rule would otherwise exclude it. This principle ensures that sellers cannot use integration clauses or disclaimers to shield themselves from liability for deceptive practices.

As seen in *Sierra Diesel*, courts balance the need to enforce integration clauses and protect the finality of written agreements with the need to prevent unfairness and misrepresentation. This flexibility underscores the importance of fairness in contract enforcement and provides a safeguard against opportunistic behavior in commercial transactions.

F. Reflections on Warranties

Warranties are essential to managing the expectations and obligations of buyers and sellers in commercial transactions. They establish a framework ensuring that goods meet reasonable standards while allowing flexibility in defining liability. This balance reflects foundational themes in contract law, including reliance, efficiency, fairness, and autonomy.

Reliance is central to the concept of warranties. Buyers trust sellers’ representations and expertise when making purchasing decisions. Express warranties, such as a seller’s claim that a lawnmower can handle wet grass, protect buyers who rely on specific promises. Implied warranties, like merchantability and fitness for a particular purpose, ensure that goods meet baseline expectations, which allows buyers to trust in their quality without negotiating every detail. For example, a buyer who communicates the need for a waterproof tent for camping in heavy rain relies on the seller’s expertise to recommend a suitable product. If the tent fails, the implied warranty of fitness ensures accountability.

Efficiency is promoted by the UCC’s warranty provisions, which streamline transactions by providing clear default rules. The implied warranty of merchantability offers a baseline standard for goods, which eliminates the need for parties to negotiate the quality of routine items. For instance, when a buyer purchases a toaster, they reasonably assume it will toast bread without requiring explicit assurances. These default rules reduce transaction costs by making commerce more predictable and reliable.

At the same time, autonomy is preserved by allowing parties to disclaim warranties under specific conditions. Disclaimers enable sellers to limit their liability, particularly in high-risk industries. A used car dealer, for example, might sell vehicles “as is” to reflect the uncertainty in the condition of older cars. Such disclaimers reduce costs and allow parties to allocate risks according to their priorities. Buyers retain

the freedom to accept or reject such terms, such as deciding whether to purchase an extended warranty for appliances. This flexibility ensures that contracts reflect the unique needs of both parties while requiring disclosure to maintain fairness.

Fairness is safeguarded by rules that protect buyers from exploitative practices. The UCC's requirement that disclaimers be conspicuous ensures that buyers are aware of warranty limitations. For example, a disclaimer buried in fine print, such as "NO IMPLIED WARRANTIES APPLY," would likely be invalidated under UCC § 2-316. Additionally, the doctrine of unconscionability prevents sellers from using disclaimers to deny buyers any remedy for defective goods. A clause that denies liability for delivering defective products might be struck down if the buyer had no meaningful opportunity to negotiate. These protections balance the freedom of contract with safeguards against abuse to ensure that buyers are not unfairly disadvantaged.

Warranties also bridge the gap between contract formation and performance. They ensure that sellers uphold their promises, whether explicit or implied, and that buyers receive goods consistent with their expectations. A seller of "Grade A" apples, for instance, guarantees that the apples will meet industry standards, creating accountability if the buyer discovers bruised or rotting fruit. This accountability fosters trust in commercial relationships and reinforces the importance of delivering on contractual promises.

Finally, warranties clarify remedies when goods fail to perform as promised. The UCC provides remedies such as repair, replacement, or refund, thus ensuring that buyers have recourse if goods do not meet the agreed standards. These remedies uphold the principle of reliance while deterring sellers from making false or misleading representations. By enforcing warranties, the law promotes trust, fairness, and reliability in the marketplace.

Cases

Reading Daughtrey v. Ashe. In this case, the court examines whether a jeweler's appraisal describing diamonds as "H color and v.v.s. quality" created an express warranty under UCC § 2-313. The case focuses on two key issues: whether the description qualified as an express warranty and whether it became part of the basis of the bargain.

As you read the case, pay attention to the court's reasoning about what constitutes an express warranty. Note how the court distinguishes between factual descriptions that create warranties, and statements of opinion or puffery that do not. Also, consider the importance of the "basis of the bargain" standard, which presumes that a seller's description becomes part of the agreement unless rebutted. Reflect on how this approach shifts the burden of proof to the seller

and ensures that buyers can rely on clear representations without needing to prove explicit reliance.

Daughtrey highlights the tension between protecting buyers' expectations and preventing sellers from being unfairly bound by casual statements. Think about how the court's decision balances these competing interests and what it implies for future transactions where sellers provide detailed descriptions of goods.

Daughtrey v. Ashe

243 Va. 73 (1992)

Opinion By WHITING, J.

Daughtrey v. Ashe, 243 Va. 73 (1992)

In this dispute between the buyers and the sellers of a diamond bracelet, the principal issues arise under the Uniform Commercial Code—Sales. Code §§ 8.2-101 through 725. Specifically, they are:

1. whether the sellers' appraisal statement of the grade of diamonds on the bracelet is a description of the goods under Code § 8.2-313(1)(b), and therefore an express warranty; and
2. whether such a statement made the description "a part of the bargain" under Code § 8.2-313(1)(b), and therefore an express warranty, when the buyers did not know of the warranty until some time after the purchase price was paid and the bracelet was delivered.

In conformity with familiar appellate principles, we state the evidence in the light most favorable to the sellers, who prevailed in the trial court.

In October 1985, W. Hayes Daughtrey consulted Sidney Ashe (Ashe), a jeweler, about the purchase of a diamond bracelet as a Christmas gift for his wife, Fenton C. Daughtrey. Ashe exhibited, and offered to sell, a diamond bracelet to Daughtrey for \$15,000. Although Ashe "knew" and "classified" the bracelet diamonds as v.v.s. grade (v.v.s. is one of the highest ratings in a quality classification system employed by gemologists and jewelers), he merely described the diamonds as "nice" in his conversation with Daughtrey. Ashe told Daughtrey that if he was later dissatisfied with the bracelet, he would refund the purchase price upon its return.

When Daughtrey later telephoned Ashe and told him he would buy the bracelet, Ashe had Adele Ashe, his business associate, complete an appraisal form which he signed. The form contained the following pertinent language:

The following represents our estimate for insurance purposes only, of the present retail replacement cost of identical items, and not necessarily the amounts that might be obtained if the articles were offered for sale . . .

DESCRIPTION	APPRAISED VALUE
platinum diamond bracelet, set with 28 brilliant full ct diamonds weighing a total of 10 carats. H color and v.v.s. quality.	\$25,000.00

When Daughtrey came with his daughter to close the sale, he showed the bracelet to his daughter and then paid Ashe for it. As Ashe was counting the money, Daughtrey handed the bracelet to Adele Ashe, who put it in a box together with the appraisal and delivered the box to Daughtrey. Daughtrey later gave the bracelet to his wife as a Christmas present.

In February 1989, Daughtrey discovered that the diamonds were not of v.v.s. quality when another jeweler looked at the bracelet. Shortly thereafter, Daughtrey complained to Ashe, who refused to replace the bracelet with one mounted with diamonds of v.v.s. quality but offered to refund the purchase price upon return of the bracelet. Because the value of diamonds generally had increased in the meantime, Daughtrey declined Ashe's offer.

On May 8, 1989, Daughtrey and his wife filed this specific performance suit against Sidney Ashe and Adele Ashe t/a Ashe Jewelers (the Ashes) to compel them to replace the bracelet with one mounted with v.v.s. diamonds or pay appropriate damages. After hearing the evidence, the trial court found that the diamonds "were of substantially lesser grade" than v.v.s. Nevertheless, because it concluded that the Daughtreys had not proven that "the appraisal was a term or condition of the sale nor a warranty upon which [they] relied in the purchase of the bracelet," the court denied relief for breach of warranty. The Daughtreys appeal.

First, we consider whether Ashe's statement of the grade of the diamonds was an express warranty. Code § 8.2-313 provides in pertinent part:

- (1) Express warranties by the seller are created as follows: . . . (b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

The Ashes argue that the statement in the appraisal form is not an express warranty for two reasons.

First, they say the "appraisal on its face stated that it was 'for insurance purposes only.'" However, we think that the balance of the emphasized language in the appraisal form demonstrates that the limiting language relates only to the statement of the appraised value. Therefore, Ashe's description of the grade of the diamonds should be treated as any other statement he may have made about them.

Second, the Ashes contend that Ashe's statement of the grade of the diamonds is a mere opinion and, thus, cannot qualify as an express warranty under Code § 8.2-313(2).

It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific

intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty. Code § 8.2-313(2).

The Ashes rely principally upon a North Carolina case construing the identical code section from the North Carolina Uniform Commercial Code. However, here, Ashe did more than give a mere opinion of the value of the goods; he specifically described them as diamonds of "H color and v.v.s. quality." Ashe did not qualify his statement as a mere opinion. And, if one who has superior knowledge makes a statement about the goods sold and does not qualify the statement as his opinion, the statement will be treated as a statement of fact.

Nor does it matter that the opinions of other jewelers varied in minor respects. All of them said, and the trial judge found, that the diamonds were of a grade substantially less than v.v.s.

Clearly, Ashe intended to sell Daughtrey v.v.s. diamonds. He testified that he used only the term "nice" diamonds but "never mentioned vvs because Daughtrey didn't know anything about vvs." Later, Ashe testified that "I know when I sold the bracelet and I classified it as vvs, I knew it was vvs."

Given these considerations, we conclude that Ashe's description of the goods was more than his opinion; rather, he intended it to be a statement of a fact. Therefore, the court erred in holding that the description was not an express warranty under Code § 8.2-313(2).

Next, the Ashes maintain that because the description of the diamonds as v.v.s. quality was not discussed, Daughtrey could not have relied upon Ashe's warranty and, thus, it cannot be treated as "a part of the basis of the bargain."

In our opinion, the "part of the basis of the bargain" language of Code § 8.2-313(1)(b) does not establish a buyer's reliance requirement. Instead, this language makes a seller's description of the goods that is not his mere opinion a representation that defines his obligation. Z

Our construction of Code § 8.2-313, containing language identical to § 2-313 of the Uniform Commercial Code, is supported by a consideration of the following pertinent portions of the Official Comment to the Uniform Commercial Code section:

The present section deals with affirmations of fact by the seller, descriptions of the goods . . . exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as a part of the description of those goods; hence *no particular reliance* on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact. *Official Comment 3 (emphasis added).*

In view of the principle that *the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell*, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and described. *Official Comment 4 (emphasis added)*.

Paragraph (1)(b) makes specific some of the principles set forth above when a description of the goods is given by the seller. *Official Comment 5*.

The precise time when words of description or affirmation are made . . . is not material. The sole question is whether the language [is] fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration, if it is otherwise reasonable and in order (Section 2-209). *Official Comment 7 (emphasis added)*.

Concerning affirmations of value or a seller's opinion or commendation under subsection (2), the basic question remains the same: *What statements of the seller have in the circumstances and in objective judgment become part of the basis of the bargain?* As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. *Official Comment 8 (emphasis added)*.

We conclude from the language used in Code § 8.2-313 and the Official Comment thereto that the drafters of the Uniform Commercial Code intended to modify the traditional requirement of buyer reliance on express warranties. Such a requirement was contained in the following pertinent language of the earlier Uniform Sales Act § 12: "any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods *relying thereon*." (Emphasis added.) We note that "induce" and "reliance" appear nowhere in Code § 8.2-313, as contrasted with the reference to buyer reliance in the subsequent section, Code § 8.2-315, dealing with an implied warranty of fitness for a particular purpose.

Hence, the seller's representation need only be "a part of the basis of the bargain," as set forth in Code § 8.2-313(1)(b). The term "bargain" is not defined in the Code, but it is used in the following definition of "agreement" as

the bargain of the parties in fact as found in their language or by implication from other circumstances . . . Whether an agreement has legal consequences is determined by the provisions of this act, if applicable; otherwise by the law of contracts as provided in Code § 8.1-103. (Compare 'Contract'). Code § 8.1-201(3).

The word “‘Contract’ means the total legal obligation which results from the parties’ agreement as affected by this act and any other applicable rules of law. (Compare ‘Agreement’).” Code § 8.1-201(11).

Ashe introduced no evidence of any factor that would take his affirmation of the quality of the diamonds out of the agreement. Therefore, his affirmation was “a part of the basis of the bargain.” Accordingly, we hold that the Daughtreys are entitled to recover for their loss of bargain, and that the court erred in ruling to the contrary.

Therefore, we will reverse the judgment of the trial court and remand the case for further proceedings to ascertain the Daughtreys’ damages.

Reversed and remanded.

Reflection

In *Daughtrey*, the court demonstrated how the UCC facilitates buyer protection by presuming that a seller’s descriptions become part of the bargain. The jeweler’s written appraisal describing the diamonds as “H color and v.v.s. quality” was a factual statement that created an express warranty under UCC § 2-313(1)(b). This warranty obligated the seller to deliver goods that conformed to the description, even though the seller argued that the appraisal was intended for “insurance purposes only.”

One key takeaway from the case is the reduced emphasis on reliance. Unlike common law, the UCC does not require buyers to prove that they explicitly relied on the seller’s statements to create an express warranty. Instead, the seller must rebut the presumption that their descriptions or affirmations were part of the bargain. This shift underscores the UCC’s focus on fairness and efficiency by holding sellers accountable for their representations, especially when the buyer lacks expertise to verify the goods independently.

The case also highlights the distinction between factual descriptions and puffery. The jeweler’s description of the diamonds as “H color and v.v.s. quality” was a factual statement about the goods’ characteristics, not a subjective opinion. This distinction reinforces the importance of clarity in seller representations. Sellers must be cautious about making specific claims that buyers could reasonably interpret as factual guarantees.

Finally, the court’s rejection of the “insurance purposes only” argument underscores how express warranties operate independently of the context in which statements are made. Even if the appraisal served multiple purposes, its factual description of the diamonds’ quality created an enforceable obligation under the UCC. This ensures that sellers cannot escape liability by attempting to limit the scope of their warranties retroactively.

This case illustrates the balance that the UCC strikes between protecting buyers’ reliance on sellers’ descriptions and ensuring that commercial transactions remain

fair and predictable. It demonstrates how express warranties are tools for enforcing accountability in transactions involving asymmetries of knowledge and expertise.

Discussion

1. How does the court distinguish between factual descriptions that create express warranties, and opinions or puffery that do not? Was the jeweler's appraisal clearly a factual description, or could it have been interpreted as opinion?
2. The court rejected the trial court's emphasis on the "insurance purposes only" language in the appraisal. Do you agree with this reasoning? Why might such language still matter in other contexts?
3. *Daughtrey* highlights the UCC's shift from reliance to the "basis of the bargain" test. Does this approach adequately balance buyer protection with seller accountability? What are its potential limitations?
4. The court placed the burden on the seller to rebut the presumption that their description was part of the bargain. What evidence might a seller present to successfully rebut this presumption?
5. How might this case influence how sellers describe their goods? Would you expect sellers to become more cautious in their representations, and how could this affect buyers?
6. If the jeweler had explicitly stated that the appraisal was for insurance purposes and not part of the transaction, would this have changed the outcome? Why or why not?

Reading Carlson v. General Motors Corp. Have you ever owned a car that ran fine—until it broke down catastrophically just after the warranty expired? That's not irony—it might be evidence of a deceptive practice.

In *Carlson v. General Motors*, the plaintiffs allege that GM sold diesel engines it knew were defective, then limited how long buyers could bring warranty claims—both through written warranties and fine-print terms restricting any implied warranties. Some plaintiffs had major engine problems, but only after the express warranty ended. Others didn't experience failure themselves but claimed their cars lost resale value due to GM's reputation for defective diesel models.

The legal issues are layered. On the surface is the implied warranty of merchantability (UCC § 2-314)—the basic promise that goods will be fit for

ordinary use. Beneath that is the doctrine of unconscionability (UCC § 2-302), which allows courts to reject contract terms that are unfair or imposed without real choice. And layered over both is a federal statute: the Magnuson-Moss Warranty Act, passed in 1975 to address deceptive warranty practices in mass-market consumer goods. The Act doesn't create new warranties, but it limits how sellers can disclaim or restrict the ones they offer—especially when they issue written warranties but try to undercut implied protections.

As you read, notice the contrast between the trial and appellate courts. The trial judge dismissed the claims outright, treating GM's warranty limits as reasonable on their face. The appellate court disagreed—at least in part—and sent the case back for further factual development. Why the difference? What role does GM's alleged knowledge of defects play in determining whether the limits were unconscionable?

You might also ask: what is the point of a warranty? Is it just about short-term performance, or should it protect longer-term expectations—especially when the seller has more information than the buyer? And how should courts decide whether a warranty term is fair, or whether the buyer had any real chance to object?

This case invites you to consider the relationship between state and federal law, contract doctrine and consumer protection, surface terms and deeper fairness. It also raises a broader question: in markets built on standard forms and asymmetric information, what does it mean for a contract to be fair?

Carlson v. General Motors Corp.

883 F.2d 287 (4th Cir. 1989)

Opinion by PHILLIPS, J.

This case involves alleged defects in 5.7-liter diesel automobile engines manufactured by the defendant-appellee, the General Motors Corporation (GM), in model years 1981 through 1985. In a seventy-four page amended complaint filed on behalf of 183 named claimants and a prospective class of “similarly situated” car owners—all of whom at one time purchased GM products equipped with diesel engines—plaintiffs charged that the engines were inherently defective and subject to frequent breakdowns, necessitating extensive and expensive repairs. Plaintiffs claimed, moreover, that GM's failure to correct these defects constituted a breach of the implied warranty of merchantability on the engines, hence a remediable violation of the Magnuson-Moss Warranty Act (the *Act*).

In response to Rule 12(b)(6) motions filed by the defendant, the district court dismissed the claims of 130 of the named plaintiffs. At the same time, it denied plaintiffs'

motion to amend the complaint and name additional claimants. This appeal followed and required us to decide:

1. whether GM diesel car owners who did not themselves encounter engine difficulties are nevertheless entitled to maintain actions for the recovery of “lost resale value”; and
2. whether the district court erred by dismissing the separate claims of some plaintiffs that GM’s durational limitations on any and all implied warranties of merchantability were “unreasonable” and “unconscionable.”

Because we agree with the district court that the implied warranty of merchantability does not encompass claims for “lost resale value,” we affirm its dismissal of those plaintiffs who alleged damages attributable only to the “poor reputation” of GM’s diesel products. We also hold, however, that the district court erred by dismissing the “unconscionability” claims of other plaintiffs solely on the basis of the pleadings. We therefore reverse as to those claims and remand them for further proceedings.

I

For present purposes, we treat the named plaintiffs in this case as falling into three separate categories: (1) those who alleged that they encountered significant mechanical difficulties with the diesel engines in their GM cars before the applicable written warranties had expired; (2) those who alleged that they encountered engine problems only after all express warranties had expired; and (3) those who did not specifically allege that their diesel vehicles were defective, but instead only that the “poor reputation” of GM’s diesel products resulted in compensable losses of “resale value.” In a single order, the district court dismissed all named plaintiffs in the latter two categories. Because it did so for conceptually distinct reasons, however, we set out separately the salient facts underlying the claims of each group.

A. Plaintiffs Claiming that GM’s “Durational Limitations” on the Operation of Implied Warranties Were Unreasonable and Unconscionable.

Included in the first group are those plaintiffs who challenge GM’s attempt to impose “durational limitations” on any and all implied warranties covering the diesel-equipped vehicles that are the subject of this dispute.

GM’s express warranties on the diesel engines it manufactured in the 1981 and 1982 model years expired by their terms after 24 months or 24,000 miles. For model years 1983 through 1985, all express warranties on the engines expired after 36 months or 50,000 miles. Critical for present purposes, however, is that the warranty documents provided to purchasers of diesel-equipped GM vehicles included provisions purporting also to limit the operation of any implied warranties to the periods covered by the express guarantees.

Of the 183 plaintiffs named in the amended complaint, 107 alleged that they had first encountered substantial difficulties with their diesel cars only after all applicable

express warranties had expired—hence after the purportedly “simultaneous” expiration of any implied warranties. Plaintiffs sought to avoid the obvious difficulties associated with GM’s written disclaimers, however, by alleging further that the underlying “durational limitations” on the operation of any implied warranties were, as a matter of law, both “unreasonable” and “unconscionable”—hence “ineffective” under § 2308 of the Act:

§ 2308. Implied warranties. (a) No supplier may disclaim or modify (*except as provided in subsection (b) of this section*) any implied warranty to a consumer with respect to [a] consumer product if (1) such supplier makes any written warranty to the consumer with respect to such consumer product, or (2) at the time of sale, or within 90 days thereafter, such supplier enters into a service contract with the consumer which applies to such consumer product. (b) For purposes of this chapter . . . , implied warranties may be limited in duration to the duration of a written warranty of *reasonable duration*, if such limitation is *conscionable* and is set forth in clear and unmistakable language and prominently displayed on the face of the warranty. (c) *A disclaimer, modification, or limitation made in violation of this section shall be ineffective for purposes of this chapter and State law.* 15 U.S.C. § 2308 (emphasis supplied).

In response to GM’s Rule 12(b)(6) motion to dismiss, however, the district court held that the implied warranty disclaimers were indeed both “reasonable” and “conscionable.” Rejecting plaintiffs’ claim that “the warranty limitations were unconscionable and of unreasonabl[y limited] duration because GM knew when it sold the cars that the diesel engines were defective,” the court reasoned as follows:

A durational limitation on an implied warranty can mean only that the manufacturer warrants that the car is fit for ordinary purposes only for the duration of that warranty. In other words, the limitation can mean only that the unmerchantability must manifest itself in some manner during the period of the warranty in order for the purchaser to have a cause of action.

If the court accepted plaintiffs’ argument, a plaintiff would need only to show that a manufacturer knew that a product would fail some time after the expiration of the implied warranty in order to recover for unmerchantability . . . This showing would rarely be difficult, and, thus, the time/mileage limitation on the warranty which Congress expressly permits would be rendered meaningless.

Turning to the specific limitations periods in this case, the court has no problem concluding that the time and mileage limits are reasonable and not unconscionable. In a class action differing from this case only in the model years of the cars involved, a United States Magistrate found a one-year/12,000 mile warranty limitation reasonable. The warranties in the instant case last longer than those found reasonable in the Kaplan case, and this court finds that the limitations are both reasonable and conscionable.

Carlson v. General Motors Corp., No. 2:86-2674-1, slip op. at 13-14 (D.S.C. April 4, 1988).

Plaintiffs now argue that the district court erred by ruling on the unconscionability question solely on the basis of the pleadings. Of course, their ultimate claim is that the amended complaint was sufficient on its face to survive GM's dismissal motion—at least insofar as it alleged facts which, if proven, would have established that the company's durational limitations on implied warranties were indeed “unreasonable” and “unconscionable.”

B. Plaintiffs Seeking Compensation Under the Implied Warranty of Merchantability for “Lost Resale Value.”

The second group of dismissed claimants includes the 17 named plaintiffs who did not allege that they encountered engine difficulties with their own cars, but instead claimed that widespread problems with GM's diesel products had substantially undermined public confidence in all diesel-equipped automobiles—and had in turn diminished markedly the “resale value” of the plaintiffs' cars. The district court held, however, that in no case may automobile owners maintain actions for breach of the implied warranty of merchantability if their cars have “operated without incident.”

The warranty of merchantability guarantees that the warranted goods are fit for the ordinary purposes for which they are used. Thus, in this case, GM warranted that the cars it manufactured would be fit for driving and transportation. GM did not warrant to each purchaser that every other purchaser's car would be fit. As plaintiffs themselves point out, the alleged loss in resale value results from the poor reputation of the cars, and not from a manifest defect in any of the cars which have experienced no mechanical problems. Only if a plaintiff first establishes that his or her car was of unmerchantable quality might he or she recover damages. Because these plaintiffs cannot establish that their cars were not fit for the ordinary purposes for which cars are used, their claims must be dismissed. Slip op. at 10-11.

On appeal, these plaintiffs of course renew their argument that lost resale value demonstrably attributable to widespread product failures constitutes “compensable injury” and gives rise to cognizable claims for breach of the implied warranty of merchantability.

II

At the outset, we pause to note that both of the questions presented in this case turn largely on principles of state law—notwithstanding the amended complaint's threshold invocation of a federal statute. Of course, resolution of the claims of both groups of dismissed plaintiffs ultimately requires that we determine the scope of the “implied warranty of merchantability,” as that phrase is used in the Magnuson-Moss Warranty Act. As the district court recognized, however, the Act “operates in conjunction with state law to regulate the warranting of consumer products.”

The statute itself defines an “implied warranty” as one “arising under State law (as modified by this title) in connection with the sale by a supplier of a consumer product,” 15 U.S.C. § 2301(7), and courts have in turn found it “beyond genuine dispute that, as to both implied and written warranties, Congress intended the application of state law, except as expressly modified by Magnuson-Moss, in breach of warranty actions.”

Each of the named plaintiffs in this case is a resident of South Carolina, and nearly all of them purchased their GM cars in that state. Like 48 of her sister states, South Carolina has adopted Article 2 of the Uniform Commercial Code (UCC or the Code), and we therefore must apply relevant provisions thereof to the full extent required for resolution of the substantive questions on which this case turns.

III

We consider first whether the district court erred by dismissing the claims of those plaintiffs who challenged GM’s “durational limitations” on the operation of implied warranties.

A

The parties do not dispute that the question of whether the limitation of a warranty to a designated period is unreasonable or unconscionable may be decided as a matter of law. Indeed, the rule is mandatory, rather than permissive. By its terms, UCC § 2-302 treats “unconscionability” as question of law; and it is therefore “the court—not the jury—[that] should make the determination of whether designated warranty periods are ‘reasonable’ or ‘unconscionable.’”

This does not suggest, however, that a trial court can always determine “on the pleadings” whether given contractual language is unconscionable. To the contrary, unconscionability claims should but rarely be determined on the bare-bones pleadings—that is, with no opportunity for the parties to present relevant evidence of the circumstances surrounding the original consummation of their contractual relationship. The gravamen of nearly every such claim is that the parties’ initial transaction was in some way tainted by “overreaching”; and it is for this reason that courts have developed “tests” of unconscionability which look, as a matter of necessity, to the presence or absence in a given setting of certain oft-encountered “indicia” of unfair bargaining. One frequently cited case holds, for example, that unconscionability “generally includes an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.” In this circuit, we apply a similar test.

The factors determining “unconscionability” are various: the nature of the injuries suffered by the plaintiff; whether the plaintiff is a substantial business concern; the relative disparity in the parties’ bargaining power; the parties’ relative sophistication; whether there is an element of surprise in the inclusion of the challenged clause; and the conspicuousness of the clause.

Trial courts obviously cannot apply these standards without carefully examining all relevant evidence of the setting in which the parties struck their bargain—and thus

cannot resolve bona fide questions of unconscionability before the litigants have had an opportunity to present such evidence. Courts therefore have strictly adhered to the UCC's express requirement that, "when it is claimed or appears that a 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."

The basic principle is of course that, in order to avoid the danger that they might dispose of viable claims prematurely, courts must allow the parties to develop an adequate record. Otherwise, if "no affidavits, interrogatories, depositions, or evidence of any sort have been submitted regarding the circumstances surrounding the transaction, a court can only speculate as to whether or not a contractual term was unconscionable."

We therefore hold that the district court erred by ruling, solely on the basis of the pleadings, that GM's durational limitations on any and all implied warranties were both "reasonable" and "conscionable" as a matter of law. The court will be equipped to address that question only after plaintiffs have had an opportunity—whether in connection with a motion for summary judgment or at trial—to present evidence that, for example, they had no "meaningful choice" but to accept the limited warranties, or that the durational limitations "unreasonably" favored the defendant.

That said, we turn to the separate question of whether there are nevertheless, as GM claims, alternative grounds on which we could affirm the dismissal order here at issue.

B

The argument is straightforward. It is that, while the dismissed plaintiffs might well have been entitled to go forward and present evidence in support of a "facially viable" claim, their amended complaint simply "failed to allege any facts from which it would appear that the durational limitations were unconscionable."

On our reading, however, the amended complaint more than sufficiently particularizes the alleged "overreaching." It specifies ten separate "reasons" why GM's imposition of durational limitations on the operation of implied warranties was both "unreasonable" and "unconscionable." Plaintiffs alleged, for example, that "due to unequal bargaining power and lack of effective warranty competition among dominant firms in the automobile manufacturing industry, purchasers had no meaningful alternative to accepting GM's attempted limitation of the duration of the implied warranty."

Here, the claim is that the plaintiffs' contractual relationship with GM was tainted by an absence of "meaningful choice" and a substantial "disparity in . . . bargaining power"—facts which, if proven, clearly would establish "unconscionability."

Similarly, plaintiffs' allegation that "diesel engines are designed to and ordinarily do function for periods substantially in excess of those specified in GM's warranties" obviously implicates the "reasonableness" of the durational limitations—hence their effectiveness under § 2308 of the Act.

Perhaps most significantly, plaintiffs also alleged that GM knew of inherent defects in its diesel engines—but failed to warn its customers of the consequential likelihood of “catastrophic failures.”

The claim is, of course, that GM imposed its durational limitations on the operation of implied warranties in the course of bargaining tainted by the “concealment of relevant facts”; that, *ipso facto*, plaintiffs had no “meaningful choice” when they accepted the limitations; and that the disclaimers themselves were therefore unconscionable as a matter of law.

GM argues vigorously, however, that its alleged “knowledge” of various defects—even if proven—has no bearing whatsoever on the “reasonableness” of its warranty disclaimers. The district court apparently agreed. It relied on the following passage from a recent Second Circuit decision, on which GM now stakes much of its case:

Virtually all product failures discovered in automobiles after expiration of the express warranty can be attributed to a “latent defect” that existed at the time of sale or during the term of the warranty. All parts will wear out sooner or later and thus have a limited effective life. Manufacturers always have knowledge regarding the effective life of particular parts and the likelihood of their failing within a particular period of time . . . A rule that would make failure of a part actionable based on such “knowledge” would render meaningless time/mileage limitations in warranty coverage. *Abraham v. Volkswagen of America, Inc.*, 795 F.2d 238, 250 (2d Cir. 1986).

We think *Abraham* is clearly distinguishable, however, at least insofar as the plaintiffs there challenged the “reasonableness” of durational limitations on express limited warranties. The claim in this case is different. The plaintiffs here allege that, even if GM’s limitations on express warranties were of “reasonable” duration, its knowledge of certain “inherent defects” in the diesel engines rendered all parallel limitations on implied warranties “unconscionable.” As should be clear, the crucial distinction is that drawn by the express terms of § 2308 between the “reasonableness” of limitations on express warranties and the “conscionability” of accompanying limitations on implied warranties. GM argues that therein lies no meaningful difference, inasmuch as § 2308 of the Act expressly authorizes limitations of implied warranties to the duration of “reasonably” limited express warranties. What the company ignores, however, is that the statute authorizes such limitations only if they are also “conscionable.”

The concepts of “reasonableness” and “conscionability” are obviously related; but for present purposes there are also, as suggested, certain critical differences. Determining whether temporal warranty limitations are of “reasonable duration” requires the court to determine nothing more than for how long, given past experience, consumers legitimately can expect to enjoy the use of a product “worry-free.” Courts should focus, in other words, on whether purchasers should “reasonably” expect that, after a certain period, the product might well need repair. Herein lies the essence of

plaintiffs' claim that "diesel engines are designed to and ordinarily do function for . . . periods substantially in excess of those specified in GM's . . . warranties"; and we must agree that, in the face of this threshold challenge only to the "reasonableness" of the warranty disclaimers, GM's alleged knowledge of various "inherent defects" in its products simply has no relevance.

Considered in isolation, the claim presents but one, purely objective question: *viz.*, whether it is "reasonable" to expect a diesel engine supplied by any manufacturer to operate "without incident" for a given period of time. Here, the separate, subjective question of whether the manufacturer knew that its product would not meet those expectations simply need not—and indeed should not—ever arise.

Determining whether the imposition of warranty limitations was "unconscionable," however, requires a court to consider somewhat broader questions. "Objective reasonableness" is certainly relevant; but so also is the fundamental fairness of the bargaining process. Indeed, it is for this reason that, when presented with a claim that the inclusion of certain contractual terms constituted unconscionable "overreaching," courts typically look to the parties' relative "bargaining power," "sophistication," "knowledge" and "expertise"—all of which constitute relevant evidence of whether their ultimate transaction was indeed tainted by an "absence of meaningful choice."

Surveying the cases, one noted treatise observes that "judicial findings of lack of 'meaningful choice' . . . are usually founded upon a recipe consisting of one or more parts of assumed consumer ignorance and several parts of seller's guile"; and it is at this level that courts have necessarily cast "unconscionability" in largely subjective terms.

Relevant in any such case are specific allegations that a seller abused his "superior knowledge" and the buyer's relative ignorance, or that the seller's actions were in some other way akin to "fraud or duress in contract formation"—the claim of course being that such behavior implicates the seller's subjective good faith, the "evenhandedness" of the bargaining process, and thus the "conscionability" of challenged contractual language.

Here, proof that GM knew of and failed to disclose major, inherent product defects would obviously suggest that its imposition of the challenged "durational limitations" on implied warranties constituted "overreaching," and that the disclaimers themselves were therefore "unconscionable." When a manufacturer is aware that its product is inherently defective, but the buyer has "no notice of or ability to detect" the problem, there is perforce a substantial disparity in the parties' relative bargaining power. In such a case, the presumption is that the buyer's acceptance of limitations on his contractual remedies—including of course any warranty disclaimers—was neither "knowing" nor "voluntary," thereby rendering such limitations unconscionable and ineffective.

Evidence of the "knowledge of a stronger party that the weaker party will be unable to receive substantial benefits from the contract"—or any related showing that "the transaction involved elements of deception"—should in most cases "contribute to a finding of unconscionability in the bargaining process." R2d § 208 cmt. d.

That is in large measure what the plaintiffs here have claimed; and we therefore cannot say that their amended complaint failed to allege facts which, if proven to the court's satisfaction, could establish that, as a matter of law, GM's durational limitations on the operation of implied warranties were indeed unconscionable. We therefore hold that the district court erred by dismissing the claims of those named plaintiffs who alleged that they first encountered substantial difficulties with their diesel-equipped GM cars only after the purported expiration of all express and implied warranties. In so doing, we express no opinion and intimate no view on what may be proven on the matter, as opposed to what we have held was, at this stage, adequately pleaded to withstand the Rule 12(b)(6) motion.

IV

The remaining substantive question is whether the district court also erred by dismissing those plaintiffs who alleged damages based solely on the "diminished resale value" of their diesel-equipped GM cars.

We think it fair to say that plaintiffs' theory here is a novel one. Indeed, they cite no case in which a court has specifically held that the implied warranty of merchantability protects against unanticipated losses in resale value. Instead, plaintiffs rely primarily on cases in which: (1) courts certified or upheld the certification of nationwide classes whose members included "all owners" of an allegedly defective vehicle; and (2) the damages allegedly suffered by the members of such a class included "diminished resale value."

We find these cases singularly unhelpful, however, for the simple reason that in not one did a court address the substantive question of whether the implied warranty of merchantability protects against an unanticipated diminution in secondary market values.

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Finding no real support for their position in the cases, plaintiffs are therefore left with the bare language of § 2-314 of the Code, which defines and gives shape to the "implied warranty of merchantability."

Under § 314(2)(c), "goods to be merchantable must be at least such as . . . are fit for the ordinary purposes for which such goods are used." Predictably, plaintiffs argue from this that, since "one of the ordinary purposes . . . of purchasing new automobiles . . . is to be able to resell the car eventually," the implied warranty of merchantability encompasses "loss of resale value" claims.

We are not persuaded, however, that § 2-314 reaches nearly that far. The difficulty is that, so far as these plaintiffs are concerned, GM's diesel-equipped cars have served the traditionally recognized "purpose" for which automobiles are used. Since cars are designed to provide transportation, the implied warranty of merchantability is simply a guarantee that they will operate in a "safe condition" and "substantially free of defects." Thus, "where a car can provide safe, reliable transportation, it is generally considered merchantable".

So defined, “merchantability” clearly does not encompass consumer expectations that a product will hold its value; and it is for this reason that several courts have rejected claims similar to those pressed here.

We simply cannot say that the implied warranty of merchantability encompasses more than these courts have held, and we therefore affirm the district court’s dismissal of those plaintiffs who alleged damages attributable only to “lost resale value.”

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VI

In summary, we reverse that portion of the district court’s order dismissing the claims of those plaintiffs who alleged breaches of warranty by reason of mechanical difficulties occurring after the purported expiration of all express and implied warranties; we affirm that portion dismissing the claims of those plaintiffs who alleged breaches of warranty solely by reason of diminutions in resale value; and we remand the case for further proceedings consistent with this opinion.

SO ORDERED.

Reflection

Contracts are temporal instruments: they structure risk and allocate benefits across time. In most transactions, performance unfolds in the future, and so does failure. Contract law must decide who bears the risk of that failure—based on what the parties promised, what they knew, and how the agreement was structured.

Warranties make this dynamic explicit. They don’t just guarantee performance; they define the period during which a certain degree of performance is guaranteed. But that period is not always chosen neutrally. A seller who knows when failure is likely to occur—and when liability can be cut off—can shape warranty terms to shift risk strategically. The structure of the warranty becomes the contractual embodiment of an information asymmetry—which, when leveraged too sharply, exceeds the boundaries of ethical business practices.

Carlson presents just such a case. The plaintiffs allege that GM sold defective diesel engines but limited both express and implied warranties to a period that expired before defects typically appeared. That choice—about how long protection should last—was not incidental. It was, allegedly, a way to avoid responsibility for a failure foreseeable only by GM. The legal dispute centers on unconscionability, but the deeper tension is about timing, knowledge, and power: Who knew what? Who controlled the contract terms? And who was better positioned to bear the risk?

The court’s analysis points toward an important insight. Warranty disputes are not just about whether a product was merchantable at the time of sale. They are also about how time was used to allocate risk—and whether that allocation was fair. When contracts are written in advance by one party and presented without negotiation, the structure of the deal deserves scrutiny. Especially when timing itself is used to offload foreseeable harm onto the less informed party.

Contract law may appear to treat time as a neutral backdrop. This case reminds us that time can be used—like any other term—as a tool of risk design. The question is whether that design should always be enforced.

Discussion

1. The plaintiffs argued that GM's durational limitation on the implied warranty of merchantability was unconscionable because GM allegedly knew about latent defects in its diesel engines. Should a manufacturer's knowledge of defects affect the enforceability of warranty disclaimers? Why or why not?
 2. The court remanded the case to determine whether there was procedural unconscionability in the bargaining process. What evidence might the plaintiffs present to prove procedural unconscionability? How might GM counter these arguments?
 3. Substantive unconscionability focuses on whether terms are unreasonably one-sided. Do you think a one-year limitation on implied warranties is inherently unfair in the context of automobiles? What factors should courts consider when evaluating fairness in this context?
 4. The court held that the implied warranty of merchantability guarantees fitness for ordinary purposes, not resale value. Do you agree with this distinction? Should merchantability encompass market value in certain circumstances, such as when latent defects reduce a product's resale price?
 5. Imagine that GM had included clearer disclaimers in its contracts stating that buyers assumed the risk of latent defects beyond the warranty period. Would this have resolved the plaintiffs' unconscionability claims? Why or why not?
 6. This case highlights the interplay between federal law (the Magnuson-Moss Warranty Act) and state warranty law. How does this overlap affect buyers and sellers? Should one set of rules take precedence, or is the dual system beneficial?
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Reading *Tyson v. Ciba-Geigy Corp.* When a product fails, who's responsible? The manufacturer who wrote the label, the local dealer who gave informal advice, or the customer who chose an off-label use?

In *Tyson*, the court confronts a product failure that sits at the intersection of formal disclaimers and informal assurances. The plaintiff used a chemical herbicide to control weeds in soybean fields. The product came with a printed label that disclaimed all implied warranties and gave specific instructions for

use. But the plaintiff relied not on the label, but on oral advice from a local seller who recommended a different mixture and assured him it would “do a good job.”

The court enforced the manufacturer’s disclaimer of merchantability—finding the label language both conspicuous and valid. It also rejected the express warranty claim, holding that the oral statement amounted to puffery, not a binding promise. Yet the court allowed the case to go forward on a different theory: an implied warranty of fitness for a particular purpose, grounded in the plaintiff’s reliance on the seller’s skill and judgment.

This case offers two puzzles. First, how much protection do disclaimers offer—especially when the buyer never relied on the written terms? Second, when does seller advice rise to the level of a legal warranty? The law draws sharp lines between puffery, promise, and advice—but in practice, those lines often blur, especially in informal transactions involving technical goods.

As you read, consider how courts balance written disclaimers against buyer expectations shaped by speech and trust. Who should bear the risk when a product fails off-label? And what kinds of statements should expose a seller to warranty liability, even when the manufacturer has disclaimed it?

Tyson v. Ciba-Geigy Corp.

82 N.C. App. 626 (1986)

Opinion by HENDRICK, J.

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In the present case, the evidence cited by plaintiff in support of the issue of negligence also supports the allegations of breach of warranty, which were raised by the pleadings.

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Plaintiff assigns as error the trial court’s granting of defendants’ motions for directed verdict. Plaintiff first argues in support of this assignment of error that the evidence is sufficient for the jury to find that Ciba-Geigy breached an express warranty on the Dual 8E label that the product was reasonably fit for the purposes referred to in the directions for use. This argument is without merit.

The label attached to the Dual 8E delivered to plaintiff contained the following express warranty:

“Ciba-Geigy warrants that this product conforms to the chemical description on the label and is reasonably fit for the purposes referred to in the Directions for Use.”

Under the “Directions for Use” the label instructs,

“In soybeans, it [Dual 8E] may be applied alone or in combination with Sencor, Lexone, or Lorox in water or fluid fertilizer with conventional ground sprayers.”

The label also contains tables describing the necessary amount of Dual 8E per acre when using Dual 8E alone or in conjunction with Sencor, Lexone or Lorox. The label does not contain directions for mixing Dual 8E with Paraquat and a surfactant.

Vance Tyson testified that he mixed the Dual 8E with Paraquat and a surfactant and that he did not mix the Dual 8E in accordance with the directions for use on the label. The record contains no evidence tending to show that the Dual 8E was not fit for the purposes referred to in the directions for use, and thus there is no evidence that this express warranty was breached by Ciba-Geigy.

Plaintiff also contends that Ciba-Geigy breached the implied warranty of merchantability and this warranty was ineffectively disclaimed on the Dual 8E label. This contention is also without merit.

G.S. 25-2-316(2) provides, in pertinent part, as follows:

“to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous.”

HN7G.S. 25-1-201(10) provides that whether a term or clause is “conspicuous” is for decision by the court and that language in the body of a form is “conspicuous” if it is in larger or contrasting type or color.

The label on the Dual 8E in the present case contains the following language:

“Ciba-Geigy makes no other express or implied warranty of Fitness or Merchantability or any other express or implied warranty.”

This language is in darker and larger type than the other language on the label and is therefore “conspicuous,” as defined by G.S. 25-1-201(10). We hold, therefore, that Ciba-Geigy effectively disclaimed any implied warranties of merchantability or fitness.

Plaintiff argues that he presented sufficient evidence for the jury to find that Farm Chemical breached express warranties relating to the effectiveness of Dual 8E to kill crabgrass in the no-till cultivation of soybeans. Plaintiff contends that the statements of the sales representative of Farm Chemical that the Dual 8E, when mixed with Paraquat and a surfactant, would “do a good job” created an express warranty.

G.S. 25-2-313(1)(a) provides that

“Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.”

A salesman's expression of his opinion in "the puffing of his wares" does not create an express warranty. Thus, statements such as "supposed to last a lifetime" and "in perfect condition" do not create an express warranty. Similarly, the statement made by the salesman in the present case that the Dual 8E would "do a good job" is a mere expression of opinion and did not create an express warranty.

Finally, plaintiff contends that the trial court erred in granting defendant Farm Chemical's motion for directed verdict on the issue of breach of implied warranty. We agree with this contention. G.S. 25-2-315 defines implied warranty of fitness for particular purpose as follows:

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

The evidence in the present case, when considered in the light most favorable to plaintiff, tends to show that plaintiff contacted defendant Farm Chemical to order the herbicides Lasso and Lorox, for the no-till cultivation of soybeans. He spoke with Mr. Gregory, an employee of Farm Chemical, on the telephone and told him that he was planning the no-till cultivation of soybeans on 145 acres of his land and described the type of soil on the land. Mr. Gregory gave Dual 8E a good recommendation and told plaintiff that it would "do a good job," would be less expensive to use than the chemicals he had used the previous year and would also be less risky to use on plaintiff's type of land. He further told plaintiff that Dual 8E could be mixed with Paraquat and a surfactant to replace Lasso and Lorox. He also told plaintiff the amount of Dual 8E per acre that he should use. Plaintiff testified that based upon Mr. Gregory's recommendation and his past business dealings with Farm Chemical, he decided to use Dual 8E and ordered thirty-five gallons from Farm Chemical. Vance Tyson testified that he mixed the chemicals in accordance with Mr. Gregory's instructions, but that the Dual 8E was ineffective in killing crabgrass. Plaintiff also introduced evidence tending to show that Dual 8E must be mixed with Sencor, Lexone or Lorox and either Ortho Paraquat CL or Roundup.

This evidence is sufficient to support a finding that the seller, Farm Chemical, had reason to know of the particular purpose, the no-till cultivation of soybeans, for which the product was required and that plaintiff was relying on its recommendation when he ordered the Dual 8E. There is no evidence in the record indicating that defendant Farm Chemical disclaimed any warranties relating to the Dual 8E. Thus, the evidence in the record is sufficient for a jury to find that Farm Chemical made an implied warranty relating to the fitness of the Dual 8E for plaintiff's purpose and that this warranty was breached. We hold, therefore, that the trial court erred in directing a verdict for defendant Farm Chemical on the issue of breach of an implied warranty of fitness for particular purpose.

By their cross-appeal, defendants contend that the trial court erred in allowing plaintiff's motion to amend his complaint made at the end of plaintiff's evidence to

allege that defendants' acts constituted unfair and deceptive trade practices in violation of G.S. 75-1.1. After the trial court allowed plaintiff's motion to amend, it allowed defendants' motions for directed verdict on all issues. In plaintiff's appeal, he has not contended that the trial court erred in granting defendants' motions for directed verdict on the issue of unfair and deceptive trade practices. Therefore, it is unnecessary for us to address defendants' assignment of error on cross-appeal.

For the foregoing reasons, directed verdict for defendant Ciba-Geigy Corporation is affirmed. Directed verdict for defendant Farm Chemical is reversed and remanded for a new trial with respect to plaintiff's claim for breach of an implied warranty of fitness for particular purpose as to defendant Farm Chemical and any and all damages resulting therefrom.

Affirmed in part, reversed in part.

Reflection

Tyson shows how contract law draws formal boundaries around what counts as a promise—but those boundaries don't always reflect how deals are actually made. Vance Tyson didn't rely on the manufacturer's label when choosing an herbicide. He relied on the advice of a local dealer who told him that Dual 8E would “do a good job” when mixed in a way not authorized by the label. The label disclaimed all warranties. The advice, by contrast, came informally—by phone, through trust, and without negotiation.

Legally, the express warranty claim fails: the dealer's statement was too vague to rise above puffery. The merchantability claim against the manufacturer fails too, blocked by a conspicuous disclaimer.

But the case doesn't end there. Perhaps in a nod to legal realism—reflecting how reasonable consumers actually make decisions—the court holds that Tyson may still have a claim. Not because of what the seller promised, but because of what the seller knew and how the buyer relied. Under UCC § 2-315, if a seller knows the buyer's particular purpose and recommends a product for that purpose, an implied warranty of fitness may arise—even without explicit promises and even absent fraud.

This shifts the frame. The issue is not just what the contract says but also how the transaction took shape. That makes the implied warranty of fitness a kind of relational doctrine: one that anchors legal duty in context, not just in text.

Tyson reminds us that formal disclaimers can foreclose some claims, but not all. Courts may still look beyond the document to the interaction that gave rise to the sale, especially when the buyer reasonably relied on a seller's apparent expertise. This isn't a case about timing or strategic warranty design. It's about whether legal obligation can arise through ordinary commercial talk—talk that isn't quite a promise, but still carries weight when the product fails.

Discussion

1. The court held that the dealer's statement—that the herbicide would “do a good job”—was too vague to constitute an express warranty under UCC § 2-313. This line between puffery and enforceable promise is often blurry. When does a seller's assurance cross into legal commitment? How should courts assess informal commercial talk that influences purchasing decisions, especially when it references a buyer's specific needs?
 2. Ciba-Geigy's disclaimer of implied warranties was upheld as “conspicuous” under UCC § 2-316. Do you agree with the court's reasoning? Should manufacturers be able to disclaim merchantability in all consumer contexts, or are there circumstances where disclaimers should be limited by public policy or practical effect?
 3. Unlike merchantability, the implied warranty of fitness for particular purpose survived—because the dealer knew the buyer's purpose and recommended a product for it. What makes this warranty more resilient in cases like this? Should that resilience depend on the buyer's ability to prove actual reliance on seller expertise?
 4. This case invites reflection on where legal obligation comes from: formal written terms or relational context. If Tyson had received a brochure with the same disclaimer language as the manufacturer's label, would your view of the case change? Does the buyer's relationship with a local dealer merit different treatment than a remote or anonymous sale?
 5. Ciba-Geigy successfully disclaimed warranties; Farm Chemical (the dealer) did not. Does this distinction seem fair? Should courts treat intermediary sellers differently than manufacturers when both are part of the same commercial chain? How should responsibility be allocated when different actors supply information, products, and disclaimers?
 6. Tyson used the product in a way not contemplated by the manufacturer's label. Does that matter? Should buyer deviation from labeled use cut off claims—especially when the deviation followed a seller's advice? How should courts weigh buyer agency against seller inducement?
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Reading *Ardagh Metal Packaging USA Corp. v. Am. CRAFT Brewery, LLC.* *Ardagh* capstones both this chapter on warranties and the broader module on interpretation by showing how warranty law and contract interpretation converge in practice. The dispute in this case involves a packaging supplier and a beverage company, clashing over product performance and long-term purchasing obligations. While part of the case turns on warranties, much of it

centers on how courts interpret contractual language when the parties disagree about what their agreement actually requires.

There are two strands to follow. First, the warranty issue in Part I.B: ACB alleges that Ardagh's cans failed to function properly, breaching the implied warranty of fitness for a particular purpose. But the contract includes a conspicuous disclaimer, and the court enforces it under UCC § 2-316. This holding ties directly to the doctrines on how implied warranties work, how disclaimers operate, and when unconscionability might still provide relief to a disappointed buyer.

Second, and more extensively, the court tackles interpretation in Part III: what does it mean for a buyer to commit to purchase a certain "Annual Minimum Volume"? Can shortfalls roll over year to year? How should courts interpret phrases like "following calendar year" in the context of a multi-year agreement? This is classic interpretive work, and it's why this case closes the entire module and not just the chapter. Even when the doctrinal headline is "warranty," the real work often lies in parsing contract text.

The larger point is that warranty law isn't isolated—it's embedded in the architecture of contract interpretation. Enforcing or disclaiming a warranty often hinges on how a court reads the surrounding agreement. By ending here, we come full circle: back to the tools of interpretation, applied now in the context of warranties.

As you read, track both dimensions. Why was the warranty disclaimer enforceable despite the product failure claim? How did the court resolve the disagreement over volume obligations? And more broadly, what does this case reveal about how commercial parties structure long-term deals—and how courts work to make those deals legally coherent?

Ardagh Metal Packaging USA Corp. v. American CRAFT Brewery, LLC

718 F. Supp. 3d 871 (2024)

Opinion by DANIEL, J.

Ardagh Metal Packaging USA Corp. ("Ardagh") and American Craft Brewery, LLC ("ACB") entered into a contract for the purchase of aluminum beverage cans. Ardagh filed suit against ACB, alleging that ACB breached its purchasing obligations under the contract.

ACB answered the complaint and asserted various counterclaims and affirmative defenses against Ardagh. Ardagh now moves for partial dismissal of ACB's counterclaims under Federal Rule of Civil Procedure 12(b)(6), to strike certain of ACB's affirmative defenses under Federal Rule of Civil Procedure 12(f), and for a declaratory

judgment against ACB on Count II of the complaint under Federal Rule of Civil Procedure 12(c).

For the reasons below, Ardagh's motion to dismiss is granted in part and denied in part; its motion to strike is granted; and its motion for judgment on the pleadings as to Count II is granted.

Background

Ardagh manufactures and supplies various metal and glass packaging to brand owners. ACB, a manufacturer of alcoholic beverages, is one of Ardagh's customers. Ardagh and ACB entered into an agreement (the "*Initial Agreement*"), effective January 1, 2020, pursuant to which Ardagh agreed to supply and ACB agreed to purchase twelve ounce "sleek" aluminum beverage can bodies and associated can ends.

In December 2020, the parties amended their agreement (the "*Amended Agreement*") and, together with the Initial Agreement, the "*Agreement*").

Relevant here, the Amended Agreement modified the Initial Agreement by:

1. extending the term of the Initial Agreement through January 1, 2027;
2. adding twelve ounce and twenty-four ounce "standard" aluminum beverage cans and associated can ends for purchase; and
3. providing minimum can purchase volumes for the years 2021 through 2026 ("*Annual Minimum Volume*").

Ardagh alleges that ACB failed to meet its Annual Minimum Volume purchase obligations for the years 2021 and 2022, and refused to provide reasonable assurances that it would make up its purchasing shortfalls or be able to perform its contractual obligations for the time remaining on the contract. Ardagh's two-count complaint raises a claim for breach of contract (Count I) and seeks a declaratory judgment in its favor (Count II).

ACB answered the complaint and asserted various counterclaims and affirmative defenses against Ardagh. Certain of ACB's counterclaims stem from Ardagh's use of a particular varnish and wax-based lubricant that is alleged to have caused a "dark, sticky buildup" on the beverage cans, resulting in slowdowns and breakdowns on ACB's processing lines. ACB alleges that Ardagh was aware of the issues that its materials caused during the filling process, but continued to use them anyway in breach of the Agreement. As a result of Ardagh's alleged use of unsuitable varnish and lubricant, ACB raises counterclaims for breach of contract (Counts II and III), breach of the duty of good faith and fair dealing (Counts IV and V), breach of warranty of fitness for a particular purpose (Counts VI and VII), and negligent misrepresentation (Count VIII).

Ardagh now moves to dismiss certain of these counterclaims under Rule 12(b)(6), and to strike certain of ACB's affirmative defenses under Rule 12(f). Ardagh further moves this Court for a declaratory judgment on Count II of the complaint.

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Analysis

I. Ardagh's Rule 12(b)(6) Motion To Dismiss ACB's Counterclaims

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B. Breach of Warranty of Fitness for a Particular Purpose (Counts VI and VII)

Next, Ardagh moves to dismiss ACB's counterclaims for breach of warranty of fitness for a particular purpose. ACB alleges that Ardagh breached the implied warranty of fitness by using unsuitable varnish and wax lubricant that rendered the beverage cans unfit for their intended purpose. Ardagh argues that these counterclaims must be dismissed because they are barred by the Amended Agreement's warranty disclaimer.

New York's Uniform Commercial Code provides that every contract carries an implied warranty of fitness unless excluded or modified. N.Y. U.C.C. Law § 2-315. To exclude an implied warranty of fitness, "the exclusion must be by a writing and conspicuous." N.Y. U.C.C. Law § 2-316(2). Conspicuous means that the writing is "so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it." N.Y. U.C.C. Law § 1-201(b)(10). "Whether a term is 'conspicuous' or not is a decision for the court." N.Y. U.C.C. Law § 1-201(b)(10).

In this case, Section 20.8 of the Initial Agreement provides:

20.8 EXPRESS WARRANTIES. EXCEPT FOR THE EXPRESS WARRANTIES SET FORTH ABOVE, ARDAGH MAKES NO OTHER WARRANTIES OF ANY KIND, WHETHER EXPRESS OR IMPLIED, STATUTORY OR ARISING BY COURSE OF DEALING OR PERFORMANCE, CUSTOM, USAGE IN THE TRADE OR OTHERWISE, INCLUDING, WITHOUT LIMITATION, THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

The Agreement's disclaimer meets the statutory requirements to exclude the implied warranty of fitness for a particular purpose. Section 20.8 clearly and explicitly disclaims all implied warranties, including the warranty of fitness for a particular purpose.

Further, and contrary to ACB's arguments in response, the disclaimer is sufficiently conspicuous. The disclaimer uses capital letters and is set off in its own discrete paragraph. Of the myriad sections included in the Agreement, only two other paragraphs use text in all capital letters, while the remainder of the Agreement uses regular text. The disclaimer is thus presented in such a way that a reasonable person ought to have noticed it.

Nevertheless, ACB contends that there are other factors that may affect the enforceability of the disclaimer, such as whether the provision is substantively unconscionable. This argument stems from the principle that, even if a disclaimer meets the basic criteria for validity, New York's U.C.C. separately provides that a court may void such a clause if it finds it "to have been unconscionable at the time it was made." N.Y. U.C.C.

Law § 2-302). A determination of unconscionability generally requires a showing that the contract was both procedurally and substantively unconscionable when made, which means a showing of absence of meaningful choice on the part of the parties together with contract terms which are unreasonably favorable to the other party.

Beyond asserting that Ardagh was aware of the intended use of the cans when the parties entered into the contract, ACB provides no explanation as to how the warranty disclaimer is procedurally or substantively unconscionable. Rather, the basis for ACB's argument appears to be that a determination of unconscionability should await development of a factual record.

The determination of unconscionability, however, is a question of law properly before the court on a motion to dismiss. Here, there are no allegations from which this Court can plausibly infer unequal bargaining power, deceptive tactics, or any other procedural irregularities in contract formation between these two commercially sophisticated parties. And ACB's conclusory allegation of substantive unconscionability is not sufficient to withstand a motion to dismiss. Accordingly, Ardagh's motion to dismiss Counts VI and VII is granted. . . .

III. Ardagh's Motion for Judgment on the Pleadings on Count II

Finally, Ardagh moves for a declaratory judgment against ACB on Count II of the complaint under Rule 12(c). Specifically, Ardagh seeks a declaration stating that, under Sections 2.2 and 2.2.1 of the Amended Agreement:

ACB has a contractual duty to purchase the Annual Minimum Volume of aluminum beverage cans from Ardagh each calendar year from 2021 through 2026;

should ACB fail to purchase the minimum number of aluminum cans in a given calendar year, the shortfall must be purchased by ACB the following calendar year; and

regardless of any failure by ACB to meet its purchase obligations, the Agreement's termination date is not to extend beyond January 1, 2028.

As noted above, the parties' Amended Agreement is governed by New York law. Under New York law, a contract that is clear, complete, and subject to only one reasonable interpretation must be enforced according to the plain meaning of the language chosen by the contracting parties. When the parties dispute the meaning of the contract, the threshold question is whether the contract terms are ambiguous, which is a question of law for the Court to decide on a claim-by-claim basis.

The language of a contract is unambiguous where it has a definite and precise meaning, unattended by danger of misconception in the purport of the contract itself, and concerning which there is no reasonable basis for difference of opinion. By contrast, ambiguity exists where a contract term could suggest more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs,

practices, usages and terminology as generally understood in the particular trade or business.

Ambiguity can arise from either the language of the contract itself or the inferences that can be drawn therefrom, but ambiguity does not exist simply because the parties urge different interpretations of the contract's language. Additionally, a court must avoid any interpretation of the contract that would be absurd, commercially unreasonable, or contrary to the reasonable expectations of the parties.

Where a contract's language is clear and unambiguous, interpretation is a matter of law, and the Court may decide a claim turning on that interpretation on a Rule 12(c) motion. If, however, the language of a contract is ambiguous, its interpretation presents a question of fact that is not amenable to resolution at the pleadings stage.

The parties dispute centers on the meaning of Sections 2.2 and 2.2.1 of the Amended Agreement, which provide, in relevant part, as follows:

2.2 Supply Minimum. During the term of the Amended Agreement, ACB will purchase from Ardagh 12 oz. Sleek, 24 oz. and 12 oz. standard can bodies and associated can ends in the Annual Minimum Volume and up to the Annual Maximum Volume as outlined below. During the calendar year as noted in the chart below,⁵ from 2021 through 2026, customer will purchase the minimum number of 12 oz. Sleek, 24 oz. and 12 oz. standard can bodies and their associated ends for shipment to ACB's US locations and ACB may elect to purchase up to the Annual Maximum Volume per calendar year as noted below, and Ardagh shall supply such Aluminum Beverage Cans as ordered by ACB up to the Annual Maximum Volume per year. Should ACB wish to purchase more than the Annual Maximum Volume in a calendar year, the Parties will work together in good faith regarding Ardagh supplying such quantities. . . .

2.2.1 Minimum Volumes. Beginning January 1, 2021, Ardagh shall supply 100% of ACB's orders up to the Annual Maximum Volumes above. Should Customer fail to purchase the Annual Minimum Volumes during the applicable calendar year, the volume shortfall will be purchased by Customer in the following calendar year and the term of this Amended Agreement shall be extended until all such purchases have been made. For clarification, ACB shall be required to purchase such Annual Minimum Volumes as noted above in the relevant calendar year. Should ACB obtain cans or ends exceeding such Annual Minimum Volume from a third party after purchasing the minimum noted above, any and all costs associated with such third-party supply are the responsibility of Customer.

Ardagh argues that the language of these provisions makes clear that ACB has a contractual duty to purchase the Annual Minimum Volumes during each calendar year and that any shortfall in a given year must be cured within the following calendar year to avoid breach of the Agreement. It follows that, should ACB fail to meet its

purchasing obligations in 2026, the final calendar year of the Agreement, the term of the contract (and, therefore, ACB's ability to cure) shall not extend beyond January 1, 2028 (the end of the "following calendar year").

ACB, on the other hand, contends that the Amended Agreement provides no limitations on the extent to which shortfalls may be rolled over into subsequent years and contemplates a flexible extension policy under which the terms of the contract may be extended until all Annual Minimum Volumes are purchased. In other words, ACB argues that its obligations to purchase Annual Minimum Volumes can be rolled over into subsequent years perpetually. Alternatively, ACB advances that Section 2.2 is ambiguous, thereby precluding judgment on the pleadings at this stage.

Here, the language of the Amended Agreement clearly and unambiguously requires that ACB purchase the Annual Minimum Volume of cans that correspond to each calendar year from 2021 through 2026. Sections 2.2 and 2.2.1 use mandatory language, i.e., "will" and "shall be required," when describing ACB's minimum purchase requirements for these years. By contrast, the Amended Agreement uses permissive terms, i.e., "may elect," when describing the Annual Maximum Volume of purchases per year.

A contract should be construed, wherever possible, in such a way as to reconcile and give effect to all of its provisions. Applying that principle here, it is clear that the Amended Agreement contemplated a minimum purchasing requirement applicable to each of the calendar years from 2021 through 2026. Any contrary interpretation would render the distinction between the mandatory "will" as to the Annual Minimum Volumes and the discretionary "may" as to the Annual Maximum Volumes meaningless.

This same principle undercuts ACB's perpetual rollover argument. Indeed, ACB advances a reading of the contract that would provide for "an adaptable minimum-maximum volume framework" and would avoid termination of the contract unless and until ACB meets its Annual Minimum Volume purchasing obligations. Such a reading, however, defies the basic tenets of contract interpretation. First, interpreting the Amended Agreement as allowing for perpetual rollover until all minimum volume purchases have been made would render Section 2.2's chart and its corresponding Annual Minimum Volume requirements for each calendar year meaningless.

Second, Section 2.2.1 provides that, "Should [ACB] fail to purchase the Annual Minimum Volumes during the applicable calendar year, the volume shortfall will be purchased by [ACB] in the following calendar year."

The plain and ordinary meaning of the term "following," is "that comes after or next in order, sequence, or time; succeeding, subsequent, ensuing." *Following*, Oxford English Dictionary. Employing the term "following" before the singular phrase "calendar year" thus runs counter to ACB's perpetual rollover position and, instead, contemplates a limited, one-year cure period for any shortfall.

The remainder of the foregoing provision, which reads, "the term of this Amended Agreement shall be extended until all such purchases have been made," does not alter

this conclusion. ACB contends that this provision makes clear that any purchasing shortfalls will continue to rollover into the “following calendar year[s]” indefinitely until “all [Annual Minimum Volume] purchases have been made.”

This interpretation, however, does not give effect to the contract as a whole. Here, the Amended Agreement defines ACB’s purchasing obligations by each “calendar year,” from 2021 through 2026, and provides for a clear end date of January 1, 2027. This end date was specifically negotiated by the parties as part of their amendment to the terms of the Original Agreement, which originally provided for an end date of January 1, 2024. Had the parties intended for a “flexible” and “long-term” structure, as ACB so contends, the inclusion of a defined end date would not be necessary.

The Court recognizes that the Amended Agreement’s “Term” provision states that the January 1, 2027 end date “may be extended per the Minimum Volume Section 2.2.1.” In turn, Section 2.2.1 provides that “the volume shortfall will be purchased by [ACB] in the following calendar year and the term of this Amended Agreement shall be extended until all such purchases have been made.”

According to ACB, these provisions show that the end date of the Amended Agreement is determinable, not by the defined date of January 1, 2027, but by the date in which all Annual Minimum Volume purchases have been made. But such an interpretation is not commercially reasonable since no rational commercial entity would incur obligations in exchange for a purely discretionary option to perform. Indeed, such an interpretation would effectively render ACB’s promises under the contract illusory.

By contrast, the argument advanced by Ardagh that these provisions work in tandem to extend the contract, at most, to January 1, 2028 (assuming a 2026 purchasing shortfall) is commercially sensible. As explained above, the plain meaning of the term “following calendar year” implies a one-year cure period to make up any purchasing shortfall from the previous calendar year. Giving effect to both the “following calendar year” provision and the term-extension provision that allows the contract to be extended beyond the defined January 1, 2027 end date means that ACB would have from January 1, 2027 to December 31, 2027 to make up any shortfalls for failing to meet its Annual Minimum Volume purchases in 2026.

For these reasons, the Court concludes that Sections 2.2 and 2.2.1 of the Amended Agreement are not ambiguous. Rather, the contract’s terms plainly impose an Annual Minimum Volume purchase obligation on ACB for each calendar year from 2021 through 2026; that any purchasing shortfall during the applicable calendar year shall be cured within the following calendar year; and, because the cure period for any 2026 purchasing shortfall would extend from January 1, 2027 to December 31, 2027 (i.e., the “following calendar year”), the contract may be extended beyond the defined end date of January 1, 2027, until all such purchases are made, but terminate no later than January 1, 2028. Accordingly, Ardagh’s motion for judgment on the pleadings on Count II of the complaint is granted.

Conclusion

Ardagh Metal Packaging USA Corp.'s partial motion to dismiss Defendant American Craft Brewery, LLC's counterclaims is granted in part and denied in part; its motion to strike affirmative defenses is granted; and its motion for judgment on the pleadings is granted.

Reflection

Ardagh rounded out our discussion of warranties with an effective disclaimer of the implied warranty of fitness for a particular purpose. The court not only interpreted the disclaimer's language as enforceable, but also clarified that even a formally valid disclaimer can be overcome by unconscionability—before holding that claims of unconscionability must be plausibly pleaded to survive a motion to dismiss and can be resolved by the court as a matter of law. In doing so, the opinion offers a textbook illustration of how disclaimers can be structured to eliminate implied warranties, while also demonstrating the limits of unconscionability as a tool to invalidate even sharply one-sided provisions when the parties are deemed to have had meaningful bargaining opportunities.

Ardagh also returns us to the deeper structure of contractual interpretation. The court's ruling on Ardagh's motion for judgment on the pleadings showcases a methodical deployment of canons of construction—especially the presumption that each contractual term must be given effect, and the avoidance of readings that would render key provisions superfluous. The court invoked the ordinary meaning canon in construing “following calendar year” to limit ACB's cure period for shortfall purchases, and harmonized that interpretation with the agreement's fixed end-date and volume schedule. By emphasizing internal coherence and commercial reasonableness, the court rejected the defendant's attempt to read flexibility into what the text treated as firm commitments.

At the same time, the case left room for relational context to shape contractual meaning where the express language is silent or indeterminate. The court allowed claims based on the implied duty of good faith and fair dealing to proceed—so long as they were pled as alternatives rather than duplicates of the express breach claims. In doing so, it acknowledged that even where a contract is silent on a particular varnish or lubricant, a party may still violate the agreement by exercising discretion in ways that frustrate the counterparty's legitimate expectations. This reinforces a core principle we've seen throughout the course: not all obligations need to appear in the four corners of the contract. Some arise from structural expectations of cooperation and mutual purpose embedded in commercial relationships.

Ardagh is a capstone case not because it breaks new ground, but because it consolidates key ideas: that contracts are construed to preserve their internal logic, and that includes the structure and operation of warranties, the disciplined use of interpretive tools, and the enduring relevance of implied duties.

Discussion

1. The court upheld Ardagh's disclaimer of the implied warranty of fitness for a particular purpose, emphasizing its conspicuous formatting and the parties' commercial sophistication. Do you agree with the court's approach? Should courts be more skeptical of warranty disclaimers even in business-to-business contracts?
 2. The implied warranty of fitness requires the buyer to rely on the seller's expertise for a particular purpose. ACB claimed it relied on Ardagh, but the court found its allegations too general. What would a stronger claim of reliance look like in this setting?
 3. The parties disagreed about whether ACB could cure a volume shortfall in the "following calendar year." The court rejected ACB's interpretation by invoking the ordinary meaning rule and the canon against surplusage. What do these canons reveal about how courts manage ambiguity in commercial contracts?
 4. The court allowed ACB's claim for breach of the duty of good faith and fair dealing to proceed, but only as an alternative to the express breach claim. Why does that distinction matter, and when should courts recognize an implied duty even when no express term is breached?
 5. The court enforced a disclaimer, rejected unconscionability, applied interpretive canons, and preserved room for good faith claims. What vision of contract law does *Ardagh* represent? Does it prioritize formal structure, commercial fairness, or something else?
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Problems

Problem 18.1. Unsinkable Boat

Acme Boat Co. advertises its new speedboat model as "unsinkable" and "capable of withstanding any storm." Bob purchases the boat based on these claims. During a moderate thunderstorm, the boat takes on water and nearly sinks, requiring Bob to be rescued. Bob wants to sue Acme for breach of express warranty. What result?

See *Keith v. Buchanan*, 173 Cal. App. 3d 13 (1985).

Problem 18.2. Will It Blend?

Sarah buys a new blender from Kitchenware Inc., a well-known retailer of kitchen appliances. The first time she uses the blender to make a smoothie, the blade assembly comes loose and damages the motor, rendering the blender unusable. Sarah wants to sue Kitchenware Inc. for breach of the implied warranty of merchantability. What factors will the court consider?

See *Denny v. Ford Motor Co.*, 87 N.Y.2d 248 (1995).

Problem 18.3. Underwater Sealant

Tom visits a local hardware store and tells the salesperson he needs a sealant for his boat that will work underwater. The salesperson recommends “AquaSeal,” assuring Tom it’s perfect for underwater applications. Tom uses the sealant, but it fails to work underwater, causing his boat to leak. Does Tom have a valid claim for breach of the implied warranty of fitness for a particular purpose?

See Gall v. Allegheny County Health Department, 521 Pa. 68 (1989).

Problem 18.4. “As Is”

Carol purchases a used car from Dave’s Dealership. The sales contract includes a clause in the same font and size as the rest of the contract that states: “This vehicle is sold AS IS. There are no warranties which extend beyond the description on the face hereof.” A week after the purchase, the car’s transmission fails. Carol wants to sue for breach of implied warranties. Will the as-is clause protect Dave’s Dealership?

See Lecates v. Hertrich Pontiac Buick Co., 515 A.2d 163 (Del. Super. Ct. 1986).

MODULE V

Performance and Breach

Contracts are enforceable promises, in the sense that they create legal obligations. But the obligation to perform promises depends on how the contract is structured and what events transpired after its formation. This module delves into what happens when parties' promises move from the realm of intention to the messy reality of execution. This module examines the doctrines that determine when obligations are due, how far performance must go to meet those obligations, and when failure to perform is excused or becomes a breach.

Many disputes over performance begin with a foundational question: what must happen before a party's obligations arise? Chapter 19 explores conditions, which define when performance is triggered. These conditions, whether explicitly stated, implied by context, or constructed by courts, act as switches dictating the flow of duties between parties in a contractual circuit. A missed condition can short-circuit the entire arrangement. Yet, as courts analyze whether conditions have been met, they often grapple with the tension between strict enforcement and equitable relief. Through this lens, you will examine how conditions allocate risk and shape the sequencing of obligations. You will also learn how most contracts contain implied mutual conditions: contractual promises are dependent on one another.

What if performance doesn't fully meet the mark? Do you have to perform your promise even if your counterparty failed to perform theirs? Chapter 20 takes up the doctrines of substantial performance and material breach, which address the quality of performance and its consequences. Substantial performance is a doctrine of balance. It ensures that a party who has done enough to fulfill the essence of the contract

still receives the benefit of the bargain, even if minor defects remain. On the other hand, material breach strikes at the heart of a contract's purpose. When performance falls so far short that the promisee's expectations are fundamentally undermined, the law permits suspension or termination of obligations. Together, these doctrines capture the constant negotiation between perfect execution and practical fulfillment.

Not all breaches occur after performance begins. Some happen in advance. Anticipatory repudiation addresses situations where one party signals, in words or actions, that it will not perform before performance is due. Chapter 21 explores the aggrieved party's responses: can they immediately treat the contract as breached, or must they seek assurances before acting? Courts balance the need to protect reliance and mitigate harm with the principle that parties should not prematurely overreact to uncertainty.

Then there are times when no one is at fault, but performance becomes impossible or loses its purpose. The doctrine of excuse, discussed in Chapter 22, comes into play when unforeseen events—a natural disaster, a regulatory change, or the destruction of critical goods—upend the assumptions underlying the contract. Courts use doctrines like impracticability and frustration of purpose to determine whether the affected party should be excused, balancing fairness with the expectation that parties should bear the risks they assume.

Finally, this module considers how parties adapt their agreements to changing circumstances. Chapter 23 on modification and discharge examines the tools available to adjust obligations while preserving the contract's integrity. Unlike initial contract formation, modifications under modern law often dispense with the need for new consideration, focusing instead on good faith and mutual assent. Whether by formal amendment, rescission, or informal waiver, this doctrine highlights the adaptability of contracts in the face of evolving realities.

The doctrines in this module provide more than a roadmap for resolving disputes. They illuminate the delicate interplay between fairness and efficiency, autonomy and accountability, risk allocation and reliance. They equip you with the analytical tools needed to navigate performance disputes, from determining whether a party has done "enough" to assessing when an obligation has been discharged. Most importantly, this module underscores that performance is not just about the letter of the promise but the realities of living up to it.

Chapter 19

Conditions

To understand when performance is required and when it is not, lawyers and law students must first master the concept of “conditions.” A condition is an event whose occurrence or non-occurrence triggers a contractual obligation. Promises are often subject to conditions. For example, Xavier says to LaVel, “I will wash and detail your car on Friday, but only if it is not raining, in exchange for \$50.” LaVel agrees. Xavier’s promise is subject to a condition. He must wash and detail LaVel’s car *only if* it does not rain on Friday. If it is raining, the condition did not occur, and Xavier’s obligation is not due.

A condition in contract law is like a switch in an electrical circuit. Imagine a circuit with a power source, a light bulb, and a switch that controls the flow of electricity. When the switch is off, the circuit is incomplete, and the light bulb stays off. Similarly, in contract law, a condition is an event that must occur (or not occur) to activate a contractual duty. If the condition is met, this is like flipping the switch to the “on” position—performance becomes due, and the obligation is triggered. If the condition is not met, the switch remains “off.” And performance is not due.

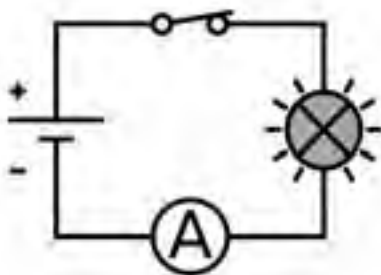


Figure 19.1. Circuit with power, amp meter, light, and switch.

Credit: MikeRun. CC ASA 4 license.

This chapter provides a structured framework for analyzing conditions, guiding students through a step-by-step process: first, identify conditions as express or implied; second, classify conditions as precedent, subsequent, or concurrent; third, determine whether the condition occurred through factual inquiry; fourth, explore how excuses or waivers might address the non-occurrence of a condition; and finally, assess the consequences of non-occurrence, including whether obligations are dis-

charged, remedies are justified, or equitable considerations apply. Each step builds on the foundational idea that conditions are designed to balance autonomy and fairness. They allow parties to specify the exact circumstances under which their obligations will arise while also ensuring that these mechanisms remain flexible enough to accommodate unforeseen inequities.

Understanding conditions is critical for navigating contractual disputes and structuring agreements. Whether a party's duty depends on securing financing, providing timely notice, or meeting performance milestones, the doctrine of conditions determines how these obligations are triggered or discharged. This analysis not only clarifies the parties' expectations but also reinforces broader principles of contract law, including efficiency, reliance, and equity.

The insights gained from this chapter will lay the groundwork for exploring performance, breach, and remedies in subsequent chapters. By mastering the doctrine of conditions, students will be equipped to address the complexities of contractual relationships with both analytical precision and practical foresight.

Rules

A. Identifying Conditions

Identifying conditions is a fundamental precursor to assessing the enforceability of contractual obligations. A condition is an event or set of circumstances that must be satisfied in order for a contractual duty to arise. For a contractual duty to become due, all conditions on that duty must be met. Conversely, if a condition is not satisfied, this will likely discharge a contractual duty, terminating the obligation due to failure of a condition.

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.

R2d § 224.

For example, in an insurance contract between an insurance company and an insured, the contract might state that the insurance company will not pay for the insured's losses "unless those losses involve property damage due to natural causes such as flood, hurricane, or tornado." This means the insurance company's duty to pay does not become due unless a condition (an event) occurs. The event that must occur here is that the insured experiences property damage due to natural causes such as flood, hurricane, or tornado. This is an event, not certain to occur, but which *must* occur in order for the company to have a duty to pay.

Conditions are categorized into "express conditions" and "implied conditions." The legal implications of each differ, so it is crucial to correctly categorize a condition as express or implied.

1. Express Conditions

Express conditions are explicitly stated within the language of the contract. For instance, in a real estate contract, an express condition might state that the buyer's obligation to purchase the property is "contingent upon" the buyer's securing financing by a specific date. Similarly, in an employment agreement, a clause might specify that the employer will pay out a bonus to the employee "only" if the employee meets certain performance targets within a fiscal year. These are examples of express conditions because they are explicitly written into the contract language, clearly demonstrating that the parties intended and agreed to these exact terms.

Parties often choose to explicitly condition their contractual obligations upon the occurrence of some event in order to reduce the risk of future unknowns. For example, if a buyer of real estate does not know whether they can secure financing from a bank, the buyer will not want to be bound to a contract to buy the real estate unless she can get the financing. By including an express condition, the buyer makes it clear that her obligation to purchase the property only comes due if she can secure the financing. The seller, by agreeing to these terms, assumes the risk that the buyer cannot get the financing and that the property sale will not go through.

Express conditions are critical for managing risk and resolving disputes. They clearly delineate the obligations and contingencies agreed upon by the parties. In practice, this clarity reduces the likelihood of disputes and fosters smoother contract performance because each party knows beforehand precisely when and how their duties will be triggered or discharged.

Express conditions are often signaled by specific phrases, such as "if," "only if," "on condition that," "provided that," "subject to," or "otherwise." For example, the term "Payment shall be due if and only if the shipment arrives without defects" establishes an express condition. If the shipment does not arrive without defects, the payment will not be due. You can identify such express conditions using the techniques that you learned in Chapter 15 regarding interpreting intrinsic evidence.

The most important feature of express conditions is that they are **strictly construed**. Partly or "substantially" satisfying an express condition is not enough. Courts apply strict interpretation to express conditions, adhering closely to the plain meaning of the contractual language. For example, in *Dove v. Rose Acre Farms, Inc.*, 434 N.E.2d 931 (1982), the court strictly enforced a condition requiring perfect attendance for a bonus, ruling that even minor deviations disqualified the plaintiff from receiving payment. Dove got sick and missed two work days, but he still wanted his bonus. The Indiana Court of Appeals determined that he did not meet the express condition, so he did not merit the bonus. This case illustrates how strict interpretation upholds the precise terms agreed upon, thus ensuring contractual clarity and predictability.

Once you identify an express condition, you should initially assume that it must be completely and perfectly satisfied before any promises subject to that condition

become obligatory. However, when there is ambiguity as to whether a term is an express condition or not, courts tend to consider the overall context and intent of the parties to decide whether the contract really contains an express condition. Courts generally aim to adopt an interpretation that will avoid a forfeiture.

In resolving doubts as to whether an event is made a condition of an obligor's duty, and as to the nature of such an event, an interpretation is preferred that will reduce the obligee's risk of forfeiture, unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk. R2d § 227(1).

A forfeiture is a denial of a party's compensation under the contract for a performance that they have already rendered or for preparations to perform that they have already taken.

"Forfeiture" is used to refer to the denial of compensation that results when the obligee loses his right to the agreed exchange after he has relied substantially, as by preparation or performance on the expectation of that exchange. R2d § 229, cmt. b.

Courts recognize that express conditions, because they must be strictly construed, can have harsh consequences. Consider an insurance policy in which an insured makes premium payments in exchange for an insurance company's promise to pay covered losses. The policy states that a claim will "only be covered if the insured gives notice of the covered loss within ten days." If this is an express condition—which it is clearly written to be—then failing to give notice of the loss within ten days will completely deny the insured their compensation under the policy. The insured will suffer a forfeiture of the entire benefit of the policy, which they paid for through premiums.

To mitigate the risk of forfeitures, in cases of ambiguity, courts may find that what appears to be an express condition is, in fact, a promise or an implied condition—assuming this interpretation is feasible and would not effectively rewrite the contract. As you will learn below, implied conditions, as well as promises, are satisfied by substantial performance, so they tend to be less harsh in their effect than express conditions. For example, if the notice condition above were implied, rather than express, giving notice within eleven days would suffice. Thus, courts can use the tools of interpretation to balance the need to retain the integrity of the contract as written and the need to uphold the value of fairness.

2. Implied Conditions

Implied conditions are not explicitly stated in the contract but are inferred from facts or law. Unlike express conditions, implied conditions are subject to the standard of substantial performance. Implied conditions are satisfied by substantial performance of the condition. They are not strictly construed.

An event may be made a condition either by the agreement of the parties or by a term supplied by the court. R2d § 226.

a. Implied-in-Fact Conditions

Implied-in-fact conditions can arise from contractual language, but they often arise from the behavior and expectations of the contracting parties. For example, in a services contract, if a cleaning company has consistently used eco-friendly products to carry out its services, and the client has accepted this without objection, this conduct may create an implied condition that eco-friendly products will continue to be used. Similarly, in a rental agreement, if a landlord has previously allowed tenants to sublet with notice, an implied condition might arise that subletting is permissible under similar terms unless explicitly prohibited in the agreement.

Implied-in-fact conditions originate in several ways, including contractual language, course of performance, course of dealing, and usage of trade.

Contractual Language. The parties may not expressly state in their contract that an event is a condition on a party's duty to perform, but when read in context, the contractual language may reveal a condition was impliedly intended. For example, in *Morrison v. Bare*, 2007-Ohio-6788 (Ohio Ct. App. 2007), which you will read below, a contract for the sale of residential property included a "special condition" that the seller would provide the buyer with a copy of a furnace repair bill within fourteen days. This appeared, on its face, to be an express condition requiring the seller to supply the repair bill within fourteen days. But the court reviewed the evidence and decided that this provision included an implied condition that the seller actually repair the furnace.

Course of Performance. The actions of the parties under the current contract may establish an implied condition. For instance, if a buyer consistently requires specific packaging for goods and the seller complies, the packaging requirement may become an implied condition.

Course of Dealing. Past transactions between the same parties can establish implied conditions. For example, if a series of contracts always included inspection as a prerequisite for payment, this behavior might imply that inspection is a condition precedent to payment.

Usage of Trade. Practices commonly accepted within a particular industry can create implied conditions. For example, in the shipping industry, it is standard practice for carriers to provide advance notice of delivery to the consignee, which might create an implied condition requiring such notice. Similarly, in the grain trade, it is customary for goods to meet specific quality standards, and such standards may become implied conditions even if not explicitly mentioned in the contract.

Since implied-in-fact conditions often require reviewing evidence from outside the contract, you may identify implied-in-fact conditions using the techniques that you learned in Chapter 16 regarding extrinsic evidence.

b. Implied-in-Law (Constructive) Conditions

Implied-in-law conditions originate from presumed intent. Presumed intent refers to the inferred expectations and purposes of the contracting parties, based on the contract's overall context and circumstances, but not necessarily on what these parties actually did or said. Recognizing implied-in-law conditions requires understanding how contract law usually interprets agreements.

For example, if a contract for the delivery of perishable goods omits a specific delivery date, a court might infer that the parties intended for delivery to occur promptly to prevent spoilage. Similarly, in a contract involving custom-made goods, a court might presume the parties intended performance to align with reasonable production timelines.

Courts supply implied-in-law conditions to achieve justice. For example, in the case of a construction contract where a contractor completes 95% of a project but fails to finalize minor details due to unforeseen circumstances, a court may impose an implied-in-law condition requiring payment for the completed work to prevent unjust enrichment of the project owner. This ensures fairness while acknowledging the substantial performance of contractual obligations.

Implied-in-law conditions ensure that obligations are performed in a logical sequence and in a manner consistent with fairness. For instance, in a construction contract, the court may imply that the owner's obligation to pay is conditioned upon the contractor's substantial completion of the project.

In sum, the identification of conditions, whether express or implied, is essential to determining the enforceability of contractual obligations. By closely examining contractual language, the conduct of the parties, and relevant trade practices, practitioners can accurately identify and interpret conditions. This foundational analysis ensures that obligations are understood and disputes are resolved in alignment with the parties' intentions and legal principles.

B. Classifying Conditions

Once conditions are identified, they need to be classified. Classifying conditions is a critical step in understanding how they affect the creation, continuation, or discharge of contractual obligations. Conditions are categorized based on their timing and the specific role they play within the contract. Students should use this classification to identify how each condition impacts the enforceability of obligations and the sequence in which duties are performed. There are three main classifications: conditions precedent, conditions subsequent, and conditions concurrent. There is also a category called "promissory conditions," which consists of conditions that are also promises.

1. Conditions Precedent

A condition precedent is an event that must occur before a contractual duty arises. Using the analogy of the electrical circuit, for conditions precedent, the switch starts in the “off” position. The condition is not satisfied until the event occurs. A condition precedent can be used to control whether a duty to perform a single promise is due or whether an entire contract comes into effect.

Conditions precedent are very common in contracts where performance depends on external factors that are beyond a party’s control. For example, in real estate purchase agreements, buyers’ obligations to purchase property are frequently made conditional on buyers’ ability to secure financing by a specific date. Similarly, in life insurance contracts, insurers’ duty to pay the policy amount is almost always conditional upon the insured’s death during the policy period.

Conditions precedent protect the party whose duty is subject to the condition by ensuring that a duty will not be imposed at all unless the specified event occurs. This shelters parties from premature obligations they did not intend to undertake. For example, consider a financing contingency in a real estate contract, which states that the buyer is not under a duty to purchase unless she secures a mortgage. The purpose of this condition is to shield the buyer from being obligated to purchase property that she cannot afford.

When analyzing conditions precedent, always determine what event must occur before a contractual duty becomes due. Look for “magic words” like “only if,” “contingent upon,” “subject to,” or “provided that” to spot these conditions. Lastly, keep in mind that these are conditions, not necessarily promises. Unless a condition precedent is also framed as a promise, neither party is promising that the event will occur. Rather, the condition merely acts as a switch that turns a duty on or off. We discuss this distinction further in the section on promissory conditions, below.

2. Conditions Subsequent

A condition subsequent is an event that, if it occurs, *extinguishes* a duty that has already arisen. These conditions are less common, but they play a significant role in contracts where obligations are tied to ongoing circumstances.

Conditions subsequent are less protective of the party whose duty is subject to the condition. Using the analogy of the electrical circuit, for conditions subsequent, the switch starts in the “on” position. The duty is activated *unless* the subsequent event occurs. If the event occurs, then the duty is discharged (released).

If under the terms of the contract the occurrence of an event discharges a duty of performance that has arisen, that event is called a condition subsequent.

R2d § 230.

For instance, a lease agreement might state that a tenant is obligated to pay rent but include a condition that terminates the tenant’s obligation to pay rent “if the property is

rendered uninhabitable due to unforeseen events, such as a natural disaster.” Similarly, an employment agreement might specify that an employer has a duty to provide an employee with benefits but include a condition stating that “the employer’s duty to provide benefits ends upon the employee’s resignation or termination for cause.”

Conditions subsequent are useful when parties have ongoing obligations to each other that they intend to end upon the occurrence of some event. Conditions subsequent can be used to mitigate the risk that a future event will occur that makes the contract unduly costly or that eliminates the underlying justification for it. In Chapter 22, you will learn about the doctrines of impracticability and frustration of purpose. These doctrines provide a party with an “excuse” for their failure to perform upon the occurrence of an unforeseen supervening event after contract formation. Many courts and commentators have theorized that these doctrines are based on the concept of conditions subsequent. In either case, a duty to perform under a contract is discharged by the occurrence of some future event.

When seeking conditions subsequent, look for language like “unless,” “shall cease upon,” or “will terminate if” to recognize these conditions. Look for contract language whose effect is to clarify that a party has a duty but that this duty will cease to exist if some contingency occurs.

You may by now have recognized that distinguishing between conditions precedent and conditions subsequent is somewhat of a philosophical exercise. As a purely technical matter, most conditions subsequent could be reengineered and formulated as conditions precedent. Take the example of the financing condition. This could be phrased either as a condition precedent or a condition subsequent. The contract might say, “Buyer is obligated to purchase the house only if buyer obtains a mortgage.” This is a condition precedent. But the contract might instead say, “Buyer must buy the house unless buyer cannot obtain a mortgage.” This is a condition subsequent. If the buyer cannot get financing, the result is functionally the same, but the conditions are structured differently.

The distinction matters for two reasons. First, as noted above, if a condition is structured as a condition precedent, the *plaintiff* in a breach of contract dispute has the burden to prove that all conditions on the defendant’s duty have been satisfied. In contrast, if the condition is structured as a condition subsequent, the burden would be on the *defendant* to show that their existing duty has been discharged by the occurrence of some event.

Second, even though the technical effect of both types of conditions is similar, the rhetorical and emotional impact is different. Would you feel differently if someone said, “You can practice law *unless* you fail the bar exam,” versus, “You can only practice law *only if* you pass the bar exam”? Some students respond that the first phrasing, which includes a condition subsequent, provides a higher expectation of receiving the result. Technically, both conditions have the same effect: a condition on practicing law is not failing the bar, and a condition on practicing law is passing the bar. But

the use of “only if” instead of “unless” implicitly suggests a higher bar to achieving the desired result.

3. Conditions Concurrent

Conditions concurrent are events that must occur simultaneously for the parties' respective obligations to become due. These conditions are common in contracts involving mutual exchanges of performance, where each party's performance is dependent on the other's readiness and willingness to perform.

For example, in a sales contract, the seller's duty to deliver goods and the buyer's duty to pay for those goods are typically conditions concurrent. Each party's obligation is conditioned on the other's performance, thus ensuring a simultaneous exchange of value. Students should assess how conditions concurrent balance risks and ensure fairness in mutual exchanges. For example, they can evaluate whether the language of the contract sufficiently ties each party's duty to the other's performance, thereby minimizing the risk of one party failing to fulfill their obligations.

Where the performances of the parties are to be exchanged under an exchange of promises, the parties must render these performances simultaneously unless the language or circumstances indicate otherwise. R2d § 234.

This classification reinforces the principle of reciprocity in contract performance and minimizes risks associated with one party's non-performance. Students should consider reciprocity as a key factor when determining whether a conditions concurrent is present. By focusing on whether the obligations are genuinely reciprocal, they can better analyze the fairness and balance within the contract's terms.

Examine whether the contract language ensures reciprocal obligations are balanced and simultaneous. Structurally, you might identify risks associated with one party's potential non-performance and consider how conditions concurrent minimize these risks. Textually, consider phrases like “simultaneous exchange” or “dependent upon” as intrinsic evidence that such conditions exist.

4. Promissory Conditions

Promissory conditions are both conditions and promises; they are conditions that a party promises will come to pass. Promissory conditions typically take the form of a promise to ensure that a condition will be satisfied. The effect of failure of a promissory condition is both the discharge of a party's duty and a breach of contract.

To give a simple example, imagine a contractor agrees to build a wall for a car factory and guarantees that the other party will be satisfied with the wall. This is both a promise and a condition. If the other party is not satisfied with the wall, the contractor does not get paid, and the contractor is in breach of contract because they failed to fulfill their promise.

Promissory conditions are not the norm. Most conditions are not promises; they are just conditions. Thus, non-occurrence of most conditions is not a breach of contract.

Non-occurrence of a condition is not a breach by a party unless they are under a duty that the condition occur. R2d § 225(3).

To decide whether a condition is a contractual obligation as well, courts closely examine both the language of the contract and the circumstances of the agreement. Courts do not subject a party to breach of contract lightly. If a contract is not completely clear that a condition is also a promise, a court will likely not view it that way.

For example, in *Morrison v. Bare*, excerpted below, a buyer's obligation to purchase a home was conditional on the seller's repair of a broken furnace. The buyer argued that this condition was also a promise and that, because the seller failed to repair the furnace, the seller was in breach of contract. The court disagreed, holding that, in fact, the seller did not promise to repair the furnace; rather, the seller promised to sell the house, and the buyer promised to buy the house subject to the condition that the seller repair the furnace. Because the seller did not repair the furnace, the buyer was free to walk away from the deal. The contractual "switch" was off, and the buyer did not have to perform their obligation of paying for the house. But the buyer could not sue the seller for failing to repair the furnace. The buyer's options were limited to not purchasing the house or to waiving the condition and going forward with the purchase regardless. (You will learn about waiver below.)

On the other hand, sometimes a condition really is also a promise. If a party unambiguously undertakes in a contract to ensure that a condition comes to pass, then failing to follow through on this promise will expose them to a claim for breach of contract while also absolving the other party of their own duty to perform.

Internatio-Rotterdam, Inc. v. River Brand Rice Mills, Inc., 259 F.2d 137 (2d Cir. 1958), excerpted below, provides an example of a promissory condition. The parties entered a contract for the sale of rice. The contract stated that a shipment of rice was to be delivered in December 1952, with two weeks' notice from the buyer. The reason for this two-week notice provision was to ensure that the buyer gave the seller shipping instructions at least two weeks before the desired shipping date so that the seller knew where and how the goods should be delivered (e.g., identifying the ship and the dock). The buyer failed to give timely notice, and the seller refused to perform. The seller argued that its duty was discharged due to the failure of a condition (giving timely notice), and that, in fact, the buyer was in breach of contract due to its failure to give two weeks' notice. It was clear to everyone involved that the reason for the seller's refusal to perform was that the market price of rice had gone up since they entered the contract, and the seller could make more money by dealing with a new buyer. Regardless, the court held for the seller, finding that the notice provision was a promissory condition—both a promise and a condition. The buyer breached a promise, and the seller's obligation to deliver the rice was discharged due to the failure of a condition.

You will see the concept of promissory conditions again in the next chapter, where you will learn that most obligations in a contract are mutually dependent on each other.

When parties make a bilateral exchange of promises, each of these promises is likely conditional on the performance of the other promise. They are mutually dependent implied promissory conditions, also called “constructive conditions of the exchange.”

Recall that most contracts involve an exchange of promises. These are bilateral contracts, in which one party makes a promise in exchange for the other party’s promise. In most bilateral contracts, each party’s duty to perform is conditional on the other party’s mutual performance. If one party fails to substantially perform, they may be in breach. Additionally, one party’s substantial performance may be a precondition to the other’s corresponding obligation, so a failure to perform can discharge the other party’s duty altogether. Thus, when performance breaks down, courts must decide whether the breach is serious enough to excuse the other party’s obligations.

To understand the impact of mutually dependent promissory conditions, consider the following example:

Ben says to Cathy, “I’ll sell you my bicycle on Thursday for \$45.” Cathy accepts, promising to show up at the appointed time and location so they can make the exchange. What happens if Cathy does not show up? Does Ben have to give Cathy his bike? The answer, as you will learn in the next chapter, is no. Ben’s and Cathy’s promises are conditional upon each other. If Cathy does not show up with the money, then a condition on Ben’s performance has not been met. Cathy did not perform, and she did not even deliver a substantial performance. Thus, Ben does not have to perform.

Note that Cathy, in these facts, is also in breach of contract. Ben could sue her for breach of contract if he wished. However, to do so, Ben would have to aver in his complaint that he is ready and able to perform by bringing Cathy the bike; otherwise, Cathy herself would have no duty to perform. This is the power of mutually dependent promissory conditions.

In sum, classifying conditions as precedent, subsequent, or concurrent, and identifying promissory conditions provides a structured framework for analyzing contractual obligations. By understanding the timing and function of conditions, you can evaluate the enforceability and sequence of duties within a contract. Subsequent sections will build on this framework to address how conditions are satisfied, what happens when conditions fail, and how conditions can be waived or excused.

C. Determining Whether Conditions Are Satisfied

Once conditions are identified and classified, the next step is to determine whether the condition has been satisfied. This step assesses whether the designated event or state of affairs occurred as required by the contract.

In practice, when a plaintiff brings a claim for breach of contract alleging that the defendant failed to perform as promised in the contract, the plaintiff will have the burden of proving that all conditions precedent to the defendant’s duty to perform have

been satisfied. The plaintiff will typically plead in the complaint that all conditions precedent to the defendant's duty have been met, and, as the dispute progresses, the plaintiff will eventually need to prove this through evidence. This will likely involve gathering evidence, such as written records, emails, performance logs, or other documentation confirming the occurrence of the condition under the specific terms of the contract.

Remember that for express conditions, strict compliance is required. This means that determining the satisfaction of an express condition focuses solely on whether the condition was fully performed. Even minor deviations or omissions will result in the failure of the condition. For instance, imagine that a contract for the sale of goods states, "Unless the seller makes the delivery by December 31, no payment will be due." The seller's delivery on January 1 constitutes failure of the condition, even though the seller is only one day late. Precise adherence to express conditions may seem harsh, but it supports predictability in contractual obligations. The failure to satisfy an express condition typically means the corresponding obligation does not arise, and so this analysis may be a key turning point in assessing the enforceability of duties.

In contrast, for implied conditions, substantial performance satisfies the condition. This inquiry is more nuanced and will be addressed in Chapter 20 on substantial performance and material breach. At this stage, just understand that substantial performance is not perfect performance, but it still largely delivers the benefit of the bargain. For example, in a contract requiring a buyer to provide shipping instructions two weeks before the delivery date, if this is merely an implied condition, then supplying the instructions nine days before delivery may well suffice. The question would be whether that performance is substantial—whether the shortfall is a "venial" fault—or whether the delay materially impairs the value of the bargain for the seller. On the other hand, if "two weeks' notice" is an express condition, then a failure to comply with the specified timing—even if there is a good reason for being just a few hours late—means the condition would not be satisfied, and the obligation contingent upon it would not arise. The next section explores the consequences of the failure of a condition.

D. Failure of Conditions

When an express condition is not perfectly satisfied, the condition has failed. Failure of a condition will typically result in the discharge (release) of a party's obligations under the contract. For conditions precedent, the duty never arises unless the condition is satisfied. Thus, the party who would have been subject to that duty does not have to perform at all. Their duty is discharged.

If the performance of a duty is subject to the occurrence of a condition, that performance is not due unless the condition occurs or its non-occurrence is excused. R2d § 225(1).

For example, in a contract to purchase real estate that is contingent on securing financing, the buyer's obligation to purchase the property is discharged if the buyer

fails to secure financing. Similarly, conditions subsequent operate to terminate a duty that has already arisen. Finally, in an insurance contract, the insurer's duty to cover a claim may be discharged if the insured fails to file the claim within the policy's specified deadline.

Importantly, just because a condition has failed does not mean any promise has been breached. Unless the condition was also a promise (called a "promissory condition" and discussed below), failure of the condition does not constitute a breach of contract because the condition was not a legal obligation to perform.

However, the non-occurrence can still result in inequities, especially when one party has conferred benefits or incurred costs in reliance on the anticipated performance. While legal remedies such as damages are unavailable in these situations, equitable remedies like restitution may be granted to prevent unjust enrichment.

When a party's failure to satisfy a condition results in harm to the other party, equitable remedies such as restitution may be awarded to prevent unjust enrichment. R2d § 229.

For instance, if the buyer's failure to secure financing was due to negligence, the seller might retain an earnest money deposit as liquidated damages. Conversely, if the financing condition was excused due to the seller's failure to cooperate, the buyer could seek restitution for expenses incurred in preparing to purchase the property, such as inspection or appraisal fees.

In addition, reliance and restitution remedies may be available when one party has conferred benefits or incurred costs in anticipation of performance. These remedies aim to restore the non-breaching party to their pre-contract position or compensate for losses incurred due to reliance on the contract.

The non-occurrence of a condition can have profound effects on contractual obligations and remedies. By systematically analyzing discharge, remedies, and equitable considerations, students can develop a comprehensive understanding of how courts address these issues. This final step in conditional analysis ensures that outcomes align with fairness, predictability, and the parties' original expectations.

E. Excuse or Waiver

Even if a condition has not been satisfied, it may be excused by a court or waived by a party under specific circumstances. Courts may excuse the non-occurrence of a condition to avoid disproportionate forfeiture. The parties may voluntarily waive a condition through their actions or through explicit agreement.

1. Excuse by Courts

Courts have the authority to excuse the non-occurrence of a condition when enforcing it strictly would result in disproportionate forfeiture. Recall that a forfeiture, in contract law, means the denial of a party's compensation under a contract.

If strict enforcement of a non-material (unimportant) condition would require a party to forego (forfeit) the benefits they contracted to obtain, and if the forfeiture is disproportionate to the harm caused by failure of the condition, a court may excuse the condition.

To the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange. R2d § 229.

For example, consider a lease agreement requiring a tenant to provide proof of insurance by the first day of the lease term. If the tenant delivers the insurance certificate two days late but the landlord's risk has not increased as a result, a court might excuse the non-occurrence of the condition to prevent the tenant from losing their lease. This would be true especially where the tenant has taken actions in reliance on the lease, like giving up some other lease and moving into the new premises. The court's decision would hinge on whether the insurance deadline was a material part of the agreed exchange or simply an ancillary requirement. By excusing the condition, the court preserves the contract's primary purpose while avoiding a disproportionate penalty for the tenant.

Courts can also excuse a condition when the non-occurrence of the condition was due to the fault or bad faith of the party seeking to enforce it. For example, if a landlord imposes a condition requiring proof of insurance but then actively avoids accepting the tenant's submission of the certificate, this bad-faith conduct would weigh heavily in favor of excusing the condition. Similarly, if a buyer fails to provide shipping instructions on time because the seller withheld necessary information, the seller's fault may justify excusal. These factors ensure that excusing the condition aligns with principles of fairness while preventing opportunistic behavior by the enforcing party.

Giving courts authority to excuse a condition serves the principles of fairness and equity while maintaining the integrity of the contractual relationship.

2. Waiver by Parties

A condition may also be waived if the party entitled to enforce it voluntarily relinquishes their right to do so. Waiver can occur explicitly, through clear statements or agreements, or implicitly, through conduct that demonstrates an intent not to enforce the condition. This analysis focuses on the actions and communications of the parties to determine whether a waiver has occurred.

For example, imagine a landlord who repeatedly accepts late rent payments without objection. Over time, the landlord's conduct may be interpreted as a waiver of the condition requiring timely payment. This scenario illustrates the importance of clear and consistent behavior, as courts often infer waiver from a pattern of conduct that contradicts the enforcement of the original condition. This implicit waiver would prevent the landlord from later enforcing strict compliance with the payment deadline unless proper notice is given to reinstate the condition.

Similarly, if a seller explicitly informs a buyer that a shipment deadline can be extended without penalty, the seller has waived the condition tied to the original deadline. Explicit waivers differ from implicit ones in that they involve clear and direct communication leaving little room for ambiguity. This clarity is crucial in avoiding disputes, as both parties can rely on the explicit statement to guide their actions. For instance, the buyer in this scenario may confidently delay the shipment without fear of breach, knowing that the seller has explicitly modified the deadline. This example demonstrates how explicit communications can modify the enforcement of a condition and highlight the need for careful documentation to avoid disputes.

In analyzing waiver, students should focus on identifying whether the waiving party's conduct or statements demonstrate a clear intention to relinquish the condition. Courts will consider whether the other party reasonably relied on the waiver and whether reinstating the condition would create unfair surprise or hardship.

In sum, excuses and waivers play a vital role in tempering the harsh rule that requires strict compliance with express conditions. These doctrines fit into the broader framework of conditional analysis by providing mechanisms for flexibility when strict enforcement would undermine equity or the practical intent of the agreement. By addressing these exceptions, courts can uphold fairness without eroding the reliability of contractual obligations.

F. Conditions of Satisfaction

Conditions of satisfaction are a unique kind of condition in contract law, and they come with special rules.

Conditions, as you now know, are events that are not certain to occur but whose occurrence determines whether a contractual duty is due. So far, we have been assessing conditions that take the form of external events outside the parties' control. But what happens when the "event" is the satisfaction of a person or even one of the parties to the contract? This creates what is called a "condition of satisfaction."

A condition of satisfaction exists when a party's performance is conditional on their being satisfied with the other party's performance. For example, a landlord offers to rent you her house for the summer only if the landlord is satisfied with your credit score. This is a condition of satisfaction. If the landlord is not satisfied with your credit score, she does not have to rent her house to you.

Satisfaction conditions can usually be identified because the contract uses words like "satisfy," "satisfied," or "satisfaction," but any other synonym would be treated similarly. The key feature is that one party's approval of the other party's performance is required before the first party's performance is due.

Satisfaction clauses, while they can be structurally simple, create a challenge for contract law because whether someone is satisfied is often a subjective question, and parties may have strong incentives to lie. For example, if one party's performance is

conditional on its satisfaction with the other party's performance, the first party can simply lie about whether it is satisfied and use this as an excuse to absolve itself of legal liability.

Contract law has responded with special rules regarding how to deal with these so-called "conditions of satisfaction." There are two different standards of satisfaction. The first, and preferred, standard is that of reasonable, objective satisfaction. The second standard is that of honest, subjective satisfaction.

No matter which standard is applied, conditions of satisfaction are subject to the requirement that parties to a contract act with good faith and fair dealing toward one another regarding their contractual obligations. This means that a party cannot dishonestly claim dissatisfaction to gain a material advantage over a contract counterparty—even where the standard is subjective.

How, then, do courts choose which standard to apply? As you will learn in *Morin Building Products Co., Inc. v. Baystone Construction, Inc.*, 717 F.2d 413 (7th Cir. 1983), the objective standard is applied in commercial agreements where satisfaction depends upon criteria like "commercial quality, operative fitness, or mechanical utility which other knowledgeable persons can judge." In commercial situations, courts generally apply a rule of reasonable or objective satisfaction, asking whether a reasonable person in the position of the promisor would or should be satisfied with the performance.

For example, in a plumbing contract where a plumber agrees to fix your plumbing in exchange for payment subject to your being satisfied, the key question is obviously one of utility and operative fitness. The plumber's work would be judged based on whether a reasonable person would be satisfied. You could not escape your duty to pay by claiming you are not personally satisfied if a reasonable person would be.

In contrast, the subjective standard of honest good faith is employed when the contract involves "personal aesthetics or fancy." In agreements regarding personal or artistic matters, such as a contract for an artist to paint your portrait, it is simply not feasible to apply a reasonable standard of satisfaction. As anyone who has evaluated a photo of themselves can attest, people have very different standards of satisfaction when it comes to their personal appearance. Thus, in a contract to paint a portrait, a court would apply a subjective standard unless the contract says otherwise. The buyer will be the sole judge of their portrait and might not be satisfied even if a reasonable person would be.

As they say, one person's trash is another person's treasure; there is no accounting for taste. When an objective standard is not applicable as a matter of law, courts then need to determine whether the promisor is actually satisfied in fact. Courts, and potentially a jury, will have to evaluate the credibility of the party claiming dissatisfaction. If they are, in reality, satisfied, they will have to perform their side of the deal.

Courts are very hesitant to apply a subjective standard to conditions of satisfaction. They tend to apply an objective standard whenever feasible, asking whether a reasonable person would be satisfied under similar circumstances.

When it is a condition of an obligor's duty that they be satisfied with respect to the obligee's performance or with respect to something else, and it is practicable to determine whether a reasonable person in the position of the obligor would be satisfied, an interpretation is preferred under which the condition occurs if such a reasonable person in the position of the obligor would be satisfied. R2d § 228.

The reason courts prefer the objective standard is that they generally strive to avoid a forfeiture. Remember that express conditions must be perfectly performed; otherwise, a promise subject to that condition does not have to be performed at all. This is a harsh result that can be very unfair. Satisfaction clauses raise the same problem, and worse. If satisfaction were judged solely based on a party's subjective mindset, this could frequently lead to forfeiture. A party could lawfully refuse to pay, simply by claiming dissatisfaction with the performance, even if the performance was reasonably good. Contract law is not designed to benefit those who are unduly picky and unreasonable.

To mitigate the risk of forfeitures, courts tend to apply the objective standard where feasible, unless the parties unambiguously indicate that a subjective standard applies or the contract is one for which an objective standard makes no sense (like the personal portrait).

For example, in *Morin*, Baystone, a general contractor for General Motors, hired Morin, a subcontractor, to build an aluminum-siding wall for a General Motors plant. The parties included a satisfaction clause that appeared to give General Motors significant discretion to judge whether it was satisfied with the wall Morin built. A General Motors agent found Morin's aluminum siding wanting—even though, under an objective reasonable person standard, the wall was undisputedly acceptable. The court, in an opinion by the famous judge Richard Posner, held that an objective reasonable person standard should be applied, even though the contract seemed to imply that “acceptability shall rest strictly with the Owner.”

This case illustrates courts' general preference for an objective standard in commercial contracts. After all, the building for which the aluminum siding was intended was a factory—not usually intended to be a thing of beauty. If the “parties really intended General Motors to have the right to reject Morin's work for failure to satisfy the private aesthetic taste of General Motors' representative,” Judge Posner reasoned, they would have clearly said so in their contract. But the contract language was instead “ambiguous” as to whether the parties intended “to subject Morin's rights to aesthetic whim.”

G. Reflections on Conditions

The doctrine of conditions provides a structured framework for analyzing when and how contractual obligations arise, are enforced, or are discharged, offering critical tools for managing risk and setting clear performance expectations in contracts. By

identifying and classifying conditions, evaluating their satisfaction, and addressing excuses or consequences of non-occurrence, you develop a deeper understanding of how contracts allocate risks and define performance expectations.

Conditions underscore the principles of autonomy and fairness in contract law. They allow parties to structure their agreements with precision while ensuring that unforeseen circumstances or inequities can be addressed through equitable doctrines like waiver and restitution. This balance reflects contract law's broader goal of aligning the parties' intent with practical realities to promote both predictability and flexibility in enforcement.

Strict interpretation of express conditions reduces the risk of judicial overreach by limiting courts to the language chosen by the parties, thereby upholding their autonomy in drafting the contract. Furthermore, this approach enhances predictability, as parties can rely on clear, unambiguous terms to guide their performance and expectations. By respecting the intent of the parties as reflected in their agreement, courts strengthen contractual certainty. However, strict interpretation is tempered by fairness doctrines that excuse the non-occurrence of a condition to avoid disproportionate forfeiture. This balance ensures that parties' expectations are protected while mitigating unjust outcomes in exceptional cases.

The analysis of conditions lays the foundation for evaluating how contractual obligations are fulfilled and what happens when they are not. In the next chapter, you will explore how most bargain contracts involve mutually dependent promises that operate as implied promissory conditions, and you will learn the special rules that apply to evaluating performance and breach of these constructive conditions.

Cases

Reading Morrison v. Bare. Our first case about conditions, *Morrison*, illustrates a clear example of a condition. The case involves the purchase and sale of a house, where the real estate purchase agreement had a section titled "Special Conditions." In this section, the parties wrote that the seller would provide the buyer with a copy of a repair bill for the furnace.

This case is useful not only for its facts and analysis thereof but also for its thorough description of the law of conditions. The Ohio Court of Appeals quotes and discusses treatises by Corbin, Williston, Murray, and Farnsworth, as well as the R2d, as they pertain to conditions and their impact.

In *Morrison*, the seller tried (and failed) to argue that he was only supposed to furnish a bill, and the bill need not show that a cracked heat exchanger (which is part of a furnace that heats the house) had been repaired. Reflect back on the canons of construction, and think about why the seller's position did not

reflect a reasonable interpretation of the written agreement. In any event, the court dismissed the seller's semantic gambit.

This case illustrates what happens when a condition does not occur. To understand this point, pay careful attention to what remedies the plaintiff wanted. Note that the buyer, Mr. Morrison, is the plaintiff as well as the appellant, signifying that he must have lost at trial.

At trial, the buyer asked the court for an order of specific performance requiring the seller to sell the house to him. Moreover, the buyer wanted the price to be the contract price minus the cost of repairing the furnace.

The court correctly refused to require the seller to sell the house at a lower cost because that is not how conditions function. Conditions are not independent promises, where the failure to bring about such independent promises could be a breach that results in an award of money damages that equals the cost of the breach. Rather, conditions are merely switches, which turn on or off contractual promises.

Since the condition did not occur in this case, the buyer's promise to buy the house was not triggered, and the buyer could rightfully refuse to conclude the purchase. Alternatively, the buyer could waive the non-occurrence of this condition and conclude the purchase anyway, pursuant to the original terms. But the buyer had no right to demand that the seller sell the house at a lower price than originally agreed.

As you read this case, highlight the specific language showing that the seller did not guarantee, warrant, or otherwise promise to fix the furnace. This language made clear that the condition was not a promise. You will want to compare this with the next case, *Internatio*, where the condition was a promise, known as a promissory condition. Why was the condition in *Morrison* not a promise, whereas the condition in *Internatio* was?

Morrison v. Bare

2007-Ohio-6788 (Ohio Ct. App. 2007)

DICKINSON, J.

Introduction

Jack W. Morrison Jr. is in the business of buying houses, refurbishing them, and renting them to college students. Tom Campensa, a real estate agent, showed Mr. Morrison a house owned by Jonas Bare. Mr. Morrison noticed a sticker on the furnace that indicated it had a cracked heat exchanger. After checking with Mr. Bare, Mr. Campensa told Mr. Morrison that the furnace had been repaired in 2004.

Mr. Morrison executed a contract to purchase the house, but included a “special condition” in the contract that Mr. Bare would provide him a copy of the 2004 furnace repair bill within 14 days.

Mr. Bare supplied a copy of a 2004 bill for repairs, but those repairs did not include replacing the heat exchanger.

Instead of closing on the house, Mr. Morrison sued Mr. Bare for specific performance and breach of contract and sued Mr. Bare, Mr. Campensa, and Mr. Campensa’s real estate agency for fraud.

The trial court granted summary judgment to all three defendants, and Mr. Morrison appealed. His sole assignment of error is that the trial court incorrectly granted the defendants summary judgment.

This court affirms the trial court’s judgment because: (1) Mr. Morrison neither performed his part of the contract nor showed his “readiness and ability” to do so; (2) the requirement that Mr. Bare provide a bill showing that the heat exchanger was repaired was a condition for Mr. Morrison’s performance, not a promise; and (3) Mr. Morrison did not justifiably rely upon Mr. Campensa’s statement that the heat exchanger had been repaired.

Background

Mr. Morrison noticed a for-sale sign on the house at issue in this case and told Mr. Campensa he would like to look at it. Mr. Campensa walked through the house with Mr. Morrison and Mr. Morrison’s father. The house was in disrepair, and the utilities were disconnected. During the walkthrough, Mr. Morrison noticed a sticker on the furnace that indicated it had a cracked heat exchanger. When he was deposed, he said the sticker had caused him concern because he knew that a cracked heat exchanger meant the furnace would have to be replaced. He further testified that he questioned Mr. Campensa about the heat exchanger and Mr. Campensa said that he would check with the seller, Mr. Bare, to see whether it had been fixed.

At some point after the walkthrough, Mr. Campensa talked to Mr. Bare about the furnace. Mr. Campensa testified that he told Mr. Bare that the furnace had a sticker on it indicating that it had a cracked heat exchanger and that Mr. Bare told him the furnace had been repaired. Mr. Bare testified that he did not recall whether Mr. Campensa had specifically mentioned the cracked heat exchanger, but that he had told Mr. Campensa the furnace had been repaired. Either way, Mr. Morrison and Mr. Campensa agree that Mr. Campensa told Mr. Morrison that the heat exchanger had been repaired.

Mr. Morrison did a second walkthrough of the house, this time with an inspector. He testified that his purpose for having the inspector look at the house with him was to try to estimate the cost of needed repairs and to “generally just look[] around the property.” The utilities were still off at the time of his second walkthrough. During the second walkthrough, Mr. Morrison concluded that the kitchen floor would have to be replaced. He and his inspector also noted some problems with windows and drywall.

They looked at the sticker on the furnace, but did not attempt to independently determine whether the heat exchanger had been repaired.

Following his second walkthrough, Mr. Morrison made a written offer to purchase the house for \$40,000, using a form real estate purchase agreement. The form included a provision permitting Mr. Morrison to have the house inspected and, if not satisfied, to notify Mr. Bare within fourteen days of the date of the agreement. If any unsatisfactory conditions could not be resolved, Mr. Morrison could void the agreement or accept the property in its “as is” condition. The form further provided that, if Mr. Morrison did not have the home inspected or did not notify Mr. Bare of any unsatisfactory conditions, he would take the property in its “as is” condition.

Under the heading “Special Conditions,” Mr. Morrison wrote: “Seller to supply buyer with copy of furnace repair bill from 2004 within 14 days.” Mr. Campensa acknowledged at his deposition that the purpose of the “special condition” was to allow Mr. Morrison to satisfy himself that the heat exchanger had been repaired. At the same time he signed the written offer, Mr. Morrison also signed a property disclosure form in which he acknowledged that he was purchasing the property “as is.”

Four days after he made his written offer, Mr. Morrison signed an amendment to that offer, removing his right to inspect the property. The amendment further provided that Mr. Morrison recognized that neither Mr. Bare nor Mr. Campensa was warranting the property in any manner:

In exercising or waiving their right to inspect, the Buyer(s) are not relying upon any representation about the property made by the Seller(s), Broker(s), Agent(s), other than those representations specified in the purchase agreement. The Buyer(s) understand that the Seller(s), Broker(s), Agent(s), and/or inspector(s) do not warrant or guarantee the condition of the property in any manner whatsoever.

Three days later, Mr. Bare signed both the form purchase agreement and the amendment, thereby accepting Mr. Morrison’s offer to purchase the house.

Prior to the date set for closing, Mr. Campensa obtained a copy of the 2004 furnace repair bill. That bill indicated that repairs totaling \$234 had been made to the furnace, but that the heat exchanger had not been repaired. In fact, it included a quote to replace the furnace for \$1600 and a notation that, if a new furnace was installed within 30 days, the \$234 for repairs would be deducted from the cost of the new furnace.

Mr. Campensa telephoned Mr. Morrison and told him that the heat exchanger had not been repaired. At that point, Mr. Morrison told Mr. Campensa that he would close on the house only if Mr. Bare either replaced the furnace or reduced the purchase price in an amount equal to what it would cost to replace the furnace. Mr. Bare was unwilling to do either.

Mr. Campensa sent Mr. Morrison a copy of the bill, along with a proposed addendum to the purchase agreement. The proposed addendum provided that Mr. Morrison agreed to accept the property with the furnace “in its as is condition and assume

all responsibility for its repair and/or replacement.” Mr. Morrison refused to execute the proposed addendum.

Prior to the date set for closing, Mr. Morrison filed his complaint in this case. Mr. Bare subsequently sold the house to another purchaser, who refurbished it and rented it to college students.

This Court’s Standard of Review

Mr. Morrison’s sole assignment of error is that the trial court incorrectly granted the defendants summary judgment. In reviewing an order granting summary judgment, this Court applies the same test a trial court is required to apply in the first instance: whether there are any genuine issues of material fact and whether the moving party is entitled to judgment as a matter of law.

Mr. Morrison’s Contract Claims

By his first cause of action, Mr. Morrison alleged that he was entitled to specific performance of his contract with Mr. Bare. In order to be entitled to specific performance of a contract, a plaintiff must either have performed his part of the contract or show his “readiness and ability” to do so. Mr. Morrison did neither. He had not paid the purchase price for the property and he had told Mr. Campensa that he was unwilling to do so unless Mr. Bare replaced the furnace or reduced the purchase price. As discussed below, the contract did not require Mr. Bare to replace the furnace or reduce the purchase price. Accordingly, Mr. Morrison is not entitled to specific performance.

Additionally, by the time the trial court granted summary judgment in this case, the property had been sold to a third party. When property has been transferred to a bona fide purchaser, specific performance is not available. Mr. Morrison has not argued that the person who purchased the property from Mr. Bare was not a bona fide purchaser. Accordingly, this is a second reason he is not entitled to specific performance.

By his second cause of action, Mr. Morrison sought damages for breach of contract. Mr. Bare has argued that the “special condition” was satisfied when he provided Mr. Morrison a copy of the 2004 bill for repairs to the furnace, even though, instead of showing that the heat exchanger had been repaired, it showed that it had not been repaired.

There can be no doubt that, in order to satisfy the “special condition” that Mr. Morrison included in his offer, the repair bill had to show that the heat exchanger had been repaired. Mr. Campensa, who was Mr. Bare’s agent, acknowledged that the purpose of the “special condition” was to allow Mr. Morrison to satisfy himself that the heat exchanger had been fixed:

Q. All right. On line 103 it says, “Seller to supply buyer with copy of furnace repair bill from 2004 within 14 days,” correct?

A. Correct.

Q. Why was that provision put in the contract?

A. *Because there was the potential that that was cracked in there was a cracked thing and Jack wanted to know if it was fixed or not.*

Q. *Okay. Because you believed it had been repaired based on your conversation with Jonas Bare, correct?*

A. *Yes.*

Q. *And you had told Jack that it had been repaired, did you not?*

A. *Yes.*

Q. *So Jack wanted to make sure as part of this deal that that furnace had already been repaired, correct?*

A. *Correct.*

Mr. Bare's argument that he satisfied the condition by supplying a bill showing that the heat exchanger had not been repaired is, at best, disingenuous. Both parties knew at the time they entered the contract that the bill Mr. Bare needed to supply to satisfy the "special condition" was a bill showing that the heat exchanger had been repaired.

That, however, does not mean that Mr. Bare breached the purchase agreement by not delivering a bill that showed the heat exchanger had been repaired and by not replacing the furnace or lowering the purchase price. To begin with, the contract does not include a promise by Mr. Bare that, if the heat exchanger was not repaired in 2004, he would replace the furnace or reduce the purchase price. Further, the "special condition" that Mr. Morrison included in the contract was just that, a condition, not a promise:

[P]romise and condition are very clearly different in character. One who makes a promise thereby expresses an intention that some future performance will be rendered and gives assurance of its rendition to the promisee. Whether the promise is express or implied, there must be either words or conduct by the promisor by the interpretation of which the court can discover promissory intention; a condition is a fact or an event and is not an expression of intention or an assurance. A promise in a contract creates a legal duty in the promisor and a right in the promisee; the fact or event constituting a condition creates no right or duty and is merely a limiting or modifying factor. 8 Catherine M.A. McCauliff, Corbin On Contracts, Section 30.12 (rev. ed. 1999).

Mr. Campensa told Mr. Morrison that the heat exchanger had been repaired. Mr. Morrison made his offer to purchase the house contingent upon receiving proof that it had been:

In contract law, "condition" is an event, other than the mere lapse of time, that is not certain to occur but must occur to activate an existing contractual duty, unless the condition is excused. The fact or event properly called a condition occurs during the performance stage of a contract, i.e., after the contract is formed and prior to its discharge. John Edward Murray Jr., Murray on Contracts, Section 99B (4th ed. 2001) (emphasis in original).

While the failure to perform a promise is a breach of contract, the failure to satisfy a condition is not:

A promise is always made by the act or acts of one of the parties, such acts being words or other conduct expressing intention. A fact can be made to operate as a condition only by the agreement of both parties or by the construction of the law. The purpose of a promise is to create a duty in the promisor. The purpose of constituting some fact as a condition is always the postponement or discharge of an instant duty (or other specified legal relation). The non-fulfillment of a promise is called a breach of contract, and creates in the other party a secondary right to damages. It is the failure to perform a legal duty. The non-occurrence of a condition will prevent the existence of a duty in the other party; but it may not create any remedial rights and duties at all, and it will not unless someone has promised that it shall occur. Corbin On Contracts, at Section 30.12.

The fact that, to satisfy the “special condition,” Mr. Bare would have had to do something (supply the bill showing that the heat exchanger had been repaired) did not mean that it was a promise rather than a condition. A condition can be an act to be done by one of the parties to the contract:

Virtually any act or event may constitute a condition. The event may be an act to be performed or forborne by one of the parties to the contract, an act to be performed or forborne by a third party, or some fact or event over which neither party, or any other party, has any control. Murray on Contracts, at Section 99C.

In this case, Mr. Bare had partial control over the condition. Even if he had a bill showing that the heat exchanger had been repaired in 2004, he could have chosen not to deliver it to Mr. Morrison, in which case the condition would not have been satisfied. It also, however, was partially out of his control. Since the heat exchanger had not been repaired in 2004, he was unable to satisfy the condition. The material part of the condition was that Mr. Morrison had to be satisfied that the heat exchanger had been repaired.

Section 225 of the Restatement (Second) of Contracts (1981) describes the consequences 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.

In this case, Mr. Morrison’s duty to pay the purchase price did not come due because Mr. Bare could not produce a 2004 bill showing that the heat exchanger had

been repaired. Once it became clear that it was impossible for Mr. Bare to produce such a bill, Mr. Morrison could have excused the condition and closed on the property. Alternatively, he could have treated his duty to close as discharged and the contract terminated:

[I]f a time comes when it is too late for the condition to occur, the obligor is entitled to treat its duty as discharged and the contract as terminated. II E.

Allan Farnsworth, *Farnsworth On Contracts*, Section 8.3 (3rd ed. 2004).

By informing Mr. Campensa that he was unwilling to close on the house unless Mr. Bare replaced the furnace or reduced the purchase price, Mr. Morrison chose to treat his duty to pay the original purchase price as discharged and the contract as terminated. His proposal to go forward under different conditions was, in effect, an offer to enter into a new contract; a new contract that Mr. Bare was free to reject, which he did.

Upon the failure of the “special condition” that he included in the real estate purchase agreement, Mr. Morrison treated the agreement as terminated, as he was entitled to do. The failure of the “special condition” was not a breach of contract.

There are no genuine issues of material fact, and Mr. Bare is entitled to judgment as a matter of law on Mr. Morrison’s demand for specific performance and on his breach of contract claim. To the extent Mr. Morrison’s assignment of error is addressed to the trial court’s summary judgment on his contract claims, it is overruled.

Mr. Morrison’s Fraud Claim

[Discussion of Morrison’s fraud claim omitted.]

III.

Mr. Morrison’s assignment of error is overruled. The judgment of the Summit County Common Pleas Court is affirmed.

Judgment affirmed.

Reflection

The *Morrison* case shows that conditions are not promises, i.e., the failure to cause a condition to occur is not a breach of a promise. Rather, conditions are merely switches that cause another contractual promise to be due for performance or not.

Many sophisticated agreements distinguish between “buyer’s conditions” and “seller’s conditions.” For example, in the standard form for the purchase and sale of preferred stock between a startup company and a venture capital investment firm, there are two sections named “Conditions to the Purchasers’ Obligations at Closing” and “Conditions of the Company’s Obligations at Closing.” If any of the conditions to the purchasers’ obligations do not occur, then the venture capital investment firm is not required to purchase the stock. If any of the conditions to the company’s obligations do not occur, then the startup company is not obligated to sell. Alternatively, each side

can waive the non-occurrence of its own conditions and thereby require the other party to close anyway. But neither party can sue the other for the non-occurrence of a condition.

It may be helpful to think of conditions as if they are owned by one party to the contract or the other. In the preferred stock purchase example above, the conditions to the purchaser's obligations are, in a sense, held by the buyer. Like cards in a player's hand, the condition can be played or ignored by its holder. Likewise, we might frame the condition in *Morrison* (production of a bill showing that the furnace was repaired) as being owned by the buyer, Mr. Morrison. When the furnace was not repaired, Mr. Morrison held this condition like a card that he could play (thereby extinguishing his obligation to purchase the house) or ignore (allowing the transaction to go through). To be clear, this is a valuable option. As the holder of a condition that did not occur, Mr. Morrison had the option to ignore its non-occurrence and effectively give away his right not to purchase the house. This is referred to as waiving the condition.

This ability to waive a condition or not gives its holder leverage or power to force a renegotiation in some instances. Here, Mr. Morrison essentially offered to "trade" this condition with the seller for a lower purchase price. This was an offer to modify a contract that was supported by new consideration. We learn about parties' voluntary modification of contractual obligations in Chapter 23. For now, simply note that Mr. Morrison's offer would have resulted in a lower purchase price if Mr. Bare had accepted it. If Mr. Bare really wanted to sell his house quickly, the parties could have agreed to buy and sell the house with a broken furnace for a lower price.

But that is not how Mr. Bare responded to Mr. Morrison's offer. Rather, Mr. Bare rejected the offer to modify their agreement. That left Mr. Morrison with two options: waive the condition and conclude the sale on the original terms promised, or assert that his obligations to purchase the house were not due because the condition had not occurred and walk away from the deal. The key point in this case was that Mr. Morrison did not have a third option to force Mr. Bare to sell the house for less money. That is just not how conditions work as a matter of law.

Discussion

1. The court ruled that the term regarding fixing the heat exchanger was a condition and not a promise. How should the buyer have revised the contract if he intended that term to be a promise?
 2. Was one party in this case trying to "pull a fast one" on the other? Do you see any evidence of bad faith or unfair dealing? If so, how does that factor into the court's resolution of this case?
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Reading Internatio-Rotterdam, Inc. v. River Brand Rice Mills, Inc. In *Morrison*, the court found that the “special condition” was just that: a condition, not a promise. But it is possible for courts to determine that a term in a contract is both a condition and a promise. Such terms are called “promissory conditions,” and they perform both the function of a promise (which when breached gives rise to damages) and of a condition (the non-occurrence of which means that a conditional promise does not need to be performed).

Note there is an important distinction between a conditional promise and a promissory condition. A conditional promise is a promise that only must be performed if the relevant condition occurs. In *Morrison*, the buyer, Mr. Morrison, made a conditional promise to pay for the house; his promise to pay was conditioned on the repair of the furnace, and when the repair did not occur, Mr. Morrison was not obligated to buy the house.

A promissory condition, as described in the next case, is both a promise and a condition. As a promise, it must be performed, lest the party who made that promise be liable for damages. As a condition, it functions as a switch that turns on the other party’s promise. As you read *Internatio*, make sure to highlight and annotate what the promissory condition is, and explain how the court finds this term has the features of both a promise and a condition.

Internatio-Rotterdam, Inc. v. River Brand Rice Mills, Inc.

259 F.2d 137 (2d Cir. 1958)

HINCKS, Circuit Judge.

Appeal from the United States District Court, Southern District of New York, Walsh, Judge, upon the dismissal of the complaint after plaintiff’s case was in.

The defendant-appellee, a processor of rice, in July 1952 entered into an agreement with the plaintiff-appellant, an exporter, for the sale of 95,600 pockets of rice.

[A “pocket” is a quantity of rice. The parties agreed upon its meaning and the court construed this term in the agreement in accordance with the parties’ intentions and industry custom.]

The terms of the agreement, evidenced by a purchase memorandum, indicated that the price per pocket was to be ‘\$8.25 F.A.S. Lake Charles and/or Houston, Texas’; that shipment was to be ‘December, 1952, with two weeks call from buyer’; and that payment was to be by ‘irrevocable letter of credit to be opened immediately payable against’ dock receipts and other specified documents.

[“F.A.S.” stands for “freight alongside ship,” a shipment term that means the seller is responsible for delivering the goods to directly next to the ship of the buyer’s choice.

This is contrasted with “F.O.B.” which stands for “free on board” and means that the seller is responsible for placing the goods onto the specified ship. In both cases, note that the buyer must identify the ship so that the seller can place the goods alongside or on the proper ship.]

In the fall, the appellant, which had already committed itself to supplying this rice to a Japanese buyer, was unexpectedly confronted with United States export restrictions upon its December shipments and was attempting to get an export license from the government. December is a peak month in the rice and cotton seasons in Louisiana and Texas, and the appellee became concerned about shipping instructions under the contract, since congested conditions prevailed at both the mills and the docks.

The appellee seasonably elected to deliver 50,000 pockets at Lake Charles and on December 10 it received from the appellant instructions for the Lake Charles shipments. Thereupon it promptly began shipments to Lake Charles which continued until December 23, the last car at Lake Charles being unloaded on December 31.

December 17 was the last date in December which would allow appellee the two-week period provided in the contract for delivery of the rice to the ports and ships designated. Prior thereto, the appellant had been having difficulty obtaining either a ship or a dock in this busy season in Houston. On December 17, the appellee had still received no shipping instructions for the 45,600 pockets destined for Houston. On the morning of the 18th, the appellee rescinded the contract for the Houston shipments, although continuing to make the Lake Charles deliveries.

It is clear that one of the reasons for the prompt cancellation of the contract was the rise in market price of rice from \$8.25 per pocket, the contract price, to \$9.75. The appellant brought this suit for refusal to deliver the Houston quota.

The trial court, in a reasoned but unreported opinion which dealt with all phases of the case, held that New York would apply Texas law. We think this ruling right, but will not discuss the point because it is conceded that no different result would follow from the choice of Louisiana law.

The area of contest is also considerably reduced by the appellant’s candid concession that the appellee’s duty to ship, by virtue of the two-week notice provision, did not arise until two weeks after complete shipping instructions had been given by the appellant. Thus, on brief, the appellant says:

we concede (as we have done from the beginning) that on a fair interpretation of the contract appellant had a duty to instruct appellee by December 17, 1952 as to the place to which it desired appellee to ship—at both ports, and that, being late with its instructions in this respect, appellant could not have demanded delivery (at either port) until sometime after December 31, 1952.

This position was taken, of course, with a view to the contract provision for shipment ‘December, 1952’: a two-week period ending December 31 would begin to run on December 17. But although appellant concedes that the two weeks’ notice to which appellee was entitled could not be shortened by the failure to give shipping

instructions on or before December 17, it stoutly insists that upon receipt of shipping instructions subsequent to December 17 the appellee thereupon became obligated to deliver within two weeks thereafter. We do not agree.

It is plain that a giving of the notice by the appellant was a condition precedent to the appellee's duty to ship. Obviously, the appellee could not deliver free alongside ship, as the contract required, until the appellant identified its ship and its location. Thus the giving of shipping instructions was what Professor Corbin would classify as a 'promissory condition': the appellant promised to give the notice and the appellee's duty to ship was conditioned on the receipt of the notice.

The crucial question is whether that condition was performed. And that depends on whether the appellee's duty of shipment was conditioned on notice on or before December 17, so that the appellee would have two weeks wholly within December within which to perform, or whether, as we understand the appellant to contend, the appellant could perform the condition by giving the notice later in December, in which case the appellee would be under a duty to ship within two weeks thereafter. The answer depends upon the proper interpretation of the contract: if the contract properly interpreted made shipment in December of the essence then the failure to give the notice on or before December 17 was nonperformance by the appellant of a condition upon which the appellee's duty to ship in December depended.

In the setting of this case, we hold that the provision for December delivery went to the essence of the contract. In support of the plainly stated provision of the contract there was evidence that the appellee's mills and the facilities appurtenant thereto were working at full capacity in December when the rice market was at peak activity and that appellee had numerous other contracts in January as well as in December to fill. It is reasonable to infer that in July, when the contract was made, each party wanted the protection of the specified delivery period; the appellee so that it could schedule its production without undue congestion of its storage facilities and the appellant so that it could surely meet commitments which it in turn should make to its customers. There was also evidence that prices on the rice market were fluctuating. In view of this factor it is not reasonable to infer that when the contract was made in July for December delivery, the parties intended that the appellant should have an option exercisable subsequent to December 17 to postpone delivery until January. That in effect would have given the appellant an option to postpone its breach of the contract, if one should then be in prospect, to a time when, so far as could have been foreseen when the contract was made, the price of rice might be falling. A postponement in such circumstances would inure to the disadvantage of the appellee who was given no reciprocal option. Further indication that December delivery was of the essence is found in the letter of credit which was provided for in the contract and established by the appellant. Under this letter, the bank was authorized to pay appellee only for deliveries 'during December, 1952.' It thus appears that the appellant's interpretation of the contract, under which the appellee would be obligated, upon receipt of shipping instructions subsequent to December 17, to deliver in January, would deprive the appellee of the security for payment of the purchase price for which it had contracted.

Since, as we hold, December delivery was of the essence, notice of shipping instructions on or before December 17 was not merely a 'duty' of the appellant—as it concedes: it was a condition precedent to the performance which might be required of the appellee. The nonoccurrence of that condition entitled the appellee to rescind or to treat its contractual obligations as discharged. On December 18th the appellant unequivocally exercised its right to rescind. Having done so, its obligations as to the Houston deliveries under the contract were at an end. And of course its obligations would not revive thereafter when the appellant finally succeeded in obtaining an export permit, a ship and a dock and then gave shipping instructions; when it expressed willingness to accept deliveries in January; or when it accomplished a 'liberalization' of the outstanding letter of credit whereby payments might be made against simple forwarder's receipts instead of dock receipts.

The appellant urges that by reason of substantial part performance on its part prior to December 17th, it may not be held to have been in default for its failure sooner to give shipping instructions. The contention has no basis in the facts. As to the Houston shipments the appellant's activities prior to December 17th were not in performance of its contract: they were merely preparatory to its expectation to perform at a later time. The mere establishment of the letter of credit was not an act of performance: it was merely an arrangement made by the appellant for future performance which as to the Houston deliveries because of appellant's failure to give shipping instructions were never made. From these preparatory activities the appellee had no benefit whatever.

The appellant also maintains that the contract was single and 'indivisible' and that consequently appellee's continuing shipments to Lake Charles after December 17 constituted an election to reaffirm its total obligation under the contract. This position also, we hold untenable. Under the contract, the appellee concededly had an option to split the deliveries betwixt Lake Charles and Houston. The price had been fixed on a per pocket basis, and payment, under the letter of credit, was to be made upon the presentation of dock receipts which normally would be issued both at Lake Charles or Houston at different times. The fact that there was a world market for rice and that in December the market price substantially exceeded the contract price suggests that it would be more to the appellant's advantage to obtain the Lake Charles delivery than to obtain no delivery at all. The same considerations suggest that by continuing with the Lake Charles delivery the appellee did not deliberately intend to waive its right to cancel the Houston deliveries. Conclusions to the contrary would be so greatly against self-interest as to be completely unrealistic. The only reasonable inference from the totality of the facts is that the duties of the parties as to the Lake Charles shipment were not at all dependent on the Houston shipments. We conclude their duties as to shipments at each port were paired and reciprocal and that performance by the parties as to Lake Charles did not preclude the appellee's right of cancellation as to Houston.

Finally, we hold that the appellant's claims of estoppel and waiver have no basis in fact or in law.

Affirmed.

Reflection

The *Internatio* case states that the term in question was a promissory condition and cites to Corbin for support. But, apparently, the court found this conclusion of law so obvious that it failed to quote the supporting treatise or to really analyze the issue. Let's review what Corbin actually said in distinguishing promises and conditions:

A promise is always made by the act or acts of one of the parties, such acts being words or other conduct expressing intention. A fact can be made to operate as a condition only by the agreement of both parties or by the construction of the law.

First, Corbin reminds us that contractual promises (that is, promises that courts of law will enforce) can only be formed intentionally. The law does not impose contractual obligations on unwilling parties.

Conditions, on the other hand, can be created either by the expression of intent by the parties or by constructions of law. This chapter deals only with express conditions. Later, we will explore the doctrine of implied conditions, which are constructions of law.

As mentioned above, courts should be reasonable in determining whether a term is intended to be a promise, a condition, or both (a promissory condition). This determination should be made in light of the purposes of promises and conditions. Here, a seller cannot ship goods until the buyer provides a delivery address, so it is reasonable to construe the buyer's provision of the delivery address as a condition to the seller's obligation to ship goods there.

Also, the purpose of a promise is to create a duty in the promisor. The purpose of constituting some fact as a condition is always the postponement or discharge of an instant duty (or other specified legal relation). Here, a seller typically wants to deliver goods and thus merit payment for them, so it is reasonable to construe the buyer's provision of the delivery address as a promise to the seller.

A contractual promise creates a duty to perform what is promised, whereas a condition acts as switch that turns on or off that duty to perform. The function or impact of promises and conditions should also be taken into account when determining if a term is a promise or a condition.

The non-fulfillment of a promise is called a "breach of contract" and creates in the other party a secondary right to damages. It is the failure to perform a legal duty. The non-occurrence of a condition will prevent the existence of a duty in the other party, but the non-occurrence of a condition will not create any remedial rights or duties at all unless someone has promised that the condition shall occur.

Corbin effectively restates the rule that was necessary to decide *Morrison*: the non-occurrence of a condition (fixing the furnace) meant that the promise subject to that condition (paying for the house) did not need to be performed. But the non-occurrence of the condition is not a breach of a legal duty and does not itself give rise to damages.

Next, Corbin explains that a term can be both a promise and a condition:

A contract can be so made as to create a duty that the fact operative as a condition shall come into existence. . . . Such a condition might be described as a promissory condition.

In other words, the parties might intend that a term is a promise, in that a party has a duty to perform it, and that the non-occurrence of this promise extinguishes the other party's duty to perform its end of the bargain. This was a necessary reading in *Internatio*, which Corbin himself analyzes.

Internatio-Rotterdam, Inc. v. River Brand Rice Mills, Inc. was a suit for alleged breach of a contract to deliver goods. The promise was to deliver the goods free alongside (F.A.S.) a ship during the month of December, the ship and place to be specified by the buyer. The buyer promised to give shipping instructions at least two weeks prior to shipment. The situation was such that time was held to be of the essence. Here the notice specifying ship and place was a "promissory condition": the buyer promised to give notice at least two weeks before the end of December; and notice was also a condition to the seller's duty to make delivery.

Let's analyze the mutual promises in this case. The seller promised to deliver rice F.A.S., which means alongside a ship to be specified by the buyer. That promise cannot be fulfilled unless and until the buyer specifies the ship. It is impossible to deliver goods to an unspecified location. Therefore, the buyer's act of specifying the ship was a condition to the seller's duty to deliver the goods. But it was also a promise—the buyer had a duty to perform it.

That dual role is what makes the buyer's notice a promissory condition. If the buyer fails to provide notice, the seller is both excused from performance (because the condition didn't occur) and entitled to claim a breach (because the buyer failed to perform a duty). However, the seller in *Internatio* did not pursue a claim for damages. That might confuse students, but the reason is straightforward: the breach turned out to benefit the seller. The market price of rice had risen, and the seller was able to resell the rice at a higher price. Since contract damages are intended to compensate for actual losses, and the seller suffered none, it chose not to bring a claim.

Discussion

1. Did you notice that when the buyer failed to provide a delivery address on time, the seller canceled the contract immediately? Was this a reasonable response? Why did the seller not attempt to work things out?
2. The buyer breached a promissory condition. Why did the seller not sue the buyer for this breach?

3. What is happening to prices in the market for rice during the time period of this agreement? How, if at all, do those commercial realities factor into the court's decision?

Reading Morin Building Products Co., Inc. v. Baystone Construction, Inc.

As you will see in the following case, courts are very hesitant to apply a subjective standard to conditions of satisfaction. Remember that express conditions must be completely performed; otherwise, the conditional promise does not have to be performed at all. This is a harsh result that can be unfair, in part, because of the problems with proving someone's subjective mindset. Consider how Judge Posner alleviates some of the harshness of this doctrine with his approach in *Morin Building*.

Judge Posner's opinion in this case illustrates how much courts disfavor the subjective standard of satisfaction. The contract in *Morin* involved putting aluminum siding on an industrial warehouse. The contract used express language suggesting that payment for this work was to be conditional on the buyer's aesthetic satisfaction with the work, and the buyer's architect claimed that "viewed in bright sunlight from an acute angle the exterior siding did not give the impression of having a uniform finish." With this claim of aesthetic dissatisfaction, the buyer refused to pay for the work.

The court disagreed. The court refused to apply a subjective standard to a contract that was obviously for a commercial application. Judge Posner found that the seller did not intend to bind itself to the difficult and perhaps unobtainable standard of precisely matching newly milled aluminum to existing metal siding. Moreover, aesthetics are not particularly important for industrial warehouses in general. Despite the express terms and intrinsic evidence requiring the buyer's aesthetic satisfaction, the court looked at reasonableness and trade usage to find that aesthetic quality should be judged by an objective, commercially reasonable standard. The court then found that the aluminum siding met this standard and decided the case in favor of the seller.

**Morin Building Products Co., Inc. v. Baystone
Construction, Inc.**

717 F.2d 413 (7th Cir. 1983)

POSNER, J.

This appeal from a judgment for the plaintiff in a diversity suit requires us to interpret Indiana's common law of contracts. General Motors, which is not a party to this case, hired Baystone Construction, Inc., the defendant, to build an addition

to a Chevrolet plant in Muncie, Indiana. Baystone hired Morin Building Products Company, the plaintiff, to supply and erect the aluminum walls for the addition. The contract required that the exterior siding of the walls be of “aluminum type 3003, not less than 18 B & S gauge, with a mill finish and stucco embossed surface texture to match finish and texture of existing metal siding.” The contract also provided “that all work shall be done subject to the final approval of the Architect or Owner’s [General Motors’] authorized agent, and his decision in matters relating to artistic effect shall be final, if within the terms of the Contract Documents”; and that “should any dispute arise as to the quality or fitness of materials or workmanship, the decision as to acceptability shall rest strictly with the Owner, based on the requirement that all work done or materials furnished shall be first class in every respect. What is usual or customary in erecting other buildings shall in no wise enter into any consideration or decision.”

Morin put up the walls. But viewed in bright sunlight from an acute angle the exterior siding did not give the impression of having a uniform finish, and General Motors’ representative rejected it. Baystone removed Morin’s siding and hired another subcontractor to replace it. General Motors approved the replacement siding. Baystone refused to pay Morin the balance of the contract price (\$23,000) and Morin brought this suit for the balance, and won.

The only issue on appeal is the correctness of a jury instruction which, after quoting the contractual provisions requiring that the owner (General Motors) be satisfied with the contractor’s (Morin’s) work, states: “Notwithstanding the apparent finality of the foregoing language, however, the general rule applying to satisfaction in the case of contracts for the construction of commercial buildings is that the satisfaction clause must be determined by objective criteria. Under this standard, the question is not whether the owner was satisfied in fact, but whether the owner, as a reasonable person, should have been satisfied with the materials and workmanship in question.” There was much evidence that General Motors’ rejection of Morin’s exterior siding had been totally unreasonable. Not only was the lack of absolute uniformity in the finish of the walls a seemingly trivial defect given the strictly utilitarian purpose of the building that they enclosed, but it may have been inevitable; “mill finish sheet” is defined in the trade as “sheet having a nonuniform finish which may vary from sheet to sheet and within a sheet, and may not be entirely free from stains or oil.” If the instruction was correct, so was the judgment. But if the instruction was incorrect—if the proper standard is not whether a reasonable man would have been satisfied with Morin’s exterior siding but whether General Motors’ authorized representative in fact was—then there must be a new trial to determine whether he really was dissatisfied, or whether he was not and the rejection therefore was in bad faith.

Some cases hold that if the contract provides that the seller’s performance must be to the buyer’s satisfaction, his rejection—however unreasonable—of the seller’s performance is not a breach of the contract unless the rejection is in bad faith. But most cases conform to the position stated in section 228 of the Restatement (Second) of Contracts (1979): if “it is practicable to determine whether a reasonable person in the

position of the obligor would be satisfied, an interpretation is preferred under which the condition [that the obligor be satisfied with the obligee's performance] occurs if such a reasonable person in the position of the obligor would be satisfied."

We do not understand the majority position to be paternalistic; and paternalism would be out of place in a case such as this, where the subcontractor is a substantial multistate enterprise. The requirement of reasonableness is read into a contract not to protect the weaker party but to approximate what the parties would have expressly provided with respect to a contingency that they did not foresee, if they had foreseen it. Therefore the requirement is not read into every contract, because it is not always a reliable guide to the parties' intentions. In particular, the presumption that the performing party would not have wanted to put himself at the mercy of the paying party's whim is overcome when the nature of the performance contracted for is such that there are no objective standards to guide the court. It cannot be assumed in such a case that the parties would have wanted a court to second-guess the buyer's rejection. So "the reasonable person standard is employed when the contract involves commercial quality, operative fitness, or mechanical utility which other knowledgeable persons can judge. . . . The standard of good faith is employed when the contract involves personal aesthetics or fancy."

We have to decide which category the contract between Baystone and Morin belongs in. The particular in which Morin's aluminum siding was found wanting was its appearance, which may seem quintessentially a matter of "personal aesthetics," or as the contract put it, "artistic effect." But it is easy to imagine situations where this would not be so. Suppose the manager of a steel plant rejected a shipment of pig iron because he did not think the pigs had a pretty shape. The reasonable-man standard would be applied even if the contract had an "acceptability shall rest strictly with the Owner" clause, for it would be fantastic to think that the iron supplier would have subjected his contract rights to the whimsy of the buyer's agent. At the other extreme would be a contract to paint a portrait, the buyer having reserved the right to reject the portrait if it did not satisfy him. Such a buyer wants a portrait that will please him rather than a jury, even a jury of connoisseurs, so the only question would be his good faith in rejecting the portrait.

This case is closer to the first example than to the second. The building for which the aluminum siding was intended was a factory—not usually intended to be a thing of beauty. That aesthetic considerations were decidedly secondary to considerations of function and cost is suggested by the fact that the contract specified mill-finish aluminum, which is unpainted. There is much debate in the record over whether it is even possible to ensure a uniform finish within and among sheets, but it is at least clear that mill finish usually is not uniform. If General Motors and Baystone had wanted a uniform finish they would in all likelihood have ordered a painted siding. Whether Morin's siding achieved a reasonable uniformity amounting to satisfactory commercial quality was susceptible of objective judgment; in the language of the Restatement, a reasonableness standard was "practicable."

But this means only that a requirement of reasonableness would be read into this contract if it contained a standard owner's satisfaction clause, which it did not; and since the ultimate touchstone of decision must be the intent of the parties to the contract we must consider the actual language they used. The contract refers explicitly to "artistic effect," a choice of words that may seem deliberately designed to put the contract in the "personal aesthetics" category whatever an outside observer might think.

But the reference appears as number 17 in a list of conditions in a general purpose form contract. And the words "artistic effect" are immediately followed by the qualifying phrase, "if within the terms of the Contract Documents," which suggests that the "artistic effect" clause is limited to contracts in which artistic effect is one of the things the buyer is aiming for; it is not clear that he was here.

The other clause on which Baystone relies, relating to the quality or fitness of workmanship and materials, may seem all-encompassing, but it is qualified by the phrase, "based on the requirement that all work done or materials furnished shall be first class in every respect"—and it is not clear that Morin's were not. This clause also was not drafted for this contract; it was incorporated by reference to another form contract (the Chevrolet Division's "Contract General Conditions"), of which it is paragraph 35. We do not disparage form contracts, without which the commercial life of the nation would grind to a halt. But we are left with more than a suspicion that the artistic-effect and quality-fitness clauses in the form contract used here were not intended to cover the aesthetics of a mill-finish aluminum factory wall.

If we are right, Morin might prevail even under the minority position, which makes good faith the only standard but presupposes that the contract conditioned acceptance of performance on the buyer's satisfaction in the particular respect in which he was dissatisfied. Maybe this contract was not intended to allow General Motors to reject the aluminum siding on the basis of artistic effect. It would not follow that the contract put Morin under no obligations whatsoever with regard to uniformity of finish. The contract expressly required it to use aluminum having "a mill finish . . . to match finish . . . of existing metal siding." The jury was asked to decide whether a reasonable man would have found that Morin had used aluminum sufficiently uniform to satisfy the matching requirement. This was the right standard if, as we believe, the parties would have adopted it had they foreseen this dispute. It is unlikely that Morin intended to bind itself to a higher and perhaps unattainable standard of achieving whatever perfection of matching that General Motors' agent insisted on, or that General Motors would have required Baystone to submit to such a standard. Because it is difficult—maybe impossible—to achieve a uniform finish with mill-finish aluminum, Morin would have been running a considerable risk of rejection if it had agreed to such a condition, and it therefore could have been expected to demand a compensating increase in the contract price. This would have required General Motors to pay a premium to obtain a freedom of action that it could not have thought terribly important, since its objective was not aesthetic. If a uniform finish was important to it, it could have gotten such a finish by specifying painted siding.

All this is conjecture; we do not know how important the aesthetics were to General Motors when the contract was signed or how difficult it really would have been to obtain the uniformity of finish it desired. The fact that General Motors accepted the replacement siding proves little, for there is evidence that the replacement siding produced the same striped effect, when viewed from an acute angle in bright sunlight, that Morin's had. When in doubt on a difficult issue of state law it is only prudent to defer to the view of the district judge, here an experienced Indiana lawyer who thought this the type of contract where the buyer cannot unreasonably withhold approval of the seller's performance.

Lest this conclusion be thought to strike at the foundations of freedom of contract, we repeat that if it appeared from the language or circumstances of the contract that the parties really intended General Motors to have the right to reject Morin's work for failure to satisfy the private aesthetic taste of General Motors' representative, the rejection would have been proper even if unreasonable. But the contract is ambiguous because of the qualifications with which the terms "artistic effect" and "decision as to acceptability" are hedged about, and the circumstances suggest that the parties probably did not intend to subject Morin's rights to aesthetic whim.

AFFIRMED.

Reflection

The contract in *Morin* involved putting aluminum siding on a warehouse. Although the contract used express language suggesting that payment for this work was to be conditional on the buyer's aesthetic satisfaction with the work, the court refused to apply such a subjective standard to a contract that was obviously for a commercial application.

Morin shows how the process of contract interpretation and substantive contract law go hand in hand. Courts will avoid interpreting written agreements in a manner that leads to an absurd or unfair result. Instead of relying on equitable powers, the court may simply understand the contract to mean something other than what it says. It appears that here the court read the contract to imply an objective standard of satisfaction despite its express language implying a subjective standard of satisfaction because the court suspected the promisor of engaging in bad faith to avoid contractual obligations.

A seemingly similar case produced a different result. *Ard Dr. Pepper Bottling Co. v. Dr. Pepper Co.*¹ concerned a long-term contract between Ard and Dr. Pepper in which Ard, a local bottler, promised to promote, distribute, and bottle Dr. Pepper's soda in a designated Mississippi territory. In return, Dr. Pepper granted Ard an exclusive license and agreed to supply the syrup at set terms. Many of Ard's obligations—such as maintaining sanitary conditions, investing in advertising, and promoting the product—were framed in terms that gave Dr. Pepper discretion to judge whether

1. 202 F.2d 372 (5th Cir. 1953)

performance was satisfactory. The contract stated that Dr. Pepper's determination, if made in good faith, would be final.

The *Ard* court found that Dr. Pepper's promise to license its product was conditioned on its subjective satisfaction with Ard's performance. The court upheld Dr. Pepper's decision to withhold further performance based on its honest dissatisfaction with Ard's sanitation and promotional efforts. However, the court also made clear that even under a subjective standard, dissatisfaction must be genuine: if Dr. Pepper's real motive had been to switch to a cheaper bottler and it merely claimed dissatisfaction as a pretext, it would have violated the contract.

Rather than distinguish the cases on their facts, it may be more accurate to see them as reflecting different jurisprudential philosophies. The *Morin* court invoked commercial context and extrinsic evidence to identify a latent ambiguity and limit opportunistic behavior. The *Ard* court, by contrast, emphasized textual primacy and freedom of contract, declaring: "The terms of the present contract in the light of its subject matter and of the circumstances of the parties leave little or no room for construction or interpretation."

As you'll see in the next section, R2d appears to favor *Morin's* approach: when a written agreement is reasonably susceptible to different interpretations, courts may consider extrinsic evidence to determine whether a condition of satisfaction should be interpreted as requiring objective reasonableness, rather than subjective discretion.

Discussion

1. Is there any aesthetic dimension to industrial construction projects? If so, what is it? Why did the parties include a term regarding aesthetic satisfaction in this contract for installation of aluminum siding on a warehouse?
 2. Should courts consider extrinsic evidence when determining whether a contractual term is a promise, a condition, or both? Identify at least one benefit and at least one cost that arises when courts consider extrinsic evidence in contract interpretation.
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Problems

Problem 19.1. Renewal of a Restaurant Lease

Cross Bay Chelsea (CBC) owned and operated a restaurant in Howard Beach, Queens, a neighborhood in New York, the location being rented from J.N.A. Realty Corp. pursuant to a 10-year lease agreement, the term of which ran from January 1, 1964, to December 31, 1974.

Paragraph 58 of that lease agreement granted tenant CBC an option to renew the lease of the building in Howard Beach with landlord JNA, “provided that Tenant shall notify Landlord in writing by registered or certified mail six (6) months prior to the last day of the term of the lease that tenant desires such renewal.” In other words, CBC was to notify JNA of its intent to renew by June 31, 1974.

Over the course of the lease, CBC invested \$40,000 in fixtures and chattels in the restaurant building. In 1974, at the end of the 10-year lease term, the restaurant business in that location was worth approximately \$155,000.

CBC failed to notify JNA of its intent to renew by the end of June. JNA ignored this and continued to bill CBC for monthly rent, which CBC paid on time, until 30 days prior to end of the lease term.

On November 31, 1974, JNA informed CBC in writing that JNA was not renewing the lease and that CBC would have to vacate the premises on December 31, 1974. CBC immediately responded in writing that they wished to exercise their right to renew the lease. JNA replied that time for renewal had expired and attached a copy of the contract with Paragraph 58 highlighted. CBC protested that this was the first time they had read Paragraph 58, but JNA moved forward with eviction proceedings regardless.

The case is now before you, the judge. JNA has sued to evict CBC. CBC has countersued for breach of contract. How should you rule?

See J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc., 42 N.Y.2d 392 (1977).

Problem 19.2. Financial Satisfaction

On August 4, 1989, Hutton and MPI executed a franchise agreement wherein MPI sold a monogramming franchise to Hutton. The franchise agreement permitted Hutton to use MPI’s patented technology to sew monograms into t-shirts, hats, and bags using the Meistergram 800 XLC computerized monogramming machine that could be operated from home or at shopping mall kiosks.

There were two major costs to start up Hutton’s monogram franchise small business. First, Hutton had to pay MPI for the franchise agreement. Second, Hutton had to buy or lease a Meistergram 800 XLC machine. The purchase or lease of the monogramming machine represented a critical component of the required financing because the entire operation revolved around the application of monograms to imprintable items of clothing.

Before signing, Hutton wrote an Appendix to the franchise agreement to which both parties agreed, which said that Hutton’s purchase of the MPI franchise for \$25,000 was on condition that if Hutton were “unable . . . to obtain financing suitable to him” within ninety days of signing the franchise agreement, he would then be entitled to a refund of the \$25,000 franchise fee.

After executing the franchise agreement and addendum, Hutton obtained a loan from Star Bank to cover the franchise fee. The loan was secured by a mortgage executed by Hutton and his wife Pamela against their residence.

The issue in this case, however, arises because Hutton was unable to obtain “suitable” financing for the monogramming machine.

To facilitate the lease or purchase of the monogramming machine, MPI issued a franchise-offering informational circular to Hutton. The circular, which MPI was required to provide under Ohio law, estimated that the total cost of an MPI franchise varied between \$32,420 and \$36,720.

The fee paid by Hutton accounted for \$25,000 of the \$36,720 total estimated franchise cost. The circular also estimated that the monogramming machine could be leased for \$520 per month for sixty months or purchased at a total cost of \$21,000.

On November 20, 1989, MPI recommended to Hutton a sixty-month lease through United Leasing Corporation. The monthly lease payments totaled \$751.01, with a total equipment cost of \$45,060.60 over the life of the lease. The lease also required Hutton to make a 10% down payment.

Since Hutton considered these terms to be substantially less advantageous than the terms offered in the MPI circular, he rejected United Leasing Corporation’s financing offer.

Subsequently, Hutton’s financing applications were rejected by Trinity Leasing and Society Bank.

After rejecting United’s offer and being rejected by Trinity and Society, Hutton wrote to Larry Meyer, MPI’s president, requesting a refund of the \$25,000 franchise fee due to the difficulty he had experienced in securing financing. This request was denied, whereupon Hutton filed suit.

Discuss whether the term regarding MPI’s return of Hutton’s franchise fee is a promise, a condition, or both. If a condition, discuss whether it is a condition precedent or condition subsequent, who holds the condition, and why.

See Hutton v. Monograms Plus, Inc., 78 Ohio App. 3d 176 (1992).

Chapter 20

Substantial Performance and Material Breach

As you learned in the previous chapter, contractual conditions play a crucial role in determining when each party to a contract must perform. In this chapter, you will learn that if one party materially fails to perform its duty, then the other side may withhold or cancel its own performance because the nonperforming party's promise is, in effect, a condition of the other party's duty.

This linkage of promises was not always the norm in English and early American law. Historically, courts tended to treat all promises as independent, meaning that each party had to perform its part of the contract regardless of whether the counterparty was fulfilling its own duties. Parties were required to render their full performance and then sue for damages if the other side did not do the same.

In *Kingston v. Preston*, 99 Eng. Rep. 437 (K.B. 1773), excerpted later in this chapter, Lord Mansfield famously challenged this older view. The case concerned a silk merchant, Mr. Preston, who contracted with Mr. Kingston for the sale of a business. Kingston promised to provide adequate security for the outstanding balance due to Preston, but Kingston failed to do so. Preston refused to transfer the business when Kingston offered no real security. At trial, Kingston argued that Preston's refusal to deliver the business was a breach, leaving Kingston free to withhold payment until he sued.

Lord Mansfield, however, recognized an implied mutuality of promises: Preston's transfer of the business was implicitly conditional on Kingston's provision of security. By recognizing that the parties' promises were mutually dependent, Mansfield held that Kingston's failure to provide security justified Preston's refusal to deliver the business. This decision marked a turning point in the law.

Courts began to presume that when two parties exchange promises within a single contract, those promises are most likely dependent, meaning each party's duty to perform is conditioned on the other side's readiness and willingness to perform in return. This shift laid the foundation for the modern doctrines of substantial performance and material breach, which balance the principle of enforcing mutual promises with the need to avoid disproportionate consequences for minor defects.

Over time, the logic of *Kingston* shaped the common law framework. It led to the modern presumption that most contractual promises are implicitly conditional on

each other's performance. Yet treating these implied conditions just like express conditions was occasionally harsh.

An example of this harshness arises when a party delivers most of the benefit but fails in a small way. Under the strict compliance rule for express conditions, even a tiny deviation completely invalidates the other side's duty of performance. This harsh outcome did not sit well with courts who saw the need for flexibility. They recognized that some measure of shortfall should still entitle the performing party to receive the bargained-for exchange, particularly if the defect can be remedied easily or does not deprive the other side of the essential substance of the deal.

In *Jacob & Youngs v. Kent*, 230 N.Y. 239 (1921), which you will also read in this chapter, Judge Cardozo brought relief to parties who substantially delivered what they promised but did not comply to the last letter. In *Jacob & Youngs*, a builder used the wrong brand of pipe when constructing a luxury home. The homeowner refused to pay, claiming that the contract explicitly demanded "Reading pipe" throughout. Cardozo, however, found that the builder's deviation was insignificant—a mere "venial" fault. The substituted pipe was of equal quality and function, so the homeowner received virtually all the benefits of the bargain.

According to Cardozo, treating that small mistake like a complete failure to meet a condition would be unjust. He explained that courts should not deliver "oppressive retribution" on a party that made an unintentional and minor mistake. Instead, he introduced the concept of substantial performance into the law, allowing the non-breaching party only to recover minor damages (if appropriate) while remaining obligated to pay most or all of the contract price—so long as the material purpose of the contract was achieved. This shift reflected a desire to avoid forfeitures and to keep the contract alive when, in fairness, the essential substance of the agreement had been delivered.

While *Jacob & Youngs* revolutionized the way courts approach implied conditions in the context of services and real estate, the UCC has adopted a stricter framework for the sale of goods. The UCC largely codifies a perfect tender rule, which allows a buyer to reject goods "if the goods or the tender of delivery fail in any respect to conform to the contract." The UCC's perfect tender rule stands in contrast to the doctrine of substantial performance, reflecting the differing priorities in transactions involving goods versus services.

At first glance, the UCC's perfect tender rule resembles the older rule for express conditions, where any deviation allowed the other party to refuse performance. However, the UCC does not stop there. It tempers this strict rule with a series of exceptions, rights to cure, and limitations on rejection and revocation. Sellers who deliver nonconforming goods may still make good on the deal if they can offer a timely cure. Buyers who have accepted goods can revoke that acceptance only if a defect substantially impairs the goods' value. Installment contracts can be canceled altogether only if the defect in one installment "substantially impairs" the value of the entire contract. Taken together, these statutory mitigations show that the UCC embraces a more measured stance in practice, despite its seemingly absolute starting principle.

In exploring the rules that follow, we will navigate these parallel but distinct analytical frameworks. The law of common law contracts after *Jacob & Youngs* focuses on substantial performance and material breach for most service and real-estate deals. The UCC's perfect tender rule and related provisions dictate the outcome for sales of goods. Both systems share a general idea that a party's right to withhold or cancel performance arises from the failure of a condition, whether express or implied. Both systems also reflect a preference for avoiding disproportionate forfeitures and encouraging opportunities to cure.

Understanding how these doctrines evolved—from the formal independence of promises in early law, through *Kingston's* recognition of mutual dependency, and culminating in *Jacob & Youngs's* doctrine of substantial performance on the one hand and the UCC's qualified perfect tender rule on the other—will help students gain a deeper appreciation of how courts and legislatures strive to balance predictability with fairness.

Rules

A. Analyzing Defective Performance under Common Law

Common law courts begin by assuming that most contractual promises in a single agreement are mutually dependent. This means that each party's duty to perform is implicitly conditional on the other party's substantial performance or tender of performance. The famous case *Jacob & Youngs v. Kent*, discussed in the introduction and presented below, helped to cement this doctrine in the realm of construction and services.

Today, the R2d's structured approach guides courts in identifying whether a party has performed, whether the breach is material, and whether the nonbreaching party can withhold or cancel its own obligations.

1. Identifying the Breach

A central principle in common law is that even a slight deviation is still a breach:

When performance of a duty under a contract is due any non-performance is a breach. R2d § 235(2).

This language is absolute. If a party promised to deliver something or perform some service, any shortfall from that promise, no matter how small, meets the definition of breach. As you will learn in the module on remedies, any breach gives rise to a claim for damages. However, when it comes to determining whether a breach by one party gives the other the right to withhold or cancel its own performance, the law distinguishes between a minor breach (substantial performance) and a material breach.

Assume a tailor promises to sew a suit using wool fabric in a specific shade of navy blue by June 1. If the tailor finishes on time but the fabric is slightly lighter than the agreed-upon shade, the tailor has technically breached. Whether this justifies the customer in refusing the suit (or withholding payment) depends on whether the deviation is material or not.

2. Evaluating Materiality

A material breach is serious enough to justify the nonbreaching party in suspending or withholding its own performance until the breaching party cures. If no cure occurs within a reasonable time, the nonbreaching party may treat the breach as total, cancel the contract, and seek remedies. To determine materiality, courts apply the factors in R2d § 241. That section explains:

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.*

Courts weigh these factors as a whole and do not simply tally them. A single factor (e.g., bad faith) may push a breach into material territory.

Consider a homeowner who pays a carpenter to install a set of customized wood cabinets. The homeowner's main expectation is that the cabinets will be sturdy and well-fitted. If the carpenter uses slightly cheaper hinges than specified, due to an administrative mistake in ordering parts, the homeowner might lose a small fraction of expected value, and the carpenter can replace the hinges easily. Damages are simple to measure, and the carpenter did not act in bad faith. The court might find the breach is not material, requiring the homeowner to pay the contract price, minus any minor damages for the cheaper hinges.

Conversely, consider a landowner who hires a builder to construct a house for \$300,000. The contract explicitly states that the builder must use pressure-treated wood for the structural framing to ensure the house's long-term durability and resistance to decay. Pressure-treated wood is a non-negotiable term in the contract

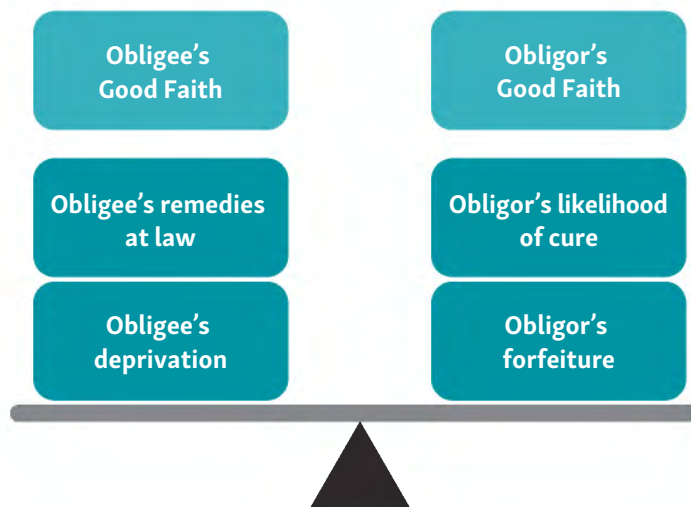


Figure 20.1. Factors in balancing test to distinguish between substantial performance and material breach.

because the house is being built in a humid climate, where untreated wood is highly susceptible to premature decomposition and structural failure.

Instead, the builder uses regular, untreated wood for the framing to save money, which reduces their costs by \$20,000. The builder does not inform the landowner of this substitution, assuming the landowner will not notice. However, shortly after completion, the landowner hires a home inspector who discovers the issue. Fixing the problem would require demolishing the house and rebuilding it entirely, as the structural integrity of the building is compromised. The untreated wood significantly reduces the expected lifespan of the home and poses safety risks, particularly if left unaddressed.

Here, the builder's actions constitute a material breach. The use of untreated wood violates a critical term of the agreement, which deprives the landowner of the benefit of a structurally sound home. The breach affects the core purpose of the contract, cannot be remedied without demolishing the house, and was done in bad faith to save costs. A is entitled to treat the contract as terminated, refuse to pay the balance, and seek damages for the cost of reconstruction and other losses.

3. *Withholding Payment*

At common law, courts encourage self-help to resolve performance disputes without immediate litigation. If a breach is material, the innocent party can suspend its own performance until the breacher cures. This can motivate the breaching party to fix errors and preserve the contract.

If the breach is minor, however, the nonbreaching party has a duty to keep performing and may instead sue for damages. The mere existence of a small breach does not

excuse the other side from performing its part of the bargain. In the examples above, the duty is to pay. The party must pay the contract price for the substantial performance, although they can later sue for breach to the extent performance was defective.

Suppose a homeowner contracts with a painter to paint all interior walls in a specified color. The painter has completed half the house but used a shade slightly off from what was promised, and the homeowner catches it mid-project. The homeowner might insist that the painter correct the shade for the remainder and possibly repaint the completed walls. If the painter refuses, the breach may become material if it undermines the homeowner's reasonable expectations about consistent color. At that point, the homeowner can withhold final payment until the painter cures by repainting the defective walls.

4. *Cancelling the Contract*

If a breach is material, the breaching party may still have a cure period to fix the defective performance. R2d § 242 instructs courts on when a material breach becomes total. The rule says:

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.*

Courts look to whether the breaching party can still cure without causing major inconvenience or additional expense to the nonbreaching side. If waiting for a cure becomes harmful, or if the contract explicitly makes time of the essence, the court may find a **total breach**. Total breach frees the innocent party from all obligations, including future performance or payment.

For example, June, a homeowner, contracts with a builder to construct an 8' × 10' wooden deck. The builder completes the deck. During a standard post-construction inspection, June discovers that the top boards are fastened using screws that are not weatherproof. While this compromises the deck's long-term durability, the builder is ready and willing to fix the problem by replacing the fasteners with appropriate decking screws, at no additional cost, within one week.

Here, the breach is material because it affects the deck's durability, but it is not total. The builder's willingness and ability to cure the defect within a reasonable timeframe means June must allow the builder to remedy the issue and cannot immediately cancel the contract.

Conversely, August, a different homeowner, contracts with a builder to construct a wooden deck designed to support the weight of a hot tub, with local code requiring materials rated for at least 2,000 pounds. The builder completes the deck, but during a post-construction inspection, August discovers that the builder used materials rated for only 250 pounds—far below what is necessary to safely support a hot tub. Correcting the issue to meet code requires dismantling and entirely rebuilding the deck. When confronted, the builder offers to add an additional stringer as a remedy but dismisses August's concerns as overblown, refusing to fully rebuild the deck.

Here, the breach is total. The use of inadequate materials violates both the contract's specifications and local safety codes, rendering the deck unfit for its intended purpose. The builder's dismissive response and unwillingness to provide a proper cure leave August unable to rely on the builder to deliver what was promised. August is justified in canceling the contract and seeking damages for reconstruction and any other losses.

5. Summary of Common Law Framework

Under the common law, courts strive to prevent injustice from overly strict enforcement of implied conditions. They do so by examining whether a breach is trivial or material, allowing a cure period for material breaches, and distinguishing partial from total breach. This approach is flexible, encouraging contract completion and discouraging unnecessary forfeiture. At the same time, it respects the *Kingston v. Preston* principle that the performance of each party is, by default, conditional on the other's readiness and willingness to perform.

In the next section, we will see how the UCC handles similar issues with goods contracts. The UCC adopts a perfect tender rule, an approach that appears stricter than common law substantial performance, yet it tempers that rule with rights to cure, revocation, and limitations on cancellation for installment contracts.

B. Analyzing Defective Performance under the UCC

The UCC adopts a framework that differs sharply from common law substantial performance. Rather than asking whether a deviation is *material*, the UCC starts by asking whether the goods “fail in any respect to conform to the contract.” UCC § 2-601. If there is *any* failure, the buyer may reject the goods entirely, even if the defect is minor. This is known as the perfect tender rule. At first glance, it resembles a strict

enforcement of conditions. However, the UCC softens this rule through rights to cure, limited revocation after acceptance, and special rules for installment contracts.

1. *Perfect Tender Rule: UCC § 2-601*

UCC § 2-601 states that if goods or the tender of delivery fail in any respect to conform to the contract, the buyer may reject the entire shipment, accept it, or accept any commercial units and reject the rest. This approach appears stricter than the common law's material breach analysis. Even a small defect in quality, quantity, or timing gives the buyer the power to reject.

Consider a buyer who orders 500 red chairs for an event. The seller delivers 490 red chairs and 10 blue chairs. Under the perfect tender rule, that is a nonconformity. The buyer may refuse the entire shipment, even if the nonconforming portion is only 2% of the total.

2. *Seller's Right to Cure: UCC § 2-508*

Although the perfect tender rule lets buyers reject nonconforming goods, the seller often has a right to cure the defect. UCC § 2-508 provides two scenarios where the seller may still tender conforming goods:

- First, if there is still time left under the contract, then the seller may seasonably notify the buyer of its intent to cure and then make a proper delivery before the deadline.
- Second, if the seller had reasonable grounds to believe the nonconforming goods would be acceptable, then the seller can still cure within a further reasonable time.

This right to cure prevents immediate cancellation in many cases. It also parallels the cure period that common law provides for a material breach. The difference is that the UCC's perfect tender rule initially grants buyers the right to reject for *any* defect, but then offers the seller a quick opportunity to make things right.

Return to the scenario where a buyer orders 500 red chairs for an event, but the seller delivers 490 red chairs and 10 blue chairs. If the time for performance has not expired, the seller can inform the buyer of its intent to deliver ten red chairs by the contract deadline. The buyer should then accept the cure if it arrives on time.

What if the buyer orders 500 red chairs, but the seller delivers 490 red chairs and 10 blue chairs—but the seller reasonably believed that the color was irrelevant because the buyer intended to cover them with black fabric? If the delivery date in the contract already passed, the question is whether late delivery would be reasonable. For example, if the contract specified delivery by January 1, and the buyer intended to use the chairs for an event on February 1, then delivery of the remaining red chairs by January 15 would be reasonable. Again, the buyer should then accept the cure if the chairs arrive by then.

3. Revocation of Acceptance

If a buyer accepts the goods initially, perhaps believing they conform, UCC § 2-608 allows later revocation if the goods have a nonconformity that “*substantially impairs its value to him*” and was not discovered (or reasonably discoverable) upon initial inspection. The buyer may revoke only if it reasonably relied on the seller’s assurances or if discovering the defect earlier was impractical.

This substantial impairment standard mirrors some of the materiality language in common law. Small or easily fixable defects usually do not allow a buyer to revoke acceptance once it has been made. For example, a buyer orders five specialized machines. Each machine appears fine upon delivery, so the buyer pays. A few weeks later, motors begin to fail, revealing a manufacturing defect that makes the machines almost worthless. The buyer may revoke acceptance because this defect *substantially impairs* the machines’ value and the defect was not apparent during initial inspection.

4. Installment Contracts: UCC § 2-612

The UCC also tempers the perfect tender rule for installment contracts, where goods are delivered and accepted in separate lots. UCC § 2-612 allows the buyer to reject an individual nonconforming installment if the defect substantially impairs the value of that installment and cannot be cured. Canceling the entire contract, however, requires the defect to substantially impair the value of the entire contract.

For instance, a year-long contract calls for the seller to deliver one hundred apples each month. In April, the apples arrive bruised. The buyer may reject the April lot if the apples’ defect substantially impairs their value. The buyer may not cancel the entire contract unless the April defect (or multiple defects across deliveries) substantially impairs the entire year-long deal. If the seller assures a proper cure for May, the buyer must accept future shipments if they conform.

5. Comparing UCC to Common Law

The UCC’s perfect tender rule might look harsher than the substantial performance standard. Yet the UCC moderates this harshness with seller’s rights to cure, partial acceptance and rejection, revocation of acceptance only for *substantial* defects, and the installment contract rules. In practice, many of these provisions mirror the common law’s desire to maintain the contract, if practical, while still allowing a buyer more leeway to reject goods that do not meet contract specifications.

6. Summary of the UCC Framework

Under the UCC, buyers initially have broad rejection powers. Any deviation opens the door for rejection. However, the seller’s statutory right to cure, as well as the limitations on revocation and the rules for installment contracts, significantly reduce the chance of a total and immediate repudiation. As in the common law, courts encourage

self-help by providing avenues to fix defective performance. The UCC simply starts from a premise of strict tender and then builds in ways to mitigate unjust forfeitures.

In the final analysis, the UCC and common law both strive to balance fairness with efficiency. The perfect tender rule enforces precise expectations but also acknowledges that commerce thrives on practical solutions, which is why cure rights and installment rules exist. The common theme is that parties should get what they bargained for, but a minor or easily rectified defect should not always lead to a catastrophic failure of the contract.

C. Reflections on Performance

This chapter introduced several new concepts. First, most contracts involve an exchange of **mutual promises**, where the performance of one promise is conditioned on the performance of the other. The mutual performances under an exchange of promises are thus **implied conditions** concurrent with each other. This was called “mutual conditions” in *Kingston* and is also referred to as “mutual and simultaneous promises.”

Implied conditions, like those found under an exchange of promises, are subject to the doctrine of **substantial performance**. This doctrine balances fairness with practicality by allowing minor deviations in performance to satisfy the implied condition and make the counterparty’s performance due. By reducing the risk of forfeitures for minor mistakes, substantial performance promotes efficiency in contract enforcement and ensures that parties receive the essential benefits of their bargains without being penalized for trivial imperfections.

This means that, unlike express conditions, which must be completely performed to trigger their return performances, promises subject to implied conditions must be performed when the implied condition is substantially performed. Until the mutual promise is substantially performed, the counterparty may withhold its performance. This usually comes up when one party refuses to pay the other because services were not completely performed. The substantial performance doctrine ensures that a party who delivers the core benefits of a contract is not unfairly denied compensation due to trivial imperfections.

A party who materially breaches (fails to substantially perform) has a reasonable amount of time, known as a “cure period,” to repair the defective performance. This doctrine of **material breach** reflects the value of self-help by providing the breaching party an opportunity to rectify their failure and maintain the contract. By encouraging resolution without immediate termination, it promotes contractual stability and minimizes litigation, allowing parties to address performance issues while preserving their relationship.

When this cure period expires, however, the material breach escalates into a state of **total breach**. At this point, the nonbreaching party gains the lawful right to withhold or suspend performance and may also cancel the contract, extinguishing any future

obligations under it. This right to cancel empowers the nonbreaching party to protect themselves from further harm and underscores the importance of clear performance standards in maintaining contractual balance.

The UCC, however, does not apply the doctrine of substantial performance. This stricter approach reflects the nature of goods transactions, where precision and conformity to the contract terms are often critical to the buyer's purpose. The UCC employs the **perfect tender rule**, which holds that a buyer can reject goods that do not completely conform to the contract in every way. In addition, buyers of goods subject to the UCC can revoke acceptance of nonconforming goods when the nonconformance substantially impairs the goods' value to the buyer.

Cases

Reading Kingston v. Preston. In 1773, a famous English judge named The Right Honorable William Murray, First Earl of Mansfield (who is referred to more simply as Lord Mansfield), recognized that when parties make mutual promises to each other, these promises are often intended to be implied conditions to their obligations.

The original text of this famous case is reproduced below. Although the entire decision is less than a thousand words, it uses old language, British spelling, and grammatical structure that would charitably be described today as a run-on sentence. To retain the color and texture of this historic case while enhancing readability, the original text has been edited by adding paragraph breaks. Try your best to understand the facts of this case and the three kinds of covenants identified by Lord Mansfield in his analysis. After the case, this casebook will explore the modern meaning of these critical concepts.

Kingston v. Preston

99 Eng. Rep. 437 (K.B. 1773)

MANSFIELD, J.

It was an action of debt, for non-performance of covenants contained in certain articles of agreement between the plaintiff and the defendant. The declaration stated;

That, by articles made the 24th of March, 1770, the plaintiff, for the considerations therein-after mentioned, covenanted, with the defendant, to serve him for one year and a quarter next ensuing, as a covenant-servant, in his trade of a silk-mercator, at £200 a year, and in consideration of the premises, the defendant covenanted, that at the end of the year and a quarter, he would give up his business of a mercator to the plaintiff, and a nephew of the defendant, or some other person to be nominated. By the defendant,

and give up to them his stock in trade, at a fair valuation; and that, between the young traders, deeds of partnership should be executed for 14 years, and from and immediately after the execution of, the said deeds, the defendant would permit the said young traders to carry on the said business in the defendant's house.

Then the declaration stated a covenant by the plaintiff, that he would accept the business and stock in trade, at a fair valuation, with the defendant's nephew, or such other person, &c. and execute such deeds of partnership, and, further, that the plaintiff should, and would, at, and before, the sealing and delivery of the deeds, cause and procure good and sufficient security to be given to the defendant, to be approved of by the defendant, for the payment of £250 monthly, to the defendant, in lieu of a moiety of the monthly produce of the stock in trade, until the value of the stock should be reduced to £4000.

Then the plaintiff averred, that he had performed, and been ready to perform, his covenants, and assigned for breach on the part of the defendant, that he had refused to surrender and give up his business, at the end of the said year and a quarter.

The defendant pleaded, 1. That the plaintiff did not offer sufficient security; and, 2. That he did not give sufficient security for the payment of the £250, &c.

And the plaintiff demurred generally to both pleas.

On the part of the plaintiff, the case was argued by Mr. Buller, who contended, that the covenants were mutual and independent, and, therefore, a plea of the breach of one of the covenants to be performed by the plaintiff was no bar to an action for a breach by the defendant of one of which he had bound himself to perform, but that the defendant might have his remedy for the breach by the plaintiff, in a separate action.

On the other side, Mr. Grose insisted, that the covenants were dependent in their nature, and, therefore, performance must be alleged: the security to be given for the money, was manifestly the chief object of the transaction, and it would be highly unreasonable to construe the agreement, so as to oblige the defendant to give up a beneficial business, and valuable stock in trade, and trust to the plaintiff's personal security, (who might, and, indeed, was admitted to be worth nothing) for the performance of his part.

In delivering the judgment of the Court, Lord Mansfield expressed himself to the following effect: There are three kinds of covenants:

1. Such as are called mutual and independent, where either party may recover damages from the other, for the injury he may have received by a breach of the covenants in his favor, and where it is no excuse for the defendant, to allege a breach of the covenants on the part of the plaintiff.

2. There are covenants which are conditions and dependent, in which the performance of one depends on the prior performance of another, and, therefore, till this prior condition is performed, the other party is not liable to an action on his covenant.

3. There is also a third sort of covenants, which are mutual conditions to be performed at the same time; and, in these, if one party was ready, and offered, to perform his part, and the other neglected, or refused, to perform his, he who was ready, and offered, has fulfilled his engagement, and may maintain an action for the default of the other; though it is not certain that either is obliged to do the first act.

His Lordship then proceeded to say, that the dependence, or independence of covenants, was to be collected from the evident sense and meaning of the parties, and, that, however transposed they might be in the deed, their precedency must depend on the order of time in which the intent of the transaction requires their performance. That, in the case before the Court, it would be the greatest injustice if the plaintiff should prevail: the essence of the agreement was, that the defendant should not trust to the personal security of the plaintiff, but, before he delivered up his stock and business, should have good security for the payment of the money. The giving such security, therefore, must necessarily be a condition precedent.

Judgment was accordingly given for the defendant, because the part to be performed by the plaintiff was clearly a condition precedent.

Reflection

The *Kingston* case introduces what are sometimes called the “Kingston covenants.” The taxonomy of promises and their interdependence that Lord Mansfield provided in this famous case remains relevant today, although the terminology varies slightly.

Discussion

1. Prior to *Kingston*, what recourse would one party have had when its counterparty breached an agreement? More specifically, what legal rights would the silk merchant in *Kingston* have had if there were no such thing as dependent covenants?
 2. When parties exchange promises, do they usually intend those promises to be independent or dependent? Explain your reasoning.
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Reading Jacob & Youngs, Inc. v. Kent. As you will see in this next case, the law treats implied conditions differently from express conditions. Recall from the prior chapter that express conditions precedent must be completely performed before the promise subject to that condition needs to be performed at all. This so-called doctrine of complete performance can lead to harsh and unjust results, which courts can equitably ameliorate through the excuse doctrine, discussed Chapter 22.

The law of implied promises developed differently. In 1921, then-Judge Benjamin Cardozo (who later became an Associate Justice of the Supreme Court of the United States) established the doctrine of substantial performance.

Jacob & Youngs, Inc. v. Kent

230 N.Y. 239 (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.

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. The distinction is akin to that between dependent and independent promises, or between promises and conditions

(Anson on Contracts [Corbin's ed.], sec. 367; 2 Williston on Contracts, sec. 842). Some promises are so plainly independent that they can never by fair construction be conditions of one another. 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. 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 minutia 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. 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." 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. There is no general license to install whatever, in the builder's judgment, may be regarded as "just as good." The question is one of degree, to be answered, if there is doubt, by the triers of the facts, and, if the inferences are certain, by the judges of the law. We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfilment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose,

in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression. 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.

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. 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." The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

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

McLAUGHLIN, J. (dissenting).

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.

Under its contract it obligated itself to use in the plumbing only pipe (between 2,000 and 2,500 feet) made by the Reading Manufacturing Company. The first pipe delivered was about 1,000 feet and the plaintiff's superintendent then called the attention of the foreman of the subcontractor, who was doing the plumbing, to the fact that the specifications annexed to the contract required all pipe used in the plumbing to

be of the Reading Manufacturing Company. They then examined it for the purpose of ascertaining whether this delivery was of that manufacture and found it was. Thereafter, as pipe was required in the progress of the work, the foreman of the subcontractor would leave word at its shop that he wanted a specified number of feet of pipe, without in any way indicating of what manufacture. Pipe would thereafter be delivered and installed in the building, without any examination whatever. Indeed, no examination, so far as appears, was made by the plaintiff, the subcontractor, defendant's architect, or anyone else, of any of the pipe except the first delivery, until after the building had been completed. Plaintiff's architect then refused to give the certificate of completion, upon which the final payment depended, because all of the pipe used in the plumbing was not of the kind called for by the contract. After such refusal, the subcontractor removed the covering or insulation from about 900 feet of pipe which was exposed in the basement, cellar and attic, and all but 70 feet was found to have been manufactured, not by the Reading Company, but by other manufacturers, some by the Cohoes Rolling Mill Company, some by the National Steel Works, some by the South Chester Tubing Company, and some which bore no manufacturer's mark at all. The balance of the pipe had been so installed in the building that an inspection of it could not be had without demolishing, in part at least, the building itself.

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. But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor was any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either "nominal or nothing." Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been "just

as good, better, or done just as well.” He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed. The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application.

What was said by this court in *Smith v. Brady* (supra) is quite applicable here: “I suppose it will be conceded that everyone has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. The specifications of the contract become the law between the parties until voluntarily changed. If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian. If the owner, having regard to strength and durability, has contracted for walls of specified materials to be laid in a particular manner, or for a given number of joists and beams, the builder has no right to substitute his own judgment or that of others. Having departed from the agreement, if performance has not been waived by the other party, the law will not allow him to allege that he has made as good a building as the one he engaged to erect. He can demand payment only upon and according to the terms of his contract, and if the conditions on which payment is due have not been performed, then the right to demand it does not exist. To hold a different doctrine would be simply to make another contract, and would be giving to parties an encouragement to violate their engagements, which the just policy of the law does not permit.” (p. 186.)

I am of the opinion the trial court did not err in ruling on the admission of evidence or in directing a verdict for the defendant.

For the foregoing reasons I think the judgment of the Appellate Division should be reversed and the judgment of the Trial Term affirmed.

Reflection

One way to understand the dissent’s criticisms of the majority opinion without throwing out Cardozo’s substantial contribution to legal doctrine is to distinguish what is radical in his opinion. The criticisms boil down to a singular complaint that Cardozo transmogrified a clear express condition into an implied one. Remember that the contract was written in a manner that would reasonably lead to the conclusion that the parties intended the installation of Reading pipe to be an express condition precedent to Kent’s obligation to pay Jacob & Youngs. In Cardozo’s effort to reach a more equitable result—and perhaps seeking to define a new doctrine in contract law—he ignores the plain meaning of the written agreement. Cardozo is not alone in doing this: look back to cases like *Nānākuli* and *Sierra Diesel* in Module IV, and you will see that judges who take a more subjective approach to contract interpretation will ignore the plain meaning when justice so requires. For an objective jurist like the dissenter McLaughlin, this is error.

But once we get past Cardozo's strong application of the subjective approach to contract interpretation, such that we accept that this contract does not have an express condition to use a certain brand of pipe but at best an implied one, then the power and importance of his opinion become clear. By creating the doctrine of substantial performance of implied conditions, Cardozo finishes in 1921 what Lord Mansfield started in 1773. The law today is now better aligned with what people would expect from their contractual relationships.

The majority of jurisdictions and the R2d have generally adopted Cardozo's approach—at least insofar as to recognize that an implied condition need only be substantially performed for the promise conditioned on that implied condition to become due. As you review the R2d's rules on the impact of performance and non-performance, consider whether it goes as far as Cardozo did.

Discussion

The dissent is critical to read in this case because in it, Judge McLaughlin points out the problems with Judge Cardozo's approach. These discussion questions center around this vigorous dissent.

1. McLaughlin criticizes Cardozo's new doctrine for violating parties' freedom of contract. Both the majority and the dissent seem to agree that contracts interpretation should accord with the parties' intentions. When a contract expressly states a condition, why should a court assume that party did not intent to make its promises dependent on the complete performance of that condition?
 2. McLaughlin criticizes Cardozo's fact finding by questioning whether the builder's error was really so trivial and innocent. We do not know why the builder failed to use the specified brand of pipe. We also do not know whether Reading pipe is better than other brands—or, for that matter, whether branded pipe is better than pipe which is not branded. Courts are not experts in the quality of pipe, so how is this court justified in asserting that these pipes were identical?
 3. McLaughlin criticizes Cardozo's application of equitable principles in this case as leading to unjust results in other cases. If parties' contracts will not be interpreted to mean what they say, how shall parties plan their business affairs? Might Kent's profession as an attorney have influenced Cardozo's decision? Is it possible that Kent was trying to use the court to save money on his mansion?
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Reading *Khiterer v. Bell*. The next case illustrates how a modern trial court applies Cardozo's rather loose framework. Read this case twice. The first time you read it, consider it in light of Cardozo's decision. Highlight the rule that the court employed and the facts analyzed under it, and write annotations explaining how those facts impact the outcome of the rule. Then, review the R2d's five-factor balancing test, and carefully note what those five factors are. Then, return to *Khiterer*. As you read *Khiterer*, apply its facts to the balancing-test rule provided by the R2d.

Compare your experience analyzing this case under Cardozo's loose standard with analyzing it under the R2d's formal rule. Do you arrive at a different result? Was it easier or harder to perform this analysis with a loose standard or with a formal rule? Does one approach require more or fewer facts or more or less evidence than the other? Which of these approaches do you think is more likely to help judges arrive at the right result in the majority of cases?

Khiterer v. Bell

800 N.Y.S.2d 348 (Civ. Ct. 2005)

JACK M. BATTAGLIA, J.

A patient who proves breach of a contract for professional dental services, but does not also prove personal or economic harm, may recover only nominal damages for the breach.

Inna Khiterer began treating with Dr. Mina Bell in October 2001. The treatment included root canal therapy on two teeth and the fabrication and fitting of crowns for those teeth, as well as the fabrication and fitting of a replacement crown for a third tooth. The crowns were fitted in June 2002, and, after several broken appointments, Ms. Khiterer last saw Dr. Bell in December 2002. Ms. Khiterer treated with another dentist the following summer, and, according to her testimony at trial, learned that the crowns with which she was fitted by Dr. Bell were not fabricated in accordance with their agreement. Specifically, the crowns were made totally of porcelain, rather than of porcelain on gold as they, allegedly, should have been.

Ms. Khiterer's complaint in this Small Claims Part action alleges "defective services rendered and breach of contract." Advised prior to trial that any claim in the nature of dental malpractice required expert proof, Ms. Khiterer elected to proceed on her breach of contract claim only.

"A breach of contract claim in relation to the rendition of medical or dental services by a physician or dentist will withstand a test of its legal sufficiency only when based upon an express special promise to effect a cure or accomplish some definite result." A contract cause of action might be based upon a "specific promise to deliver a baby without administration of blood."

The agreement alleged here, for dental services including root canal therapy and the fabrication and fitting of crowns made of porcelain on gold, had as its predominant purpose the furnishing of services, and is, therefore, governed by the general law of contracts and not by Article 2 of the Uniform Commercial Code. As will appear, however, the result would be the same in any event.

Ms. Khiterer testified that, because she had previously been fitted with crowns made of porcelain on gold (actually an 86% gold alloy, as Dr. Bell explained), she requested that the three crowns that she would receive from Dr. Bell also be made of porcelain on gold. Ms. Khiterer also offered the testimony of a friend, Sergei Leontev, who said that he was present during a conversation between Ms. Khiterer and Dr. Bell, and heard Dr. Bell assure Ms. Khiterer that she would be receiving three “golden-based crowns.” Mr. Leontev also testified that he made a similar agreement with Dr. Bell that was later changed to all-porcelain crowns.

Dr. Bell testified that she had no independent recollection of any conversation with Ms. Khiterer about the composite material for the crowns. She testified further that an all-porcelain crown was therapeutically superior to a crown containing any metal, including the gold alloy, because the presence of metal created a risk of patient reaction. The cost to her, she said, of an all-porcelain crown and a porcelain-on-metal crown is the same, but the cement that binds the all-porcelain crown is more expensive.

Dr. Bell presented a copy of Ms. Khiterer’s chart, showing an entry for the first visit on October 21, 2001 of “crowns metal-free.” Impressions for the crowns, however, were apparently taken seven months later on May 30, 2002. Ms. Khiterer presented a summary of all treatment she received from Dr. Bell, handwritten by Dr. Bell, showing the notations for two teeth “rct/post/crown/pfm” and for one additional tooth “pfm.” Dr. Bell explained that “rct” stood for “root canal therapy” and that “pfm” stood for “porcelain fused metal.” She maintained that “pfm” was shorthand for any crown no matter the composition, but did not satisfactorily explain the then-redundant notation “crown/pfm.”

The Court finds that the contract between Ms. Khiterer and Dr. Bell called for crowns made of porcelain on gold, but that the crowns with which Ms. Khiterer was fitted were made of all porcelain. There is no evidence that Dr. Bell intentionally substituted all porcelain for porcelain on gold. Intent is not required, of course, for a breach of contract, but, as will appear, it may affect the remedy for the breach. Dr. Bell pointed to an entry in Ms. Khiterer’s chart for June 5, 2002, the date the crowns were fitted, that reads, “Patient satisfied w/esthetic [sic] cementation,” as evidence that Ms. Khiterer was satisfied with the all-porcelain crowns. But the entry cannot bear that weight, particularly in light of the evidence that Ms. Khiterer could not and did not know that the crowns were all porcelain until her teeth were x-rayed by her successor dentist.

The damages recoverable in a contract action against a doctor or dentist “are restricted to payments made and to the expenditures for nurses or medicines or other damages that flow from the breach.” The precise scope of this damage formula is not entirely clear. It would include the amount of the fee paid or due to the doctor or

dentist, but, as the decisions make clear, would not include “pain and suffering.” It would seem, therefore, that Ms. Khiterer would be entitled to recover as damages at least the fee she paid to Dr. Bell for the fabrication and fitting of the three crowns. The opinions, however, appear to assume that there had not been substantial performance of the contract by the doctor.

Developed in the context of construction contracts, the substantial performance doctrine allows the contractor to recover or retain the contract price for the work, with a deduction for the cost of completion or correction to contract requirements. The doctrine is applicable to employment contracts, real estate brokerage agreements, and leases, and no reason suggests itself for not applying the doctrine as well to contracts for medical or dental services.

As articulated by Judge Cardozo in his seminal opinion in *Jacob & Youngs v. Kent*: “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.” The doctrine is required by justice, so as not “to visit venial faults with oppressive retribution,” and “the transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong.” But “the willful transgressor must accept the penalty of his transgression.” “The interrupted work may have been better than called for in the plans. Even so, there can be no recovery if the contractor willfully and without excuse has substituted something else.”

“Conveying a benefit upon a party does not *ipso facto* constitute substantial performance.” “A contractor is not entitled to compensation from an owner even for improvements which benefit the owner unless that is a benefit for which an owner agreed to pay.”

“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. . . . There is no general license to install whatever, in the builder’s judgment, may be regarded as ‘just as good’ 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.”

Where substantial performance has been rendered, the remedy is the cost of completion or correction, unless that cost “is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value.” The “difference in value rule” is applied to avoid “economic waste.” But where the defect in performance is substantial, the cost of completion or correction will be awarded “notwithstanding the relatively small fee . . . charged for services rendered.”

Here, as already noted, there is no evidence that Dr. Bell intentionally substituted all porcelain for porcelain on gold as the material from which Ms. Khiterer’s crowns

were to be fabricated. The all-porcelain crowns were clearly suitable functionally for the intended purpose; indeed, there is no evidence to contradict Dr. Bell's opinion that they were better. Nor was there evidence to contradict her testimony of economic equivalence, and Ms. Khiterer testified that the fee she was charged by Dr. Bell was significantly less than the fee she had been quoted by other dentists. There is no evidence of physical harm to Ms. Khiterer from the all-porcelain crowns; although she testified that two of the crowns have been replaced by porcelain-on-gold crowns, there was no evidence that the replacement was necessitated by the composition of the all-porcelain crowns. And Ms. Khiterer was satisfied with the all-porcelain crowns from an aesthetic perspective.

If, therefore, there is to be a determination that Dr. Bell did not substantially perform her contract with Ms. Khiterer—or, to put it differently, that her performance was substantially defective—it must rest on recognition of a patient's right to control, without qualification, any material that would become part of her body. The only decision of which this Court is aware that seems relevant to the issue suggests that the contract action against a doctor or dentist does not extend that far.

In *Semel v. Culliford*, the patient alleged that the doctor “failed to accomplish what he specifically undertook and agreed to do, take out all of the wire sutures” that had been implanted in the patient during previous open-heart surgery. The court held that, “as drafted,” the patient's contract cause of action could not withstand the doctor's motion for summary judgment. Although the court saw “an issue of fact concerning the extent of the surgery [the doctor] actually contracted to perform, the only damage said to have been sustained is . . . pain and suffering items of injury not obtainable in a contract action.”

Tort cases concerning lack of consent to medical treatment address a somewhat similar issue. “Every human being of adult years and sound mind has a right to determine what shall be done with his own body; and a surgeon who performs an operation without his patient's consent, commits an assault, for which he is liable for damages.” But, if the patient “fails to prove any damages causally related to her lack of consent,” she may recover only nominal damages.

And so, when a patient sued her dentist because “the wrong tooth had been extracted,” but “the tooth that was extracted was badly diseased and should have been extracted,” a judgment for the patient could not stand. The court noted that “no injurious results to the patient were proved” and “no special contract was made.” A dissenting judge disagreed on the latter issue, finding proof of a “breach of a special contract resulting in a trespass.” He would have allowed damages “predicated . . . upon the additional expense the patient would be required to incur for contemplated bridge work by reason of the absence of the tooth extracted.” There was no suggestion of an award of general damages, unrelated to proof of physical or economic harm.

Whether the form of action is contract or tort, “the inquiry must always be, what is an adequate remedy to the party injured”; “the law awards to the party injured a

just indemnity for the wrong which has been done him, and no more.” The tort cases for lack of consent to medical treatment support a conclusion that an invasion of the interest to control one’s body is not compensable beyond an award of nominal damages, in the absence of proof of other harm, presumably including, in an appropriate case, emotional harm.

The Court concludes that Dr. Bell’s breach of her contract with Ms. Khiterer, fitting her with all-porcelain crowns rather than porcelain-on-gold crowns, was not substantial, so as to warrant a return of her total fee. An award based upon the cost of replacement (which, in any event, has not been established by competent evidence) would be “grossly and unfairly out of proportion to the good to be obtained.” And, under the circumstances here, the “difference in value rule” yields an award of only nominal damages, to which Ms. Khiterer is entitled upon proof of breach of contract.

The Court’s analysis and conclusion are supported by an analysis of Ms. Khiterer’s claim, and the conclusion that would be reached, under Article 2 of the Uniform Commercial Code. The contract description of the goods, porcelain-on-gold crowns, would constitute “an express warranty that the goods shall conform to the description.” (See UCC § 2-313 [1][b].) Ms. Khiterer could reject the crowns if they “fail[ed] in any respect to conform to the contract.” (See UCC § 2-601.) But Ms. Khiterer’s use of the crowns for approximately two years would constitute acceptance of them (see UCC § 2-606 [1][c]); and, consistent with the substantial performance doctrine in general contract law, Ms. Khiterer could revoke her acceptance of the crowns only if the “non-conformity substantially impair[ed] [their] value” (see UCC § 2-608 [1].) Without a substantial impairment of value, Ms. Khiterer’s acceptance would stand, and she would be obligated to pay for the crowns “at the contract rate.” (See UCC § 2-607 [1].) She would retain a claim for damages, however, measured by the “difference . . . between the value of the goods accepted and the value they would have had if they had been as warranted.” (See UCC § 2-714 [2].) Applying that formula, her damages would be nominal.

Judgment is awarded to Ms. Khiterer for \$10.00, plus disbursements.

Reflection

As you may have surmised from analyzing *Khiterer* both under Cardozo’s standard for substantial performance, and also under the R2d’s five-factor rule, there are costs and benefits to both rules and standards.

A standard like the one Cardozo provides for determining substantial performance gives judges a wide degree of freedom in deciding what justice requires for a certain case. But this freedom inherently means that it is harder for parties to predict how courts will rule. A rule like the R2d’s results in a more structured analysis. That structure gives parties more advance notice about how courts will evaluate circumstances where one party withheld performance. This makes it easier to plan actions that will not violate the law. But this also means that parties could plan their actions

not to violate the specific blackletter law while violating the spirit of contract law in general, and that other parties who deserve relief under the law might not receive it for technical reasons.

Whether a rule or a standard is better depends in large part on what this specific law is trying to accomplish. Recall that the R2d's approach to this aspect of contract law is to encourage parties to engage in self-help. To accomplish this end, the R2d needs to provide parties clarity about what is or is not lawful. A rule is a better tool than a standard when the goal is giving parties certainty or clarity in advance about how courts will decide such cases. This allows parties to accurately predict how courts will behave and to plan their actions accordingly. This may explain why the R2d provides a more formal five-factor test in the form of a rule and not a standard, so parties can determine with greater certainty whether or not to withhold performance in response to their counterparties' breach.

Discussion

1. When you apply the R2d test to the facts in *Khiterer*, do you arrive at the same legal result?
 2. Are you suspicious of either *Khiterer's* or *Bell's* motives in this case? Does either party appear to be acting in bad faith? Or was this just an innocent and good-faith mistake?
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Problems

Problem 20.1. Direct Timber Shipment

In the nineteenth century, a ship captain and a timber producer entered into a contract for the shipment of timber from Riga, the capital of Latvia, to Portsmouth, United Kingdom. The contract specified that the ship would "sail with the first favorable wind direct to Portsmouth."

The contract also has a "Choice of Law" clause that specifies: "The validity of this agreement, its construction, interpretation, and enforcement, and the rights of the parties hereto shall be determined under, and construed in accordance with, the laws of the State of Delaware." Assume for purposes of this problem that Delaware follows the R2d and has adopted the UCC.

Instead of sailing directly to Portsmouth, the ship stopped along the way in Copenhagen, Denmark, where it was detained for several weeks. Upon arriving at Portsmouth, the producer's agent accepted delivery of the timber, but the producer refused to pay the ship captain, citing both the delay and the detour.



Figure 20.2. Map showing the relative locations of Riga, Copenhagen, and Portsmouth.

How would you characterize the promises and/or conditions in this agreement? Based on that characterization, analyze whether or not the timber producer's duty to pay the ship captain has come due.

See *Bornmann v. Tooke*, 170 Eng. Rep. 991 (1807).

Problem 20.2. Sewer System

This case involves a sewer system that was not fully completed. In June 2004, appellant Roberts Contracting Company, Inc. (Roberts) agreed to build and complete a sewer system for appellee Valentine-Wooten Road Public Facility Board (VWR) by April 12, 2005. The contract provided that VWR would pay \$2,088,166 for Roberts to build the sewer system, which was to be accepted by the City of Jacksonville, and that, if Roberts did not complete the work on time, it would pay \$400 per day until completion. Roberts received an extension from VWR until October 20, 2005, but did not finish the job by then.

Although VWR agreed to obtain all necessary easements, it did not resolve disputes with two landowners, Pickens and Harris, until very late in the project. Those issues, along with wet weather and a contract dispute between the project engineer, Bond Consulting Engineers, Inc., and Pulaski County delayed construction. The parties disagree about whether VWR's failure to fulfill its obligations hindered Roberts's ability to perform.

By fall 2005, Roberts had installed and tested the sewer lines, and had installed five pump stations and the force-main pipes and related equipment. But the pump station on the Pickens property still lacked power, and Mr. Harris had damaged a force main on his property that Roberts had, at VWR's direction, placed outside the easement. The Pickens easement was finally settled in January 2006, but the

Harris dispute was not resolved until May 2006. Further, Bond Consulting Engineers stopped its on-site supervision of the job in December 2005 after a dispute with Pulaski County over payment.

More than a year past the original completion date, with at least one extension granted, Roberts walked off the job, and VWR refused to pay all of Roberts's last bill. The sewer system was not operational. A video inspection performed by Jacksonville Waste Water Utility in November 2006, more than a year after the lines had been successfully tested, revealed numerous defects and debris in the sewer system. Roberts took the position that the problems in the lines had developed during the year-long interval between its completion of the lines and the taping.

On May 16, 2006, VWR refused to pay Roberts the entire amount of a bill on the ground that it had not completed all of the work. The pay estimate indicated that retainage (from work already performed and partially paid) at that time was \$104,408.30, and that Roberts had earned an additional \$57,532.50, which had not yet been paid. Roberts refused to perform further and asserted that the purportedly incomplete work was not within the scope of the contract. It also claimed that its ability to perform had been hampered by VWR's failure to perform its obligations.

Roberts sued VWR for breach of contract, alleging that Roberts had substantially performed, and seeking \$162,502.80. VWR filed a counterclaim for damages caused by Roberts's failure to complete and repair the system.

Evaluate the competing claims based on whether the parties substantially performed pursuant to the rule articulated in the R2d. Specifically, evaluate whether any failure to completely, substantially, or materially perform has any impact on the other party's duty to perform its obligations. Make sure to characterize any contractual obligations as mutual or independent promises, conditions, or promissory conditions.

See Roberts Contracting Co. v. Valentine-Wooten Rd. Pub. Facility Bd., 2009 Ark. App. 437.

Problem 20.3. Newspaper Stock

As of July 8, 1961, Paul Spindler was the owner of a majority of the shares of S & S Newspapers, a corporation which, since April 1, 1959, had owned and operated a newspaper in Santa Clara known as the *Santa Clara Journal*. In addition, Spindler, as president of S & S Newspapers, served as publisher, editor, and general manager of the *Journal*.

On July 8, 1961, Spindler entered into a written agreement with Sheldon Sackett whereby the latter agreed to purchase 6,316 shares of stock in S & S Newspapers, this number representing the total number of shares outstanding. The contract provided for a total purchase price of \$85,000 payable as follows:

- \$6,000 on or before July 10,
- \$20,000 on or before July 14, and
- \$59,000 on or before August 15.

In addition, the agreement obligated Sackett to pay interest at the rate of 6% on any unpaid balance. And finally, the contract provided for delivery of the full amount of stock to Sackett free of encumbrances when he made his final payment under the contract.

Sackett paid the initial \$6,000 installment on time and made an additional \$19,800 payment on July 21. On August 10, Sackett gave Spindler a check for the \$59,200 balance due under the contract; however, due to the fact that the account on which this check was drawn contained insufficient funds to cover the check, the check was never paid.

Meanwhile, however, Spindler had acquired the stock owned by the minority shareholders of S & S Newspapers, had endorsed the stock certificates, and had given all but 454 shares to Sackett's attorneys to hold in escrow until Sackett had paid Spindler the \$59,200 balance due under the contract. However, on September 1, after the \$59,200 check had not cleared, Spindler reclaimed the stock certificates held by Sackett's attorney.

Thereafter, on September 12, Spindler received a telegram from Sackett which stated that the latter "had secured payments [for] our transaction and was ready, willing and eager to transfer them" and that Sackett's new attorney would contact Spindler's attorney. In a return telegram, Spindler gave Sackett the name of Spindler's attorney. Subsequently, Sackett's attorney contacted Spindler's attorney and arranged a meeting to discuss Sackett's performance of the contract.

At this meeting, which was held on September 19 at the office of Sackett's attorney, in response to Sackett's representation that he would be able to pay Spindler the balance due under the contract by September 22, Spindler served Sackett with a notice to the effect that unless the latter paid the \$59,200 balance due under the contract plus interest by that date, Spindler would not consider completing the sale and would assess damages for Sackett's breach of the agreement.

Also discussed at this meeting was the newspaper's urgent need for working capital. Pursuant to this discussion, Sackett on the same date paid Spindler \$3,944.26 as an advance for working capital.

However, Sackett failed to make any further payments or to communicate with Spindler by September 22, and on that date, the latter, by letter addressed to Sackett, again extended the time for Sackett's performance until September 29. Again, Sackett failed to tender the amount owed under the contract or to contact Spindler by that date.

The next communication between the parties occurred on October 4 in the form of a telegram by which Sackett advised Spindler that Sackett's assets were now free, having previously been tied up in his divorce proceedings; that he was "ready, eager

and willing to proceed to . . . consummate all details of our previously settled sale and purchase.” Accordingly, Sackett, in this telegram, urged Spindler to have his attorney contact Sackett’s attorney “regarding any unfinished details.”

In response to this telegram, Spindler’s attorney, on October 5, wrote a letter to Sackett’s attorney stating that as a result of Sackett’s delay in performing the contract and his previous unwillingness to consummate the agreement, “there will be no sale and purchase of the stock.”

Following this letter, Sackett’s attorney, on October 6, telephoned Spindler’s attorney and offered to pay the balance due under the contract over a period of time through a “liquidating trust.” This proposal was rejected by Spindler’s attorney, who, however, informed Sackett’s attorney at that time that Spindler was still willing to consummate the sale of the stock, provided Sackett would pay the balance in cash or its equivalent. No tender or offer of cash or its equivalent was made, and Sackett thereafter failed to communicate with Spindler until shortly before the commencement of suit.

During the period scheduled for Sackett’s performance of the contract, Spindler found it increasingly difficult to operate the paper at a profit, particularly due to the lack of adequate working capital. In an attempt to remedy this situation, Spindler obtained a \$4,000 loan by mortgaging various items of his personal property. In addition, in November, Spindler sold half of his stock in S & S Newspapers for \$10,000. Thereafter, in December, in an effort to minimize the cost of operating the newspaper, Spindler converted the paper from a daily to a weekly. Finally, in July 1962, Spindler repurchased for \$10,000 the stock which he had sold the previous November and sold the full 6,316 shares for \$22,000, which netted Spindler \$20,680 after payment of brokerage commission.

Sackett (the flaky buyer) then commenced this action against Spindler (the seller), claiming that Spindler had breached his promise to sell the stock to Sackett.

- a. Did Sackett completely perform, such that Spindler had to perform his obligations under the contract?
- b. Did Sackett substantially perform or materially breach, such that Spindler could withhold his performance but not cancel the contract?
- c. Did Sackett have time to cure, or did he totally breach his promise to Spindler, such that Spindler was legally able to cancel the contract?

See Sackett v. Spindler, 248 Cal. App. 2d 220 (1967).

Chapter 21

Repudiation

Contracts are built on the expectation of performance, but what happens when one party signals it will not meet its obligations before performance is due? This is the central question addressed by the doctrine of anticipatory repudiation. The repudiation doctrine allows the aggrieved party to take immediate action, such as suspending performance, seeking assurances, or pursuing remedies, rather than waiting for an inevitable breach to occur. These actions benefit the aggrieved party by avoiding further losses, preserving their contractual rights, and creating an opportunity to address the breach efficiently before the situation worsens. This chapter examines how courts determine when a party's words, actions, or failures rise to the level of repudiation, and it explores the legal remedies available in response.

Repudiation can take two primary forms. The first is simple repudiation, where a party makes a clear and unequivocal statement or takes an action that demonstrates an intent not to perform. For the intent to be unequivocal, it must leave no reasonable doubt about the party's refusal to fulfill their obligations. Vague or conditional statements, such as "We might not be able to deliver," are generally insufficient to meet this standard.

The second form arises from reasonable insecurity, when circumstances give one party legitimate concern about the other's ability or willingness to perform. For instance, discovering that a supplier has missed key deadlines with other clients or is facing insolvency could constitute reasonable insecurity. In such cases, the insecure party can demand adequate assurances. If the assurances are not provided within a reasonable time, the failure itself becomes a repudiation, which triggers the same consequences as a total breach.

The legal framework governing repudiation is designed to balance fairness and predictability by safeguarding the stability of contractual relationships. This balance ensures that parties are not left in prolonged uncertainty while also protecting their rights to clear and equitable remedies in the face of repudiation. The procedure for demanding assurances provides a structured way to address uncertainty without prematurely treating the contract as breached. At the same time, the failure to provide those assurances within a reasonable time allows the aggrieved party to act decisively to protect their interests.

On the one hand, this framework protects parties from being forced to endure prolonged uncertainty or harm caused by a counterparty's refusal to perform. On the

other hand, it requires clarity and proportionality to avoid unfairly penalizing a party based on mere doubts or misunderstandings.

Through the lens of common law principles and statutory provisions in the R2d and UCC, this chapter explores the mechanics and implications of anticipatory repudiation. It examines key doctrines, such as the difference between uncertainty and unequivocal refusal; the proper procedure for demanding assurances; and the consequences of failing to provide those assurances. Case examples and practical problems illustrate how these principles are applied in real-world disputes.

By the end of this chapter, you will have gained a deeper understanding of how contract law addresses repudiation. Whether dealing with direct refusals, ambiguous signals, or insecurity-based demands, knowing these doctrines will equip you to navigate performance disputes with confidence and precision.

Rules

A. Repudiation

A simple repudiation is a direct and unequivocal statement or action that a party will not perform an obligation. Both the R2d and the UCC recognize repudiation and analyze it in similar ways.

1. *Determining Whether a Statement Is a Repudiation*

A statement is a repudiation under the common law if a party unequivocally refuses to perform:

A repudiation is 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. R2d § 250(a).

Under the UCC, a similar principle appears in § 2-610. A party repudiates when it communicates an intent not to perform, and that refusal substantially impairs the contract's value to the other side:

[Anticipatory repudiation is] [w]hen either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other. NH UCC § 2-610.

In both cases, uncertainty or hesitation does not amount to repudiation. The intent not to perform must be clear. Saying, "I am not sure I can fulfill the contract," is insufficient. Saying, "I will not fulfill the contract under any circumstances," constitutes repudiation.

What contract law requires to constitute simple repudiation is a clear refusal. A clear refusal is something like saying, “I will not deliver these goods.” This suffices for repudiation. A mere worry, such as “I might be late,” does not. The law demands unequivocal language or conduct that leaves no real uncertainty about the party’s intent.

For example, Chris hires Nadia to paint his house next month. One week before painting begins, Nadia says, “I have decided not to paint at all.” This is a straightforward repudiation under R2d § 250(a). On the other hand, if Nadia says, “I’m not sure if I’ll have enough time, but I’ll try,” this is not a repudiation. Nadia’s statement expresses doubt, not a refusal. Another example: a manufacturer of shoes tells a retailer, “I have shut down my factory and cannot fill your order.” This is a repudiation under UCC § 2-610. The retailer may act immediately to find another supplier. But if the shoe manufacturer tells the retailer, “We are experiencing delays due to supply chain issues, but we are doing everything we can to fulfill your order,” then this is not a repudiation because it does not unequivocally signal an intent not to perform.

2. Determining Whether an Action Is a Repudiation

Actions may amount to repudiation if they clearly signal an intent not to perform or if they make performance impossible:

A repudiation is a voluntary affirmative act which renders the obligor unable or apparently unable to perform without such a breach. R2d § 250(b).

Examples include selling goods promised to another party under a contract, dismantling a factory required for production under a contract, or mortgaging or selling property that is the subject of a contract. In these cases, actions speak louder than words. Courts look at whether the conduct leaves no reasonable doubt that the party intends not to perform.

For example, Chris contracts to sell a specific car to Lisa. Before the delivery date, Chris sells the car to another buyer. This act makes performance impossible and constitutes a repudiation under R2d § 250(b). On the other hand, if Lisa discovers that Chris’s car is still listed for sale online after she contracts with Chris to buy it, that leaves doubt as to his intentions and does not constitute a repudiation. Another example: a construction company contracts to build a house for a client. Two weeks before work begins, the company sells all its construction equipment and fires its workers. These voluntary acts render performance apparently impossible and constitute repudiation under UCC § 2-610. However, if the company’s workers go on strike, that creates reasonable insecurity about the company’s ability to build the house but does not constitute a simple repudiation.

The distinction hinges on whether the actions unequivocally indicate an intent to breach or make performance impossible. Ambiguity or uncertainty is insufficient. Courts assess the context, including whether the obligor took voluntary steps that clearly demonstrate an inability or unwillingness to fulfill the contract.

3. Applying the Impact of Repudiation

When repudiation is clear, the law treats it like a **total breach**. R2d § 253 and UCC § 2-610 each allow the non-repudiating party to:

- (1) Stop its own performance.
- (2) Seek alternatives or cover.
- (3) Sue for damages without waiting for the due date.

The rule is more clearly spelled out in the UCC provision, which states:

[Upon anticipatory repudiation,] the aggrieved party may

- (a) for a commercially reasonable time await performance by the repudiating party; or*
- (b) resort to any remedy for breach, even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and*
- (c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods. NH UCC § 2-610.*

This rule comes from *Hochster v. De La Tour*, 118 Eng. Rep. 922 (Queen's Bench, 1853), where an employer told a courier well in advance that his services would not be used. The court let the courier sue at once, rather than wait for the scheduled start date.

For example, Theo contracts with Amber to design a website by May 1. On April 15, Amber says, "I won't be able to do it." Theo can immediately hire another designer, then hold Amber liable for any extra cost. Amber's statement is a direct repudiation, which has the effect of her total breach.

B. Reasonable Insecurity and the Demand for Adequate Assurances

Sometimes, a party suspects that the other side will not or cannot perform, but the evidence is less explicit than "I refuse." In such cases, the insecure party can demand **adequate assurances**. If those assurances do not come, the failure to give adequate assurances itself can be a repudiation—equivalent to a total breach.

1. Grounds for Insecurity

Under R2d § 251, a party may demand assurances if "reasonable grounds arise" to believe that the other side will not perform. Under UCC § 2-609, a party must make this demand in writing for goods contracts, and the insecurity must meet

a commercial standard of reasonableness. Minor rumors or vague doubts are not enough. The perceived risk must be significant, such that a reasonable person would fear nonperformance.

For example, Aria agrees to renovate Sam's kitchen. Sam hears from a credible source that Aria sold all her tools and plans to move to another state. Sam now has reasonable grounds for insecurity. Sam can call Aria and ask her to explain how she plans to fulfill the contract. Until Aria responds, Sam may refuse to let Aria begin any further work and refuse to pay any advance funds. But, until Sam affords Aria a reasonable time to respond, he may not cancel the contract.

In a UCC context, Delta Electronics orders 2,000 memory chips from ChipTek. Delta learns that ChipTek is in financial trouble, having missed payroll the past month. Delta should send a written request for assurance that ChipTek can still deliver. If ChipTek stays silent or responds with "We're not sure yet," Delta can probably treat the silence or vague reply as a failure to assure. But ChipTek must give Delta the opportunity to offer assurances that it is in a financial position to pay.

2. Demanding Assurances: Proportionality

Any demand for assurances about future performance must be proportional to the reasonable insecurity. Asking to see a simple proof of solvency or a supplier contract may be fair. Requiring the other side's entire financial history might be too extreme. Good faith underlies these rules. Harassing or baseless demands can backfire and possibly constitute a breach by the insecure party.

For example, Omni Foods sees news that its produce supplier, VeggieCorp, lost half its fields to flooding. Omni writes, "Please show me evidence that you can still harvest enough produce." VeggieCorp replies with a clear plan detailing how it will source from partner farms. This is adequate assurance. Omni must keep the contract. If VeggieCorp had ignored Omni or offered no plan, that silence could become a repudiation. However, if Omni demands access to VeggieCorp's financial statements for the past five years, that would likely exceed what is reasonable under the circumstances. Such an overreaching demand could backfire, leading to unnecessary conflict or undermining Omni's good faith.

3. Failure to Assure as Repudiation

Under both R2d §251(2) and UCC §2-609(4), if the demanded assurance is not provided within a reasonable time, the insecure party may treat the failure as a repudiation. This creates the same result as an outright refusal: a total breach. The nonbreaching party can cancel the contract, secure a substitute, and sue for damages. However, it can be challenging to determine the exact moment when insecurity crosses into repudiation. The risk of getting that analysis wrong is that the party claiming the other repudiated becomes the wrongful, breaching party.

For example, Quad Copter Inc. is a company that builds custom drones. Surveillance Corp. orders from Quad Copter one hundred drones for delivery in eight weeks. Two weeks later, Surveillance hears from an industry source that Quad Copter's main factory has shut down due to a fire. Concerned, Surveillance writes the following to Quad Copter: "We have reliable information that your production capacity has been compromised. Please provide evidence of how you will meet our order on time."

Day 1: Quad Copter responds vaguely: "We're working on solutions and hope to resolve this soon." This response does not provide adequate assurance but also does not constitute a clear repudiation. Surveillance cannot yet treat this as a breach but may repeat its demand.

Day 5: Surveillance writes back: "Your prior response was insufficient. Please provide a detailed production plan within five days, or we will consider this a failure to assure." Quad Copter remains silent.

Day 11: Quad Copter's silence after the second demand creates a stronger basis for Surveillance to treat the failure as a repudiation under both R2d § 251(2) and UCC § 2-609(4). Surveillance cancels the contract, sources drones from another supplier, and notifies Quad Copter of its intent to claim damages for the additional costs incurred.

This timeline demonstrates the difficulty of determining when insecurity transitions to repudiation. Had Surveillance acted prematurely, for example, on Day 5, after Quad Copter's vague initial response, Surveillance might have breached the contract by overreacting. The case underscores the importance of clear, proportional demands and patience when seeking assurances.

4. Retraction Repudiation

A repudiating party can sometimes retract its repudiation before the other side relies on it or formally cancels. R2d § 256 and UCC § 2-611 allow retraction if no material change of position has occurred. However, once the insecure party commits resources or hires a replacement, it is too late. The repudiator must then bear liability for breach.

For example, a concert pianist contracts with a piano maker for delivery in two months. The piano maker announces that a fire will prevent delivery. The pianist takes no action. Days later, the maker repairs its workshop and confirms delivery is back on schedule. The pianist must accept the retraction if he has not yet sought a substitute. However, if the pianist responded to the maker's announcement by purchasing a new piano, the subsequent retraction would be ineffective. His reliance on the initial repudiation renders its retraction invalid.

C. Reflections on Repudiation

The doctrine of anticipatory repudiation provides a vital framework for managing uncertainty in contractual relationships. By allowing parties to take immediate actions such as suspending performance, seeking assurances, or pursuing alternative arrangements, the doctrine minimizes the risks associated with prolonged uncertainty and enables parties to address potential breaches proactively. It ensures that parties do not have to wait for an inevitable failure when nonperformance becomes certain, empowering them to act decisively to protect their interests. By addressing both clear refusals and insecurity-based concerns, the doctrine balances fairness and efficiency while preserving the integrity of contractual obligations.

At its core, anticipatory repudiation is designed to protect reliance by preventing wasted resources and enabling timely decision-making. This ensures that parties can redirect their efforts and resources effectively when a breach becomes imminent. A clear and unequivocal refusal to perform constitutes a total breach enabling the aggrieved party to withhold their own performance and seek remedies immediately. This immediate response minimizes further losses and allows the nonbreaching party to pursue alternatives without unnecessary delay.

The doctrine also emphasizes the importance of communication and transparency. In situations where one party suspects nonperformance but lacks direct evidence of refusal, the ability to demand adequate assurances bridges the gap. This mechanism encourages cooperation by requiring the potentially breaching party to confirm their intent and ability to perform. If assurances are provided, the contract remains intact. If they are not, the law treats the failure as a repudiation, which then permits the aggrieved party to protect themselves and seek remedies.

By offering these two pathways, simple repudiation and insecurity-based demands, contract law ensures both predictability and flexibility. Predictability allows parties to rely on structured remedies and plan their next steps with confidence, while flexibility ensures that contracts can adapt to unforeseen challenges without immediate termination. Together, these principles uphold the broader goals of fairness and efficiency in contract law, creating stability in commercial relationships. The R2d and the UCC reflect this balance by providing structured rules that align with commercial realities. These doctrines help maintain trust and stability in contractual relationships while allowing parties to navigate unforeseen challenges with confidence.

Anticipatory repudiation is not merely about addressing failures; it is about managing risk and preserving value. It equips parties with tools to respond proportionately to uncertainty, thereby fostering open communication and reducing the likelihood of unnecessary disputes. Through this lens, the doctrine highlights contract law's broader commitment to balancing reliance, efficiency, and fairness in commercial transactions.

Cases

Reading McCloskey & Co. v. Minweld Steel Co. Cases are not decided in a vacuum. Rather, judicial opinions reflect the realities of their time. Some cases, like this next one, are best understood in light of contemporary circumstances.

The dispute in *McCloskey* arose in the summer of 1950, which coincides precisely with the beginning of the Korean War on June 25, 1950. American troops were deployed to the region in July of that same year to defend the “38th Parallel,” the geographic boundary between the Democratic People’s Republic of Korea to its north and the Republic of Korea to its south. Despite having similar names, these governments could not have been more different. The Democratic People’s Republic of Korea, now referred to as North Korea, was a Communist regime, while the Republic of Korea, now referred to as South Korea, was a pro-Western Democracy. The Korean War was thus seen by America as a war against Communism itself, and America was prepared to put full effort into this war. The war ended in July 1953, after millions of soldiers and civilians had lost their lives.

Wars require a lot of steel. During World War II, which had ended just five years earlier, there were frequent shortages of steel and other metals. One could not purchase a new tube of toothpaste or a tub of shaving cream without first turning in the old container. Ration books issued by the Office of Price Administration gave American families a limited number of coupons to purchase necessities like car tires, and a national speed limit of 35 miles per hour was instituted to conserve gasoline. Recent memories of this severe wartime rationing may have justified anxiety about similar limits being imposed during the Korean War.

Meanwhile, taxes were raised to pay for the war effort, and wages did not keep apace. Labor unions were upset about the declining purchase power of working-class Americans. The steel unions were in an especially strong position to demand higher wages, as their products were vital to the war effort and to the economy at large. Steel worker strikes were threatened several times. President Harry S. Truman responded by threatening to nationalize the steel industry, just as President Woodrow Wilson had nationalized the railroad industry to prevent workers from striking during World War I. A 1948 amendment to the Selective Service Act allowed the President to seize industrial factories that failed to fulfill government orders, so threats on all sides were very real and likely to result in severe disruptions and shortages.

Although the steel workers did not strike during the times relevant to this case, they did plan to go on strike starting on April 9, 1952. President Truman made good on his threats, nationalizing the entire American steel industry

on that very day. In a case better suited for a constitutional law casebook, the Supreme Court of the United States determined that the president lacked the authority to seize the steel mills, ending this brief period of industrial nationalization.

Pennsylvania, the jurisdiction in which *McCloskey* originated, produced much of the nation's steel in the 1950s. It is thus a fitting site for this famous case that asks whether a steel fabricator repudiated its promise.

McCloskey & Co. v. Minweld Steel Co.

220 F.2d 101 (3d Cir. 1955)

McLAUGHLIN, Circuit Judge.

Plaintiff-appellant, a general contractor, sued on three contracts alleging an anticipatory breach as to each. At the close of the plaintiff's case the district judge granted the defense motions for judgment on the ground that plaintiff had not made out a cause of action.

By the contracts involved the principal defendant, a fabricator and erector of steel, agreed to furnish and erect all of the structural steel required on two buildings to be built on the grounds of the Hollidaysburg State Hospital, Hollidaysburg, Pa. and to furnish all of the long span steel joists required in the construction of one of the two buildings. Two of the contracts were dated May 1, 1950 and the third May 26, 1950. By Article V of each of the contracts:

Should the Sub-Contractor (the defendant herein) . . . at any time refuse or neglect to supply a sufficiency . . . of materials of the proper quality, . . . in and about the performance of the work required to be done pursuant to the provisions of this agreement, or fail, in the performance of any of the agreements herein contained, the Contractor shall be at liberty, without prejudice to any other right or remedy, on two days' written notice to the Sub-Contractor, either to provide any such . . . materials and to deduct the cost thereof from any payments then or thereafter due the Sub-Contractor, or to terminate the employment of the Sub-Contractor for the said work and to enter upon the premises.

There was no stated date in the contracts for performance by the defendant sub-contractor. Article VI provided for completion by the subcontractor of its contract work "by and at the time or times hereafter stated to-wit":

Samples, Shop Drawings and Schedules are to be submitted in the quantities and manner required by the Specifications, for the approval of the Architects, immediately upon receipt by the Sub-Contractor of the contract drawings, or as may be directed by the Contractor. All expense involved in the submission

and approval of these Samples, Shop Drawings and Schedules shall be borne by the Sub-Contractor.

All labor, materials and equipment required under this contract are to be furnished at such times as may be directed by the Contractor, and in such a manner so as to at no time delay the final completion of the building.

It being mutually understood and agreed that prompt delivery and installation of all materials required to be furnished under this contract is to be the essence of this Agreement.

Appellee Minweld Steel Co., Inc., the subcontractor, received contract drawings and specifications for both buildings in May, 1950. On June 8, 1950, plaintiff McCloskey & Co. wrote appellee asking when it might "expect delivery of the structural steel" for the buildings and "also the time estimated to complete erection." Minweld replied on June 13, 1950, submitting a schedule estimate of expecting to begin delivery of the steel by September 1, and to complete erection approximately November 15. On July 20, 1950 plaintiff wrote Minweld threatening to terminate the contracts unless the latter gave unqualified assurances that it had effected definite arrangements for the procurement, fabrication and delivery within thirty days of the required materials. On July 24, 1950 Minweld wrote McCloskey & Co. explaining its difficulty in obtaining the necessary steel. It asked McCloskey's assistance in procuring it and stated that, "We are as anxious as you are that there be no delay in the final completion of the buildings or in the performance of our contract."

Plaintiff-appellant claims that by this last letter, read against the relevant facts, defendant gave notice of its positive intention not to perform its contracts and thereby violated same. Some reference has already been made to the background of the July 24th letter. It concerned Minweld's trouble in securing the steel essential for performance of its contract. Minweld had tried unsuccessfully to purchase this from Bethlehem Steel, US Steel and Carnegie-Illinois. It is true as appellant urges that Minweld knew and was concerned about the tightening up of the steel market. And as is evident from the letter it, being a fabricator and not a producer, realized that without the help of the general contractor on this hospital project particularly by its enlisting the assistance of the General State Authority, Minweld was in a bad way for the needed steel. However, the letter conveys no idea of contract repudiation by Minweld. That company admittedly was in a desperate situation. Perhaps if it had moved earlier to seek the steel its effort might have been successful. But that is mere speculation for there is no showing that the mentioned producers had they been solicited sooner would have been willing to provide the material.

Minweld from its written statement did, we think, realistically face the problem confronting it. As a result it asked its general contractor for the aid which the latter, by the nature of the construction, should have been willing to give. Despite the circumstances there is no indication in the letter that Minweld had definitely abandoned all hope of otherwise receiving the steel and so finishing its undertaking. One of the

mentioned producers might have relented. Some other supplier might have turned up. It was McCloskey & Co. who eliminated whatever chance there was. That concern instead of aiding Minweld by urging its plea for the hospital construction materials to the State Authority which represented the Commonwealth of Pennsylvania took the position that the subcontractor had repudiated its agreement and then moved quickly to have the work completed. Shortly thereafter, and without the slightest trouble as far as appears, McCloskey & Co. procured the steel from Bethlehem and brought in new subcontractors to do the work contemplated by the agreement with Minweld.

Under the applicable law Minweld's letter was not a breach of the agreement. The suit is in the federal court by reason of diversity of citizenship of the parties. Though there is no express statement to that effect the contracts between the parties would seem to have been executed in Pennsylvania with the law of that state applicable. In *McClelland v. New Amsterdam Casualty Co.*,¹ the Pennsylvania Supreme Court held in a case where the subcontractor had asked for assistance in obtaining credit, "In order to give rise to a renunciation amounting to a breach of contract, there must be an absolute and unequivocal refusal to perform or a distinct and positive statement of an inability to do so." Minweld's conduct is plainly not that of a contract breaker under that test.

Restatement of Contracts, Comment (i) to Sec. 318 (1932) speaks clearly on the point saying:

Though where affirmative action is promised mere failure to act, at the time when action has been promised, is a breach, failure to take preparatory action before the time when any performance is promised is not an anticipatory breach, even though such failure makes it impossible that performance shall take place, and though the promisor at the time of the failure intends not to perform his promise.

Appellant contends that its letter of July 20, requiring assurances of arrangements which would enable appellee to complete delivery in thirty days, constituted a fixing of a date under Article VI of the contracts. The short answer to this is that the thirty day date, if fixed, was never repudiated. Appellee merely stated that it was unable to give assurances as to the preparatory arrangements. There is nothing in the contracts which authorized appellant to demand or receive such assurances.

The district court acted properly in dismissing the actions as a matter of law on the ground that plaintiff had not made out a prima facie case.

The order of the district court of July 14, 1954 denying the plaintiff's motions for findings of facts, to vacate the judgments and for new trials will be affirmed.

1. 322 Pa. 429 (1936).

Reflection

In reading the *McCloskey* case, did you wonder why the McCloskey Corporation was so concerned about Minweld's ability to obtain the steel needed for its building? To pressure one's counterparty so often and so early into the relationship belies some deeper tensions. Did America's entrance into the Korean War and the potential nationalization of steel mills impact how reasonable parties would behave under these specific circumstances? Or does this judicial decision reflect general principles that persist throughout time?

Even judges on the same court may not agree about whether law is immutable or relative. Consider another Pennsylvania case about repudiation: *2401 Pennsylvania Avenue Corp. v. Federation of Jewish Agencies of Greater Philadelphia*, 507 Pa. 166 (1985). In *2401*, Chief Justice Nix, writing for the majority, concluded that a determination of repudiation required a finding that the purported repudiating party make an "absolute and unequivocal refusal to perform or a definite and positive statement of an inability to fulfill its obligations under the contract." In doing so, Pennsylvania staked out a minority position of requiring a much higher standard than the R2d, which requires only an apparent inability to perform.

Justice Larsen dissented, arguing that Pennsylvania law does not comply with how modern business transactions actually operate. Larsen cited the following portions from the treatise on contracts written by Dr. John Murray, who taught contract law in Pittsburgh, Pennsylvania:

The modern view as to what constitutes a repudiation may be stated as follows: A positive statement by the obligor to the obligee which is reasonably interpreted by the obligee to mean that the obligor will not or cannot perform his contractual duty constitutes a repudiation.

Statements of doubt by the obligor as to his ability or willingness to perform are insufficient though such statements may suggest reasonable grounds for insecurity and ultimately constitute a repudiation. Moreover, language which, alone, would not be sufficient to constitute a repudiation, may constitute a repudiation when accompanied by some nonperformance by the obligor. A positive manifestation that the obligor cannot or will not perform need not be expressed in language. It may be inferred from conduct which is wholly inconsistent with an intention to perform. Any voluntary affirmative act which actually or apparently precludes the obligor from performing amounts to a repudiation.

It would seem that Pennsylvania is a jurisdiction at war with itself, at least with regard to the doctrine of repudiation. Even at the time of *McCloskey*, the courts in Pennsylvania might have been moving toward a relaxed standard for what counts as repudiation. As you consider the R2d's approach via the cases and problems below, think about whether *McCloskey* would have been decided differently if it occurred in another place or time.

Discussion

1. When you read Minweld's letter, does it seem like an unequivocal refusal to perform? Why or why not?
2. Why did McCloskey treat Minweld's letter as a repudiation? Was this a good-faith interpretation of the letter, or did McCloskey have ulterior motives?

Reading Hornell Brewing Co., Inc. v. Spry. *Hornell Brewing* required the court to determine whether and when one party had reasonable insecurity about the other's performance. Students looking for sharp lines and easy answers will be disappointed. Matters such as reasonableness occur on a continuum. Insecurity develops over time as trust erodes. There may be some points where insecurity is obviously unreasonable and others where insecurity is obviously present, but most circumstances requiring legal advice fall somewhere in between. Lawyers must operate in this gray area between the lines, giving advice regarding fuzzy concepts and ambiguous facts.

This type of predicament is known in philosophy as the sorites paradox. Sorites is derived from the Greek word for "heap" (σωρός), as in a heap of sand. The paradox goes something like this: If you take a heap of sand and remove one grain, is it still a heap? If so, how many grains must one remove to turn the heap of sand into a mere pile? There is, of course, no absolute number of grains of sand that constitute a heap. Likewise, there is no absolute amount of insecurity that makes it inherently reasonable to demand assurances, nor is there a specific quantity of assurance that adequately resolves such insecurity. Although the rule that a party who is reasonably insecure can demand adequate assurance is straightforward enough, it can be difficult to determine exactly when it is reasonable to feel insecurity, what assurance is reasonable to demand, and whether an insecure party has been reasonably reassured. The next case will help you better understand how courts will analyze the reasonableness of parties in such a case.

Hornell Brewing Co., Inc. v. Spry

174 Misc. 2d 451 (N.Y. Sup. Ct. 1997)

LOUISE GRUNER GANS, Justice.

Plaintiff Hornell Brewing Co., Inc. ("Hornell"), a supplier and marketer of alcoholic and non-alcoholic beverages, including the popular iced tea drink "Arizona," commenced this action for a declaratory judgment that any rights of defendants

Stephen A. Spry and Arizona Tea Products Ltd. to distribute Hornell's beverages in Canada have been duly terminated, that defendants have no further rights with respect to these products, including no right to market and distribute them, and that any such rights previously transferred to defendants have reverted to Hornell.

In late 1992, Spry approached Don Vultaggio, Hornell's Chairman of the Board, about becoming a distributor of Hornell's Arizona beverages. Vultaggio had heard about Spry as an extremely wealthy and successful beer distributor who had recently sold his business. In January 1993, Spry presented Vultaggio with an ambitious plan for distributing Arizona beverages in Canada. Based on the plan and on Spry's reputation, but without further investigation, Hornell in early 1993 granted Spry the exclusive right to purchase Arizona products for distribution in Canada, and Spry formed a Canadian corporation, Arizona Iced Tea Ltd., for that express purpose.

Initially, the arrangement was purely oral. In response to Spry's request for a letter he needed to secure financing, Hornell provided a letter in July 1993 confirming their exclusive distributorship arrangement, but without spelling out the details of the arrangement. Although Hornell usually had detailed written distributorship agreements and the parties discussed and exchanged drafts of such an agreement, none was ever executed. In the meantime, Spry, with Hornell's approval, proceeded to set himself up as Hornell's distributor in Canada. During 1993 and until May 1994, the Hornell line of beverages, including the Arizona beverages, was sold to defendants on 10-day credit terms. In May 1994, after an increasingly problematic course of business dealings, Hornell de facto terminated its relationship with defendants and permanently ceased selling its products to them.

The problem dominating the parties' relationship between July 1993 and early May 1994 was defendants' failure to remit timely payment for shipments of beverages received from plaintiff. Between November and December 1993, and February 1994, defendants' unpaid invoices grew from \$20,000 to over \$100,000, and their \$31,000 check to Hornell was returned for insufficient funds. Moreover, defendants' 1993 sales in Canada were far below Spry's initial projections.

In March and April 1994, a series of meetings, telephone calls, and letter communications took place between plaintiff and defendants regarding Spry's constant arrearages and the need for him to obtain a line and/or letter of credit that would place their business relationship on a more secure footing. These contacts included a March 27, 1994 letter to Spry from Vanguard Financial Group, Inc. confirming "the approval of a \$1,500,000 revolving credit facility" to Arizona Tea Products Ltd., which never materialized into an actual line of credit; Spry sent Hornell a copy of this letter in late March or early April 1994.

All these exchanges demonstrate that during this period plaintiff had two distinct goals: to collect the monies owed by Spry, and to stabilize their future business relationship based on proven, reliable credit assurances. These exchanges also establish that during March and April, 1994, Spry repeatedly broke his promises to pay by

a specified deadline, causing Hornell to question whether Vanguard's \$1.5 million revolving line of credit was genuine.

On April 15, 1994, during a meeting with Vultaggio, Spry arranged for Vultaggio to speak on the telephone with Richard Worthy of Metro Factors, Inc. The testimony as to the content of that brief telephone conversation is conflicting. Although Worthy testified that he identified himself and the name of his company, Metro Factors, Inc., Vultaggio testified that he believed Worthy was from an "unusual lending institution" or bank which was going to provide Spry with a line of credit, and that nothing was expressly said to make him aware that Worthy represented a factoring company. Worthy also testified that Vultaggio told him that once Spry cleared up the arrears, Hornell would provide Spry with a "\$300,000 line of credit, so long as payments were made on a net 14 day basis." According to Vultaggio, he told Worthy that once he was paid in full, he was willing to resume shipments to Spry "so long as Steve fulfills his requirements with us."

Hornell's April 18, 1994 letter to Spry confirmed certain details of the April 15 conversations, including that payment of the arrears would be made by April 19, 1994. However, Hornell received no payment on that date. Instead, on April 25, Hornell received from Spry a proposed letter for Hornell to address to a company named "Metro" at a post office box in Dallas, Texas. Worthy originally sent Spry a draft of this letter with "Metro Factors, Inc." named as the addressee, but in the copy Vultaggio received the words "Factors, Inc." were apparently obliterated. Hornell copied the draft letter on its own letterhead and sent it to Metro over Vultaggio's signature. In relevant part, the letter stated as follows:

Gentlemen:

Please be advised that Arizona Tea Products, Ltd. (ATP), of which Steve Spry is president, is presently indebted to us in the total amount of \$79,316.24 as of the beginning of business Monday, April 25, 1994. We sell to them on "Net 14 days" terms. Such total amount is due according to the following schedule: . . .

Upon receipt of \$79,316.24. (which shall be applied to the oldest balances first) by 5:00 P.M. (EST) Tuesday, May 2, 1994 by wire transfer(s) to the account described below, we shall recommence selling product to ATP on the following terms:

- 1) All invoices from us are due and payable by the 14th day following the release of the related product.*
- 2) We shall allow the outstanding balance owed to us by ATP to go up to \$300,000 so long as ATP remains "current" in its payment obligations to us. Wiring instructions are as follows: . . .*

Hornell received no payment on May 2, 1994. It did receive a wire transfer from Metro of the full amount on May 9, 1994. Upon immediate confirmation of that payment, Spry ordered 30 trailer loads of "product" from Hornell, at a total purchase

price of \$390,000 to \$450,000. In the interim between April 25, 1994 and May 9, 1994, Hornell learned from several sources, including its regional sales manager Baumkel, that Spry's warehouse was empty, that he had no managerial, sales or office staff, that he had no trucks, and that in effect his operation was a sham.

On May 10, 1994, Hornell wrote to Spry, acknowledging receipt of payment and confirming that they would extend up to \$300,000 of credit to him, net 14 days cash "based on your prior representation that you have secured a \$1,500,000. US line of credit." The letter also stated,

Your current balance with us reflects a 0 [zero] balance due. As you know, however, we experienced considerable difficulty and time wasted over a five week time period as we tried to collect some \$130,000 which was 90-120 days past due.

Accordingly, before we release any more product, we are asking you to provide us with a letter confirming the existence of your line of credit as well as a personal guarantee that is backed up with a personal financial statement that can be verified. Another option would be for you to provide us with an irrevocable letter of credit in the amount of \$300,000.

Spry did not respond to this letter. Spry never even sent Hornell a copy of his agreement with Metro Factors, Inc., which Spry had signed on March 24, 1994 and which was fully executed on March 30, 1994. On May 26, 1994, Vultaggio met with Spry to discuss termination of their business relationship. Vultaggio presented Spry with a letter of agreement as to the termination, which Spry took with him but did not sign. After some months of futile negotiations by counsel this action by Hornell ensued.

At the outset, the court determines that an enforceable contract existed between plaintiff and defendants based on the uncontroverted facts of their conduct. Under Article 2 of the Uniform Commercial Code, parties can form a contract through their conduct rather than merely through the exchange of communications constituting an offer and acceptance.

Section 2-204(1) states: "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." Sections 2-206(1) and 2-207(3) expressly allow for the formation of a contract partly or wholly on the basis of such conduct. 1 White & Summers, Uniform Commercial Code, *ibid*.

Here, the conduct of plaintiff and defendants which recognized the existence of a contract is sufficient to establish a contract for sale under Uniform Commercial Code sections 2-204(1) and 2-207(3). Both parties' undisputed actions over a period of many months clearly manifested mutual recognition that a binding obligation was undertaken. Following plaintiff's agreement to grant defendant an exclusive distributorship for Canada, defendant Spry took certain steps to enable him to commence

his distribution operation in Canada. These steps included hiring counsel in Canada to form Arizona Tea Products, Ltd., the vehicle through which defendant acted in Canada, obtaining regulatory approval for the labelling of Arizona Iced Tea in conformity with Canadian law, and obtaining importation approvals necessary to import Arizona Iced Tea into Canada. Defendants subsequently placed orders for the purchase of plaintiff's products, plaintiff shipped its products to defendants during 1993 and early 1994, and defendants remitted payments, albeit not timely nor in full. Under the Uniform Commercial Code, these uncontroverted business dealings constitute "conduct . . . sufficient to establish a contract for sale," even in the absence of a specific writing by the parties.

Notwithstanding the parties' conflicting contentions concerning the duration and termination of defendants' distributorship, plaintiff has demonstrated a basis for lawfully terminating its contract with defendants in accordance with section 2-609 of the Uniform Commercial Code. Section 2-609(1) authorizes one party upon "reasonable grounds for insecurity" to "demand adequate assurance of due performance and until he receives such assurance . . . if commercially reasonable suspend any performance for which he has not already received the agreed return." The Official Comment to section 2-609 explains:

This 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.

Whether a seller, as the plaintiff in this case, has reasonable grounds for insecurity is an issue of fact that depends upon various factors, including the buyer's exact words or actions, the course of dealing or performance between the parties, and the nature of the sales contract and the industry.

Subdivision (2) defines both "reasonableness" and "adequacy" by commercial rather than legal standards, and the Official Comment notes the application of the good faith standard.

Once the seller correctly determines that it has reasonable grounds for insecurity, it must properly request assurances from the buyer. Although the Code requires that the request be made in writing, UCC § 2-609(1), courts have not strictly adhered to this

formality as long as an unequivocal demand is made. After demanding assurance, the seller must determine the proper “adequate assurance.” What constitutes “adequate” assurance of due performance is subject to the same test of commercial reasonableness and factual conditions.

Applying these principles to the case at bar, the overwhelming weight of the evidence establishes that at the latest by the beginning of 1994, plaintiff had reasonable grounds to be insecure about defendants’ ability to perform in the future. Defendants were substantially in arrears almost from the outset of their relationship with plaintiff, had no financing in place, bounced checks, and had failed to sell even a small fraction of the product defendant Spry originally projected.

Reasonable grounds for insecurity can arise from the sole fact that a buyer has fallen behind in his account with the seller, even where the items involved have to do with separate and legally distinct contracts, because this “impairs the seller’s expectation of due performance.”

Here, defendants do not dispute their poor payment history, plaintiff’s right to demand adequate assurances from them and that plaintiff made such demands. Rather, defendants claim that they satisfied those demands by the April 15, 1994 telephone conversation between Vultaggio and Richard Worthy of Metro Factors, Inc., followed by Vultaggio’s April 18, 1994 letter to Metro, and Metro’s payment of \$79,316.24 to Hornell, and that thereafter plaintiff had no right to demand further assurance.

The court disagrees with both plaintiff and defendants in their insistence that only one demand for adequate assurance was made in this case to which there was and could be only a single response. Even accepting defendants’ argument that payment by Metro was the sole condition Vultaggio required when he spoke and wrote to Metro, and that such condition was met by Metro’s actual payment, the court is persuaded that on May 9, 1994, Hornell had further reasonable grounds for insecurity and a new basis for seeking further adequate assurances.

Defendants cite the UCC for the proposition that “[i]f a party demands and receives specific assurances, then absent a further change of circumstances, the assurances demanded and received are adequate, and the party who has demanded the assurances is bound to proceed.” Repeated demands for adequate assurances are within the contemplation of section 2-609.

Here, there was a further change of circumstances. Vultaggio’s reported conversation with Worthy on April 15 and his April 25 letter to Metro both anticipate that once payment of defendants’ arrears was made, Hornell would release up to \$300,000 worth of product on the further condition that defendants met the 14 day payment terms. The arrangement, by its terms, clearly contemplated an opportunity for Hornell to test out defendants’ ability to make payment within 14-day periods.

By placing a single order worth \$390,000 to \$450,000 immediately after receipt of Metro’s payment, Spry not only demanded a shipment of product which exceeded the proposed limit, but placed Hornell in a position where it would have no opportunity

learn whether Spry would meet the 14-day payment terms, before Spry again became indebted to Hornell for a very large sum of money.

At this point, neither Spry nor Worthy had fully informed Hornell what assurance of payment Metro would be able to provide. Leaving aside the question whether the factoring arrangement with Metro constituted adequate assurance, Hornell never received any documentation to substantiate Spry's purported agreement with Metro. Although Spry's agreement with Metro was fully executed by the end of March, Spry never gave Hornell a copy of it, not even in response to Hornell's May 10, 1994 demand. The March 27, 1994 letter from Vanguard coincided with the date Spry signed the Metro agreement, but contained only a vague reference to a \$1.5 million "revolving credit facility," without mentioning Metro Factors, Inc. Moreover, based on the Vanguard letter, Hornell had expected that payment would be forthcoming, but Spry once again offered only excuses and empty promises.

These circumstances, coupled with information received in early May (on which it reasonably relied) that Spry had misled Hornell about the scope of his operation, created new and more acute grounds for Hornell's insecurity and entitled Hornell to seek further adequate assurance from defendants in the form of a documented line of credit or other guarantee.

Defendants' failure to respond constituted a repudiation of the distributorship agreement, which entitled plaintiff to suspend performance and terminate the agreement.

Even if Hornell had seen Spry's agreement with Metro, in the circumstances of this case, the agreement did not provide the adequate assurance to which plaintiff was entitled in relation to defendants' \$390,000–\$450,000 order. Spry admitted that much of the order was to be retained as inventory for the summer, for which there would be no receivables to factor within 14 days. Although the question of whether every aspect of Hornell's May 10 demand for credit documentation was reasonable is a close one, given the entire history of the relationship between the parties, the court determines that the demand was commercially reasonable. This case is unlike *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572 (7th Cir.1976), cited by defendants, in that plaintiff's demand for credit assurances does not modify or contradict the terms of an elaborated written contract.

The court notes in conclusion that its evaluation of the evidence in this case was significantly influenced by Mr. Spry's regrettable lack of credibility. The court agrees with plaintiff, that to an extent far greater than was known to Hornell in May 1994, Mr. Spry was not truthful, failed to pay countless other creditors almost as a matter of course, and otherwise engaged in improper and deceptive business practices.

For the foregoing reasons, it is hereby

ORDERED and ADJUDGED that plaintiff Hornell Brewing Co., Inc. have a declaratory judgment that defendants Stephen A. Spry and Arizona Tea Products, Ltd. were duly terminated and have no continuing rights with respect to plaintiff Hornell Brewing Co.'s beverage products in Canada or elsewhere.

Reflection

Although Spry's entire pattern of behavior constitutes grounds for reasonable insecurity, it is difficult to pin down exactly which action tipped the scales and created Hornell's right to demand assurance. It may also be hard to fix exactly when Hornell gained the right to cancel its contract with Spry. Remember that the parties—and their attorneys—usually do not have knowledge of all the facts and circumstances at the time they must decide how to act. Parties act with incomplete information about the circumstances and uncertainty with regard to how a court would interpret those circumstances and thereby assign rights and responsibilities. Parties who cancel a contract or threaten to cancel it if they do not receive certain assurances of performance are taking the risk that a court might find their action wrongful.

Discussion

1. When exactly did Spry give Hornell grounds to demand assurances? Which specific action by Spry engendered this right in Hornell?
 2. If you were the attorney for Hornell, when exactly would you advise your client that Spry had repudiated? Which specific act made it reasonable for Hornell to cancel the contract?
 3. What are the risks to Hornell of canceling or threatening to cancel its contract with Spry before Spry technically repudiated?
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Problems

Problem 21.1. The Rumored Bankruptcy

RingGold Pharmacy purchases its house-branded, over-the-counter inventory from MiracleDrug Distributors. MiracleDrug has an exclusive arrangement with RingGold. Under the contract, RingGold is not permitted to purchase house-branded products from any other distributor.

Earlier this week, Erin Ringgold, the owner of the pharmacy, heard a rumor from another reliable pharmacist that MiracleDrug was near bankruptcy. If true, RingGold would have to quickly find another distributor willing to package and sell products that the pharmacy would sell under the RingGold name.

What should Erin do? Should RingGold cancel the contract with MiracleDrug based upon this rumor?

Problem 21.2. Circuit Boards

EI manufactures electronic components for military and civilian aircraft. On March 1, 2015, EI was awarded a contract to supply components for military aircraft. The contract included detailed specifications and a strict deadline of August 31, 2015, for delivery of the components. On March 15, 2015, EI subcontracted with Circuits, Inc. (Circuits) to manufacture and supply certain circuit boards that EI needed to make the components for the military contract. EI had never worked with Circuits. The subcontract required Circuits to meet the strict specifications of the military contract, pass sample testing during manufacture, and deliver the required circuit boards by July 31, 2015.

In early April, Al (EI's president) learned that Circuits was having financial difficulties, had several judgments entered against it, and was running late on making deliveries under its existing contracts with other customers. Also, the first circuit board that EI received from Circuits failed the test. Al immediately wrote to the president of Circuits and asked for an updated financial statement from Circuits and written verification that it would be able to deliver circuit boards complying with the contract specifications on time. He also asked that Circuits provide another circuit board for testing. In early May, having received no response to his earlier demand, Al repeated his request in writing to Circuits's president. As of today, Al has received no response from Circuits.

Concerned about Circuits's ability to perform, Al has found another supplier for the circuit boards, Boards, Inc. (Boards), which has the required circuit boards in its inventory. A purchase of the circuit boards from Boards will cost EI \$20,000 more (inclusive of shipping costs) than the contract price with Circuits. Respond to the following questions with a thorough legal analysis:

- a. Was EI within its rights to demand assurances from Circuits that it would be able to fulfill its obligations under the subcontract, and what is the effect of Circuits's failure to respond?
- b. Can EI buy the circuit boards it needs from Boards, and, if so, is there any basis for EI to recover the \$20,000 excess cost from Circuits?

Problem 21.3. "No Use" for the Space

On November 8, 1973, the Federation of Jewish Agencies of Greater Philadelphia (the "Lessee") and 2401 Pennsylvania Avenue Corp. (the "Lessor") signed a two-year lease for four floors of office space at 1528 Walnut Street in Philadelphia (the "Space"). The lease term was set to begin May 1, 1974 and end April 30, 1976. An addendum acknowledged that the start date might be delayed until "no later than August 31, 1974," due to complications involving the existing tenant.

At the time of contracting, both parties understood that part of the Space was still occupied by Catalytic, Inc., whose lease would not expire until August 31, 1974. A

contemporaneous letter from Lessor (which Lessee received before signing the lease) noted that Catalytic expected to vacate in May and promised that Lessor would make “every effort” to deliver possession as close to May 1 as possible.

In mid-1974, a construction strike delayed Catalytic’s move-out. Catalytic informed Lessor that it might not vacate by August 31 and requested a 90-day extension. Lessor initially declined, citing its obligations under the lease. Around the same time, Lessee purchased another property for its permanent headquarters. A week later, Lessee’s general counsel sent a letter to Lessor stating:

“We have no use for the space in the Walnut Street building and believe there are serious doubts about the validity of the lease under these circumstances. We are unwilling to agree to any extension of Catalytic’s tenancy unless we are released from liability under the lease.”

Lessee did not take possession of the Space, made no preparations to occupy it, and did not respond to a rent invoice sent in September. It made no further communication. Lessor, interpreting the July letter and subsequent silence as an anticipatory repudiation, entered into an agreement with Catalytic allowing it to remain in possession for 90 more days. Lessor then sued Lessee for breach of contract.

Did the Lessee anticipatorily repudiate the lease?

See 2401 Pennsylvania Ave. Corp. v. Federation of Jewish Agencies of Greater Philadelphia, 507 Pa. 166, (1985).

Chapter 22

Excuse

Imagine a concert venue that sells out of tickets for an event months in advance, only for the venue to burn down days before the event. Or a supplier who is unable to deliver goods due to an unexpected trade embargo. Contracts are built on the premise that parties will fulfill their promises, but what happens when unforeseen events disrupt performance? The doctrines of excuse address this critical question by providing a legal framework for determining when obligations can be discharged due to circumstances beyond a party's control. These doctrines ensure that contract law remains fair and adaptable by balancing the need to enforce promises with the reality that not all risks can or should be borne by the performing party.

The doctrines of impossibility, impracticability, and frustration of purpose form the foundation of this analysis. Under common law, impossibility applies when performance becomes literally impossible due to an unforeseen event, such as the destruction of specific goods or the death of a party whose personal services are central to the contract. Impracticability, a more flexible standard, extends relief when performance becomes unreasonably difficult or expensive due to unforeseen circumstances. Frustration of purpose focuses on situations where the core purpose of the contract is undermined, even though performance remains technically possible. Each doctrine serves to allocate risk in ways that align with fairness and commercial reasonableness.

The UCC builds on these common law principles, particularly through UCC § 2-615, which governs commercial impracticability in the sale of goods. Unlike common law impracticability, § 2-615 explicitly incorporates considerations of foreseeability and the allocation of risk between the parties. This provision ensures that risks reasonably anticipated or contractually assigned are not used to excuse performance, emphasizing the importance of clear agreements in commercial transactions. Force majeure clauses further illustrate how parties can proactively manage risks by defining the events that may excuse performance.

These doctrines are not merely theoretical but highly practical. They play a crucial role in commercial contracts, particularly during times of crisis. The COVID-19 pandemic, for example, brought renewed attention to the importance of excuse doctrines, as parties grappled with disrupted supply chains, government-imposed restrictions, and radically altered market conditions. For instance, many suppliers were unable to fulfill contracts due to factory shutdowns, which forced courts to evaluate whether such disruptions constituted impracticability under common law or commercial

impracticability under UCC § 2-615. These cases illustrated how excuse doctrines were applied to balance fairness with the need to uphold contractual obligations in unprecedented circumstances. In such cases, courts must balance the principle of holding parties to their promises with the recognition that enforcing a contract under extreme circumstances may lead to unjust outcomes.

This chapter explores the doctrines of excuse in depth, analyzing their application under common law and the UCC. Through case studies and practical examples, you will gain an understanding of how courts evaluate claims of impossibility, impracticability, and frustration of purpose, as well as how parties can anticipate and manage risks through careful drafting. By the end of this chapter, you will not only understand the legal standards for excuse but also appreciate how these doctrines serve as practical tools for addressing uncertainty and managing risk in contractual relationships.

Rules

A. Foreseeability

Foreseeability is the cornerstone of the contract law excuse doctrines. Before determining whether a party's performance should be excused, courts first analyze the event that allegedly disrupted the agreement. Not all disruptions warrant relief. For an event to support an excuse, it must meet specific criteria and be deemed truly unforeseeable at the time of contracting.

An event, for purposes of excuse, is an occurrence that materially alters the conditions under which the contract was expected to be performed. Examples of such events include natural disasters, the destruction of essential goods, significant changes in law, or unexpected economic disruptions. To qualify as a basis for excuse, the event must fundamentally affect performance, going beyond mere inconvenience or additional cost.

For instance, if a supplier agrees to deliver oranges to a buyer but the orchard's entire crop is destroyed by an unprecedented blight, this destruction constitutes an event that may trigger an excuse analysis. By contrast, if the supplier's costs merely rise by 20% due to seasonal labor shortages, a foreseeable industry risk, the increased cost alone does not qualify as a disruptive event. Courts expect parties to account for ordinary risks inherent in their business dealings.

Once an event is identified, courts evaluate its foreseeability. Foreseeability asks whether the event was reasonably predictable at the time the contract was made. If the event was foreseeable, the parties are generally expected to have accounted for it in their agreement, either through specific provisions or by implicitly bearing the associated risks. Courts are less likely to excuse performance in such cases.

For example, consider a contract for the delivery of steel during a period of geopolitical tension. If war breaks out in a region central to steel production, leading to

embargoes, courts will likely find the event foreseeable if the tension was widely reported before the contract was signed. The supplier could have anticipated potential disruptions and incorporated clauses addressing this risk. On the other hand, if the steel mill is destroyed by an unexpected earthquake in a region with no history of seismic activity, the event would likely be deemed unforeseeable.

Another example highlights how courts analyze foreseeability concerning industry norms. Imagine a company that contracts to ship goods through a specific canal. If the canal is temporarily closed due to routine maintenance scheduled and publicly announced before the contract's formation, the closure is foreseeable. By contrast, if an unannounced blockade occurs due to sudden political upheaval, the closure may qualify as unforeseeable. The distinction hinges on what a reasonable party in the same industry could have anticipated at the time of contracting.

Courts also evaluate foreseeability in the context of specific clauses, such as force majeure provisions. These clauses typically enumerate events considered unforeseeable and beyond the parties' control. If the event aligns with the types specified in the clause, such as "natural disasters" or "government actions," it is more likely to support an excuse. However, even with such a clause, the party invoking it must show that the event genuinely disrupted performance in a way that was not contemplated or mitigated by the agreement.

Foreseeability balances fairness and predictability. By limiting excuses to unforeseeable events, courts encourage careful drafting and allocation of risks. At the same time, they provide relief in truly exceptional circumstances, in order to ensure that parties are not unfairly penalized for events beyond their reasonable anticipation. This focus on foreseeability underscores its critical role in determining whether the doctrines of excuse apply.

B. Common Law Doctrines of Excuse

The common law doctrines of excuse provide the foundation for determining when a party's performance may be discharged due to unforeseen events. These doctrines—impossibility, impracticability, and frustration of purpose—offer distinct but related paths for relief. Together, they balance the principle of holding parties accountable for their agreements with ensuring fairness when extraordinary circumstances arise.

1. Impossibility

Impossibility applies when performance becomes objectively impossible. This means that no one, not just the obligated party, could perform under the contract. Common examples include the destruction of a unique item necessary for performance or the death of a person essential to fulfilling the contract.

The landmark case *Taylor v. Caldwell*, 122 E.R. 309 (1863), illustrates this doctrine. In *Taylor*, a music hall was destroyed by fire before the date of a scheduled

performance. The court excused both parties, reasoning that the continued existence of the music hall was an implied condition precedent to the obligation to rent the hall. Because performance was impossible, the contract was discharged. This case demonstrates one well-established basis for impossibility: the destruction of a thing necessary for performance. Without that thing, performance is impossible, and its nonexistence constitutes a failure of a basic assumption underlying the contract.

Restatement (Second) of Contracts § 263 explains this principle:

If the existence of a specific thing is necessary for the performance of a duty, its failure to come into existence, destruction, or such deterioration as makes performance impracticable is an event the non-occurrence of which was a basic assumption on which the contract was made.

Similarly, when a contract requires personal performance, the death or incapacity of the obligated individual is treated like the destruction of a necessary thing. R2d § 262 reflects this:

If the existence of a particular person is necessary for the performance of a duty, his death or such incapacity as makes performance impracticable is an event the non-occurrence of which was a basic assumption on which the contract was made.

For example, suppose a collector contracts to purchase an original Bob Ross painting that Ross personally planned to create. If Ross dies before completing the painting, the contract would be discharged for impossibility because Ross's unique artistic vision and personal involvement were essential. Contrast this with a contract for #23 of 50 in Ross's "Mountain Serenity" series, where trained artists produce indistinguishable paintings and Ross only adds his signature. If Ross dies before signing #23, performance becomes partially impossible. A court might justify modifications, such as allowing the collector to purchase an unsigned version or receive a substitute remedy.

Despite its clear applications, impossibility is interpreted narrowly. Courts require strong evidence that performance is entirely unfeasible. For example, if a contractor's machinery breaks down but replacement equipment is available, impossibility does not apply. Courts expect parties to mitigate challenges unless doing so would impose extraordinary burdens.

2. Impracticability

Impracticability broadens the doctrine of impossibility by addressing situations where performance, while technically possible, has become excessively difficult or expensive due to unforeseen events. R2d § 261 establishes this doctrine, excusing performance when:

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 . . . is discharged. . . .

In *Transatlantic Financing Corp. v. United States*, 363 F.2d 312 (D.C. Cir. 1966), excerpted below, a shipping company argued that the closure of the Suez Canal made its performance impracticable. The court rejected the claim, finding that the alternate route was merely inconvenient and not unreasonably expensive. This case highlights how courts weigh the severity of the hardship.

Increased costs alone do not justify impracticability. The disruption must significantly alter the nature of performance beyond the normal risks of a contract. For instance, a natural gas supplier might claim impracticability if a sudden embargo causes prices to skyrocket tenfold, but not if market fluctuations lead to modest increases in costs. Similarly, a builder contracting to construct a bridge might claim impracticability if a trade embargo makes steel ten times more expensive, fundamentally altering the agreement's assumptions.

3. Frustration of Purpose

Frustration of purpose focuses on the reason behind the contract rather than the act of performance itself. Under this doctrine, a party may be excused if an unforeseen event destroys the principal purpose of the contract, rendering performance essentially meaningless.

In *Krell v. Henry*, 2 K.B. 740 (1903), a tenant rented an apartment to view the coronation of King Edward VII. When the coronation was postponed, the court excused the tenant, reasoning that the purpose of the rental—viewing the coronation—had been frustrated. Renting the apartment was neither impossible nor impracticable, but the coronation's cancellation destroyed the contract's core purpose.

R2d § 265 reflects this principle:

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.

Courts closely scrutinize whether the frustrated purpose was truly central to the contract and whether the event was unforeseeable.

C. Excuse under the UCC

For contracts involving the sale of goods, the UCC provides specific rules for determining when performance may be excused due to unforeseen events. These rules, found in UCC §§ 2-613 and 2-615, adapt and refine common law doctrines of excuse

to address the unique circumstances of goods transactions. While the UCC and common law share similar principles, the UCC's provisions are tailored to the commercial context, emphasizing practicality and fairness.

1. Casualty to Identified Goods

Under UCC § 2-613, performance is excused if specific goods identified in the contract are destroyed, damaged, or lost without fault before the risk of loss passes to the buyer. This provision mirrors the common law doctrine of impossibility but applies exclusively to contracts for the sale of goods where the goods' identity is essential to performance.

Suppose a jeweler contracts to sell a rare diamond that is specifically identified in the agreement to a buyer. If the diamond is destroyed in a fire before delivery and without the seller's fault, the contract is discharged under UCC § 2-613. The diamond's destruction makes performance objectively impossible because the contract depends on delivering that specific diamond.

However, if the goods are not identified or if suitable substitutes are available, UCC § 2-613 does not apply. For example, if a seller agrees to deliver 1,000 generic widgets but a fire destroys part of the inventory, the seller may still be required to source replacement widgets. The UCC's focus on commercial practicality means that performance is only excused when substitution is truly impossible.

2. Failure of Presupposed Conditions (UCC § 2-615)

UCC § 2-615 expands on the common law doctrine of impracticability by excusing performance when unforeseen contingencies make performance commercially impracticable. This provision applies to all sellers of goods and emphasizes fairness and efficiency in addressing disruptions.

Under § 2-615(a), a seller is excused from performance if an unforeseen event occurs, the non-occurrence of which was a basic assumption of the contract, and the event makes performance impracticable. Additionally, the seller must have acted in good faith and without fault. Unlike § 2-613, which focuses on the destruction of specific goods, § 2-615 addresses broader contingencies, such as supply chain disruptions, embargoes, or significant labor shortages.

For instance, a supplier contracts to deliver steel to a manufacturer at a fixed price. If an unanticipated international embargo on steel imports makes procurement ten times more expensive, the supplier might invoke UCC § 2-615 to excuse performance. The court would consider whether the cost increase renders performance commercially impracticable and whether the event was unforeseeable at the time of contracting.

UCC § 2-615(b) requires sellers to allocate available goods among customers in a reasonable and fair manner if partial performance is possible. This allocation

requirement ensures that sellers do not act opportunistically by favoring higher-paying customers. For example, if a drought reduces a grain supplier's harvest, the supplier must distribute the remaining grain equitably among its customers.

3. Procedural Requirements

The UCC imposes additional procedural requirements when a seller seeks excuse under § 2-613 or § 2-615. Most notably, the seller must provide timely notice to the buyer. This notice must explain the nature of the disruption and, where applicable, outline any proposed modifications or partial performance. The notice requirement ensures transparency and allows the buyer to take appropriate steps, such as sourcing alternatives or renegotiating the agreement.

For example, if a lumber supplier cannot deliver the agreed quantity due to a forest fire, the supplier must promptly notify the buyer. Failure to provide notice could result in the supplier's losing the protection of the UCC's excuse provisions.

4. Differences between the UCC and Common Law

While the UCC's excuse provisions share foundational principles with common law doctrines, they emphasize the commercial realities of goods transactions. The UCC explicitly addresses partial performance, allocation of goods, and notice requirements, reflecting its focus on maintaining fairness and efficiency in commerce. Additionally, the UCC's provisions are often more forgiving of disruptions, provided the seller acts in good faith and adheres to procedural requirements.

However, the UCC retains the common law's high bar for excuse. Sellers must demonstrate that the disruption was unforeseeable, substantial, and beyond their control. By balancing these requirements with practical solutions, the UCC ensures that excuse doctrines serve both fairness and predictability in commercial transactions.

D. Force Majeure Clauses and Contractual Risk Allocation

Force majeure clauses are a common contractual mechanism for managing the risk of unforeseen events that might disrupt performance. Unlike the doctrines of excuse under the common law and the UCC, which operate as default rules, force majeure clauses allow parties to preemptively allocate risk and define the scope of permissible excuses within their agreement. By specifying the types of events that excuse performance, these clauses provide greater predictability and clarity in the event of a disruption.

A force majeure clause typically identifies extraordinary events or circumstances that excuse a party's performance. Common examples include natural disasters (e.g., hurricanes, earthquakes, floods), acts of war, terrorism, labor strikes, pandemics, and

governmental actions. The clause may also specify procedural requirements, such as notice obligations, and outline the remedies available to the affected party.

For instance, a standard force majeure clause might state: “Neither party shall be liable for any failure or delay in performance due to events beyond their reasonable control, including but not limited to acts of God, war, labor disputes, or governmental restrictions, provided that the affected party provides timely written notice to the other party.”

While force majeure clauses address unforeseen events, the concept of foreseeability plays a critical role in their interpretation. Courts often examine whether the event was genuinely unforeseeable at the time of contracting and whether the clause adequately anticipated the risk. If the event was foreseeable but not explicitly listed in the clause, courts may be reluctant to excuse performance.

Consider a contract executed during the early stages of a geopolitical conflict. If the force majeure clause fails to mention war or embargoes, a court might find that the parties should have foreseen potential disruptions and accounted for them. Conversely, a clause explicitly listing such events would likely excuse performance in the event of an escalation.

DRAFTING EFFECTIVE FORCE MAJEURE CLAUSES

The effectiveness of a force majeure clause depends on its clarity and comprehensiveness. Key considerations when drafting include:

Specificity. The clause should clearly define the events that trigger excuse. Broad, vague terms like “unforeseen circumstances” may lead to disputes.

Causation. The clause should require the party seeking excuse to demonstrate that the event directly caused the failure or delay in performance.

Mitigation. Many clauses include a duty to mitigate the impact of the disruptive event. For example, a party might be required to explore alternative means of performance.

Notice. The clause should specify how and when the affected party must notify the other party of the disruption.

For example, consider this clause:

If a party's performance is delayed or prevented due to acts of God, natural disasters (including earthquakes, floods, and hurricanes), pandemics, acts of government or regulatory authorities, war, riots, or other similar events beyond the party's reasonable control (each, a “Force Majeure Event”), such party shall:

(a) notify the other party in writing within 5 days of becoming aware of the Force Majeure Event, specifying the nature and expected duration of the disruption;

(b) demonstrate that the Force Majeure Event directly caused the delay or failure to perform; and

(c) make reasonable efforts to mitigate the effects of the Force Majeure Event, including seeking alternative methods to perform its obligations.

Performance shall be excused only for the duration of the Force Majeure Event and only to the extent that the event prevents performance.

The above force majeure clause demonstrates the key considerations of specificity, causation, mitigation, and notice by clearly defining the obligations of the parties and providing detailed guidance on how they should respond to a disruptive event. Specificity is addressed by listing examples of qualifying events, such as natural disasters, pandemics, and acts of government, which eliminates ambiguity and reduces the likelihood of disputes over whether a particular event qualifies as force majeure. The requirement to demonstrate that the event directly caused the delay or failure ensures that causation is explicitly established, thus preventing parties from using unrelated disruptions as an excuse for nonperformance. Mitigation is addressed by requiring the affected party to make reasonable efforts to reduce the impact of the disruption, including “seeking alternative methods of performance,” which clarifies the expectations placed on the party invoking the clause. Finally, the clause incorporates a clear notice requirement mandating written notification within a specified timeframe and detailing the nature and expected duration of the disruption. These provisions ensure that the clause is both practical and enforceable by balancing the need for flexibility in extraordinary circumstances with the parties’ mutual reliance on the terms of their agreement.

The application of force majeure clauses often depends on the specific language of the agreement and the context of the disruption. During the COVID-19 pandemic, for instance, many disputes arose over whether generic references to “acts of God” or “governmental actions” encompassed pandemic-related restrictions. Courts analyzing these cases have emphasized the importance of precise language and the causal link between the event and nonperformance.

Consider a manufacturer unable to deliver goods due to a government-imposed lockdown. If the contract’s force majeure clause explicitly includes “pandemics” and “governmental orders,” the manufacturer is likely to be excused. However, if the clause

is silent on such events, the manufacturer might need to rely on default doctrines of excuse, which impose stricter requirements.

Force majeure clauses coexist with, but do not replace, the common law and UCC doctrines of excuse. Instead, they supplement these default rules by allowing parties to define their own standards for excuse. For instance, a force majeure clause might provide relief for events that would not satisfy the strict requirements of impracticability or frustration of purpose. However, if the clause does not cover the event, the default rules may still apply.

This interplay is particularly important in commercial contexts where parties value predictability and control over risk allocation. By carefully drafting force majeure clauses, parties can reduce uncertainty and avoid reliance on judicial interpretation of common law or statutory doctrines.

E. Reflections on Excuse

The doctrines of excuse—impossibility, impracticability, and frustration of purpose—illustrate the legal system's commitment to balancing the rigid enforcement of contracts with fairness in extraordinary circumstances. These doctrines recognize that while contracts are built on promises, those promises must be understood within their context. Context includes unforeseen events such as the destruction of specific goods, sudden changes in law or regulation, or widespread disruptions like natural disasters. By addressing these realities, the doctrines ensure that contractual obligations align with the practical challenges parties may face, which facilitates fair exchanges and effective risk management.

Impossibility, the strictest of the excuse doctrines, emphasizes the importance of clear contractual terms and the allocation of risks. By requiring performance to be literally impossible, this doctrine underscores the significance of foreseeability and the need for parties to account for potential disruptions when drafting their agreements. Impracticability, by contrast, introduces a more flexible standard. It provides relief when performance becomes unreasonably difficult or expensive due to unforeseen events, reflecting the principle that fairness sometimes necessitates rebalancing obligations. Similarly, frustration of purpose addresses situations where the fundamental purpose of a contract is destroyed, making performance inequitable even when it remains technically possible. These doctrines collectively ensure that contracts remain fair and meaningful under extraordinary circumstances.

The UCC's treatment of commercial impracticability under § 2-615 builds on these common law principles while providing additional clarity. It explicitly addresses foreseeability, causation, and risk allocation, to ensure that disruptions not reasonably anticipated or contractually assigned do not excuse performance. Force majeure clauses, commonly included in commercial contracts, further illustrate how these doctrines operate in practice. By defining specific events that excuse performance, these clauses enable parties to proactively allocate risks and reduce the potential for disputes.

The COVID-19 pandemic underscored the relevance and adaptability of excuse doctrines. During the pandemic, courts grappled with cases involving disrupted supply chains, government-imposed restrictions, and altered market conditions. These disputes highlighted the tension between holding parties to their promises and avoiding manifestly unfair outcomes. Courts relied on doctrines of excuse to navigate these challenges, which reaffirmed excuse's importance in maintaining contractual integrity and fairness during unprecedented times.

Ultimately, the doctrines of excuse embody the dual goals of contract law: predictability and fairness. Doctrines like impossibility uphold contractual reliability by enforcing strict standards, while frustration of purpose ensures fairness by addressing situations where the contract's core purpose has been undermined. This balance enables the legal system to uphold agreements while adapting to extraordinary circumstances, as demonstrated in cases involving natural disasters, regulatory changes, and other unforeseen events. By understanding these doctrines, students gain the ability not only to evaluate claims of excuse but also to draft contracts that anticipate and effectively manage risks, which ensures continued stability and equity in contractual relationships.

Cases

Reading Taylor v. Caldwell. Historically, courts held parties to contracts regardless of circumstances. By the mid-nineteenth century, however, courts recognized that parties should not be forced to carry out obligations that were made impossible by some intervening event.

In this famous case, the plaintiffs agreed to rent Surrey Music Hall and Gardens from defendant. According to the court, before the appointed date, the hall burned down due to a fire that was neither party's fault. (*The Western Morning News* of Plymouth, Devon, England, reported on June 12, 1861, that the fire was due to negligence of third-party plumbing contractors that defendant hired.) The court held that the defendant was excused from providing the hall because it could not have foreseen its burning down. Likewise, the plaintiff was not responsible for this risk. Accordingly, the court excused both parties' performances under the agreement.

The next two cases, *Taylor* and *Krell*, are perhaps two of the most important cases under English law for understanding modern American contract law. Although the American common law system was substantially inherited from the English system, the systems have been drifting apart from even before the American Revolution began in 1775, yet they have also dovetailed from time to time since then.

Taylor v. Caldwell

122 E.R. 309 (1863)

The declaration alleged that by an agreement, bearing date the 27th May, 1861, the defendants [Caldwell & Bishop] agreed to let, and the plaintiffs [Taylor & Lewis] agreed to take, on the terms therein stated, The Surrey Gardens and Music Hall, Newington, Surrey, for the following days, that is to say, Monday the 17th June, 1861, Monday the 15th July, 1861, Monday the 5th August, 1861, and Monday the 19th August, 1861, for the purpose of giving a series of four grand concerts and day and night fêtes, at the Gardens and Hall on those days respectively, at the rent or sum of £1001 for each of those days.

On the trial, before Blackburn J., at the London Sittings after Michaelmas Term, 1861, it appeared that the action was brought on the following agreement:

Royal Surrey Gardens, 27th May, 1861. Agreement between Messrs. Caldwell & Bishop, of the one part, and Messrs. Taylor & Lewis of the other part, whereby the said Caldwell & Bishop agree to let, and the said Taylor & Lewis agree to take, on the terms hereinafter stated, The Surrey Gardens and Music Hall, Newington, Surrey, for the following days: [Monday the 17th June, 1861, Monday the 15th July, 1861, Monday the 5th August, 1861, and Monday the 19th August, 1861] for the purpose of giving a series of four grand concerts and day and night fêtes at the said Gardens and Hall on those days respectively at the rent or sum of £1001 for each of the said days.

The said Caldwell & Bishop agree to find and provide at their own sole expense, on each of the aforesaid days, for the amusement of the public and persons then in the said Gardens and Hall, an efficient and organised military and quadrille band, the united bands to consist of from thirty-five to forty members; al fresco entertainments of various descriptions; coloured minstrels, fireworks and full illuminations; a ballet or divertissement, if permitted; a wizard and Grecian statues; tight rope performances; rifle galleries; air gun shooting; Chinese and Parisian games; boats on the lake, and (weather permitting) aquatic sports, and all and every other entertainment as given nightly during the months and times above mentioned. . . .

And the said Taylor & Lewis agree to pay the aforesaid respective sum of £1001. in the evening of the said respective days by a crossed cheque, and also to find and provide, at their own sole cost, all the necessary artistes for the said concerts, including Mr. Sims Reeves, God's will permitting.

[The contract was signed by signed by J. Caldwell and C. Bishop and witnessed by S. Denis.]

On the 11th June the Music Hall was destroyed by an accidental fire, so that it became impossible to give the concerts.

The judgment of the Court was now delivered by BLACKBURN J.

[Blackburn's recitation of the facts omitted as it is virtually identical to the statement of facts given by the court reporter above.]

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.



Figure 22.1. The Adelphi Theatre Calendar revised, reconstructed and amplified.

Credit: Alfred L. Nelson, Gilbert B. Cross, Joseph Donohue. CC-A 3.0 License.

[Lengthy discussion of precedent in English and Roman law omitted. In summary, where promises are independent, the contractor must perform or pay damages for

not performing. But when there is some express stipulation that the destruction of a person or thing shall excuse performance, or when such excuse is a condition implied by law, then the destruction of said person or thing shall excuse the performance conditioned on its existence.]

[Here,] 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 [Caldwell & Bishop, such that they do not have to pay for failing to provide the use of Surrey Music Hall].

Rule absolute.

Reflection

While it may seem obvious after reading *Taylor* that neither party should be obligated to perform under a contract where its subject matter was destroyed, the court does not address why the owners of Surrey Music Hall did not bear responsibility for ensuring it remained. Why did the owners of the hall not bear the risk of its loss? The owners were in a better position to prevent fires or to maintain insurance that would cover the liability resulting from this loss.

Discussion

1. Consider how the doctrine of mistake would apply to this case. A party is only entitled to void a contract on the basis of mistake where that party does not bear the risk of that mistake. Should a party be able to use the excuse defense where its performance became impossible due to the party's own fault? What would be the economic impact of such a rule?
 2. How could a court determine whether the impossibility of a party's performance is due to that party's fault? Tort law uses the idea of proximate causation to determine fault for negligence. Does contract law incorporate some idea of proximate causation for impossibility? Should it? If so, how?
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Reading Krell v. Henry. In *Taylor*, the owner-seller was excused, but buyers can be excused as well. In *Krell v. Henry*, 2 K.B. 740 (1903), another English case, a man rented an apartment at a significantly above-market rate simply because it afforded an excellent view of the King's coronation. The King, however, got appendicitis, and the coronation was postponed. A court found that the buyer was excused from renting the room because his purpose in renting it was completely frustrated by the postponement.

Krell v. Henry

2 K.B. 740 (1903)

VAUGHAN WILLIAMS, L.J.

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. The Roman law dealt with obligationes de certo corpore.

Whatever may have been the limits of the Roman law, the case of *Nickoll v. Ashton* makes it plain that the English law applies the principle not only to cases where the performance of the contract becomes impossible by the cessation of existence of the thing which is the subject-matter of the contract, but also to cases where the event which renders the contract incapable of performance is the cessation or non-existence of an express condition or state of things, going to the root of the contract, and essential to its performance.

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 [of King Edward VII and Alexandra that was scheduled for June 26, 1902], but speak merely of the taking of [plaintiff and owner] Mr. Krell's chambers, or, rather, of the use of them, in the

daytime of June 26 and 27, for the sum of £751, £251 then paid, balance £501 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, shew 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 licence 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 nonoccurrence of the coronation and procession along the proclaimed route they would discharge both parties from further performance of the contract.

[Counsel argued that the following hypothetical is analogous to the instant case:] If a cabman was engaged to take someone to Epsom on Derby Day at a suitable enhanced price for such a journey, say £10, both parties to the contract would be discharged in the contingency of the race at Epsom for some reason becoming impossible. [This was counsel's effort to make a slippery slope argument; that is, if the court excuses the renter's payment in this case, it must also excuse many other payments, and this cannot be the correct result because too many contractual promises would thus be excused.]

[Judge Williams distinguished the counsel's hypothetical thus:] 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.



Figure 22.2. Procession passing along a busy London thoroughfare during the Coronation of Edward VII (1841–1910) on August 9, 1902. The view from the apartment on Pall Mall would have been similar to this. Public domain work.

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 licence 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.

[The judge, having distinguished the Epsom cab analogy from the instant case, goes on to discuss general rules that can apply in all such cases.]

Each case must be judged by its own circumstances. In each case one must ask oneself:

1. First, what, having regard to all the circumstances, was the foundation of the contract?
2. Secondly, was the performance of the contract prevented?
3. 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.

[Extensive discussion of English case law omitted.]

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 £501 unpaid balance of the price agreed to be paid for the use of the rooms. . . . I think this appeal ought to be dismissed.

Reflection

Krell offers a more sophisticated analysis than *Taylor*, which is unsurprising given that *Krell* benefited from *Taylor* and other precedent analyses. But the *Krell* court does



Figure 22.3. *Le Derby de 1821 à Epsom*, an 1821 painting by Théodore Géricault in the Louvre Museum, showing *The Derby* (the main horse race or “course de chevaux”) of that year. Public domain work distributed by DIRECTMEDIA Publishing GmbH.

not seem to explicitly discuss why the tenant (Henry) or, alternatively, the landlord (Krell) bears any risk or responsibility for the cancellation of an event. Instead, the court seems to excuse the tenant because the landlord is in a better position to afford the loss of the rental. (The landlord can re-let the premises, presumably for a similar rate, when the coronation is reconvened.) This appears to be based on the reliance interest, which you will learn about in Chapter 24. But it does not account for the expectancy interest, which, as you will learn, is the basis for the typical measure of damages, known as expectation damages. This deviation from the norm signifies that the court was considering equitable basis for excuse.

Discussion

1. Why is foreseeability the basis for the frustration of purpose excuse? Should a court consider instead, or also, which party bears the risk of frustration of purpose? How would this consideration change the outcome in this case?
2. How would the rule apply to similar matters, such as renting an expensive hotel room in order attend the Super Bowl, where the event is canceled due to an outbreak of a virulent disease?

3. How does the *Krell* rule impact the incentives on parties to be careful, or careless, when transacting about goods, services, or real or intellectual properties that are to be used for a particular purpose? Specifically, does this rule encourage parties to disclose their purposes, or does it encourage them to keep information private?

Reading Transatlantic Financing Corp. v. United States. *Transatlantic* shows how the doctrine formerly known as “impossibility” has broadened into “impracticability.” (The correlated doctrine of frustration of purpose has likewise broadened, as you will see in the case following *Transatlantic*.)

Transatlantic also shows the limits of the excuse doctrine. Impracticability does not require impossibility of performance, but it does require performance to be so onerous that it would be unconscionable for a court to require it. You will learn in the module on remedies that courts usually award an aggrieved party money damages calculated pursuant to the expectation interest when one party breaches a contract. This measure of damages is useful because it ensures parties to a contract get what they expected (or its monetary value). As you will learn in subsequent chapters, this measure of damages encourages an efficient result: performance when it is socially beneficial and payment when it is not.

But excusing performance has a different legal result than either requiring performance or payment. Excusing performance makes it as if the contract was not formed. This can leave parties in a difficult position, and, moreover, it puts courts in the challenging role of trying to assess what damages should be owed when the expectation interest must be disregarded.

Today, courts may excuse performance even where it is not strictly impossible but only highly impracticable, such that it has become unfair to hold both parties to the bargain. The following case outlines the modern test for determining whether to grant the excuse of impracticability.

Transatlantic Financing Corp. v. United States

363 F.2d 312 (D.C. Cir. 1966)

J. SKELLY WRIGHT, Circuit Judge:

This appeal involves a voyage charter between Transatlantic Financing Corporation, operator of the SS CHRISTOS, and the United States covering carriage of a full cargo of wheat from a United States Gulf port to a safe port in Iran. The District Court dismissed a libel filed by Transatlantic against the United States for costs attributable to the ship’s diversion from the normal sea route caused by the closing of the Suez Canal. We affirm.

On July 26, 1956, the Government of Egypt nationalized the Suez Canal Company and took over operation of the Canal. On October 2, 1956, during the international crisis which resulted from the seizure, the voyage charter in suit was executed between representatives of Transatlantic and the United States. The charter indicated the termini of the voyage but not the route. On October 27, 1956, the SS CHRISTOS sailed from Galveston for Bandar Shapur, Iran, on a course which would have taken her through Gibraltar and the Suez Canal. On October 29, 1956, Israel invaded Egypt. On October 31, 1956, Great Britain and France invaded the Suez Canal Zone. On November 2, 1956, the Egyptian Government obstructed the Suez Canal with sunken vessels and closed it to traffic.

On or about November 7, 1956, Beckmann, representing Transatlantic, contacted Potosky, an employee of the United States Department of Agriculture, who appellant concedes was unauthorized to bind the Government, requesting instructions concerning disposition of the cargo and seeking an agreement for payment of additional compensation for a voyage around the Cape of Good Hope. Potosky advised Beckmann that Transatlantic was expected to perform the charter according to its terms, that he did not believe Transatlantic was entitled to additional compensation for a voyage around the Cape, but that Transatlantic was free to file such a claim. Following this discussion, the CHRISTOS changed course for the Cape of Good Hope and eventually arrived in Bandar Shapur on December 30, 1956.

Transatlantic's claim is based on the following train of argument. The charter was a contract for a voyage from a Gulf port to Iran. Admiralty principles and practices, especially stemming from the doctrine of deviation, require us to imply into the contract the term that the voyage was to be performed by the "usual and customary" route. The usual and customary route from Texas to Iran was, at the time of contract, via Suez, so the contract was for a voyage from Texas to Iran via Suez. When Suez was closed this contract became impossible to perform. Consequently, appellant's argument continues, when Transatlantic delivered the cargo by going around the Cape of Good Hope, in compliance with the Government's demand under claim of right, it conferred a benefit upon the United States for which it should be paid in quantum meruit.

The doctrine of impossibility of performance has gradually been freed from the earlier fictional and unrealistic strictures of such tests as the "implied term" and the parties' "contemplation." It is now recognized that "A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost." The doctrine ultimately represents the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance. When the issue is raised, the court is asked to construct a condition of performance based on the changed circumstances, a process which involves at least three reasonably definable steps. First, a contingency—something unexpected—must have

occurred. Second, the risk of the unexpected occurrence must not have been allocated either by agreement or by custom. Finally, occurrence of the contingency must have rendered performance commercially impracticable. Unless the court finds these three requirements satisfied, the plea of impossibility must fail.

The first requirement was met here. It seems reasonable, where no route is mentioned in a contract, to assume the parties expected performance by the usual and customary route at the time of contract. Since the usual and customary route from Texas to Iran at the time of contract was through Suez, closure of the Canal made impossible the expected method of performance. But this unexpected development raises rather than resolves the impossibility issue, which turns additionally on whether the risk of the contingency's occurrence had been allocated and, if not, whether performance by alternative routes was rendered impracticable.

Proof that the risk of a contingency's occurrence has been allocated may be expressed in or implied from the agreement. Such proof may also be found in the surrounding circumstances, including custom and usages of the trade. The contract in this case does not expressly condition performance upon availability of the Suez route. Nor does it specify "via Suez" or, on the other hand, "via Suez or Cape of Good Hope." Nor are there provisions in the contract from which we may properly imply that the continued availability of Suez was a condition of performance. Nor is there anything in custom or trade usage, or in the surrounding circumstances generally, which would support our constructing a condition of performance. The numerous cases requiring performance around the Cape when Suez was closed, indicate 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. The doctrine of deviation supports our assumption that parties normally expect performance by the usual and customary route, but it adds nothing beyond this that is probative of an allocation of the risk.

If anything, the circumstances surrounding this contract indicate that the risk of the Canal's closure may be deemed to have been allocated to Transatlantic. We know or may safely assume that the parties were aware, as were most commercial men with interests affected by the Suez situation, see *The Eugenia*, *supra*, that the Canal might become a dangerous area. No doubt the tension affected freight rates, and it is arguable that the risk of closure became part of the dickered terms. We do not deem the risk of closure so allocated, however. Foreseeability or even recognition of a risk does not necessarily prove its allocation. Parties to a contract are not always able to provide for all the possibilities of which they are aware, sometimes because they cannot agree, often simply because they are too busy. Moreover, that some abnormal risk was contemplated is probative but does not necessarily establish an allocation of the risk of the contingency which actually occurs. In this case, for example, nationalization by Egypt of the Canal Corporation and formation of the Suez Users Group did not

necessarily indicate that the Canal would be blocked even if a confrontation resulted. The surrounding circumstances do indicate, however, a willingness by Transatlantic to assume abnormal risks, and this fact should legitimately cause us to judge the impracticability of performance by an alternative route in stricter terms than we would were the contingency unforeseen.

We turn then to the question whether occurrence of the contingency rendered performance commercially impracticable under the circumstances of this case. The goods shipped were not subject to harm from the longer, less temperate Southern route. The vessel and crew were fit to proceed around the Cape. Transatlantic was no less able than the United States to purchase insurance to cover the contingency's occurrence. If anything, it is more reasonable to expect owner-operators of vessels to insure against the hazards of war. They are in the best position to calculate the cost of performance by alternative routes (and therefore to estimate the amount of insurance required), and are undoubtedly sensitive to international troubles which uniquely affect the demand for and cost of their services. The only factor operating here in appellant's favor is the added expense, allegedly \$43,972.00 above and beyond the contract price of \$305,842.92, of extending a 10,000 mile voyage by approximately 3,000 miles. While it may be an overstatement to say that increased cost and difficulty of performance never constitute impracticability, to justify relief there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case, where the promisor can legitimately be presumed to have accepted some degree of abnormal risk, and where impracticability is urged on the basis of added expense alone.

We conclude, therefore, as have most other courts considering related issues arising out of the Suez closure, that performance of this contract was not rendered legally impossible. Even if we agreed with appellant, its theory of relief seems untenable. When performance of a contract is deemed impossible it is a nullity. In the case of a charter party involving carriage of goods, the carrier may return to an appropriate port and unload its cargo, subject of course to required steps to minimize damages. If the performance rendered has value, recovery in quantum meruit for the entire performance is proper. But here Transatlantic has collected its contract price, and now seeks quantum meruit relief for the additional expense of the trip around the Cape. If the contract is a nullity, Transatlantic's theory of relief should have been quantum meruit for the entire trip, rather than only for the extra expense. Transatlantic attempts to take its profit on the contract, and then force the Government to absorb the cost of the additional voyage. When impracticability without fault occurs, the law seeks an equitable solution, and quantum meruit is one of its potent devices to achieve this end. There is no interest in casting the entire burden of commercial disaster on one party in order to preserve the other's profit. Apparently the contract price in this case was advantageous enough to deter appellant from taking a stance on damages consistent with its theory of liability. In any event, there is no basis for relief.

Affirmed.

Reflection

The *Transatlantic* court used the following three-part test for determining when excuse is merited on the basis of impracticability:

1. An unexpected occurrence must have happened;
2. The risk of the unexpected occurrence must not have been allocated by contract or custom; and
3. The unexpected occurrence must have rendered performance commercially impracticable.

These elements were not met in *Transatlantic*. While the closure of the Suez Canal may have been unexpected, there remained a commercially reasonable alternative route. This case clearly shows that increased cost alone is insufficient to prove that performance is impracticable. This accords with the broader contract notion that parties generally bear the risks associated with their own performance.

Discussion

1. If the court had excused the contract in *Transatlantic*, assuming that the United States had not yet paid anything for shipment, how much should the United States have paid Transatlantic? Answer this based on your intuition and allow yourself to change your view after you learn the rules regarding money damages.
2. If the cost of delivering the wheat to Iran becomes more expensive than the value of the wheat itself as a result of geopolitical issues involving shipping that were beyond the control of either party, should Transatlantic be required to deliver the wheat anyway? What does justice require? What judgment is most economically efficient? Is there a difference between equitable results and efficient results in cases regarding commercial matters?

Reading Adbar, L.C. v. New Beginnings C-Star. Frustration of purpose operates in much the same way that impracticability does, but it is phrased in such a way that this tends to be a buyer's excuse, whereas impracticability tends to be a seller's excuse. As you read *Adbar*, think about whether the buyer's purpose in renting a building was totally or substantially frustrated, and also think about who should bear the risk that the event which caused the purported frustration would occur.

Adbar, L.C. v. New Beginnings C-Star

103 S.W.3d 799 (Mo. Ct. App. 2003)

GLENN A. NORTON, Judge.

Adbar, L.C. appeals the judgment in favor of New Beginnings C Star on Adbar's claim for breach of lease. We reverse in part and affirm in part.

I. Background

New Beginnings provides rehabilitation services for alcohol and drug abuse to both adults and adolescents. In the fall of 1999, New Beginnings was searching for a new location and entered into negotiations with Adbar for lease of a building in the City of St. Louis. New Beginnings received a preliminary indication from the City's zoning administrator that its use of the property constituted a permitted use under the zoning regulations. New Beginnings and Adbar subsequently entered into a three-year lease. The total rent due for the three-year term was \$273,000.

After the lease was executed, the City denied New Beginnings' application for an occupancy permit on the grounds that the operation constituted a nuisance use under the zoning regulations. At trial, Alderman Freeman Bosley, Sr. testified that due to his opposition to New Beginnings moving into his Ward, he had called the zoning administrator and asked him to reverse his preliminary indication that New Beginnings' operation constituted a permitted use.

New Beginnings appealed the denial of the occupancy permit to the board of adjustment. Alderman Bosley and other neighborhood residents testified in opposition to New Beginnings at the board's hearing. The board affirmed the denial of the permit. New Beginnings then sought a writ, which was granted by the circuit court, and New Beginnings was issued an occupancy permit. Alderman Bosley contacted the judge who issued the writ and asked him to reverse his decision. The judge declined. A few weeks later, at the City counselor's request, the City revoked New Beginnings' occupancy permit. New Beginnings filed a motion for contempt with the circuit court. The motion was granted, and the City re-issued the occupancy permit.

After the permit was reissued, New Beginnings began preparing to move in, including having some construction done on the building. At this same time, Alderman Bosley contacted then State Representative Paula Carter, chairwoman of the appropriations committee responsible for New Beginnings' state funding. Alderman Bosley asked Representative Carter to "pull the funding" for New Beginnings. Alderman Bosley did not get a commitment from Representative Carter, but told her that "if you don't get their funding, you are going to have trouble running" for re-election.

New Beginnings alleges that it was then contacted by Michael Couty, director of the Missouri Division of Alcohol and Drug Abuse, who threatened to rescind all

state contracts with New Beginnings if it moved into the new location. New Beginnings convened a meeting of its board of directors to conduct a conference call with Director Couty. New Beginnings alleges that during that conference call Director Couty repeated his threat to rescind funding if it moved into the new location. At the end of the meeting, New Beginnings' board decided not to occupy the building they had leased from Adbar. At trial Director Couty denied making any such threats to New Beginnings.

Adbar filed a petition for breach of the lease. New Beginnings asserted a defense of legal impossibility. On the first day of the trial, New Beginnings was granted leave to amend its answer to add the defense of commercial frustration. Following a bench trial, the trial court ruled that New Beginnings was excused from its performance under the lease because of commercial frustration. This appeal follows.

II. Discussion

On review of this court-tried case, we will sustain the judgment of the trial court unless there is no substantial evidence to support it, it is against the weight of the evidence, it erroneously declares the law, or it erroneously applies the law. We accept the evidence and inferences favorable to the prevailing party and disregard all contrary evidence. We will defer to the factual findings of the trial judge, who is in a superior position to assess credibility; however, we independently evaluate the court's conclusions of law.

A. Commercial Frustration

In its first point on appeal, Adbar asserts that the trial court erroneously applied the law when it excused New Beginnings' performance under the lease due to the doctrine of commercial frustration. We agree.

[Under common law,] the doctrine of commercial frustration grew out of demands of the commercial world to excuse performance under contracts in cases of extreme hardship. Under the doctrine of commercial frustration, if the occurrence of an event, not foreseen by the parties and not caused by or under the control of either party, destroys or nearly destroys the value of the performance or the object or purpose of the contract, then the parties are excused from further performance.

If, on the other hand, the event was reasonably foreseeable, then the parties should have provided for its occurrence in the contract. The absence of a provision in the contract providing for such an occurrence indicates an assumption of the risk by the promisor. In determining foreseeability, courts consider the terms of the contract and the circumstances surrounding the formation of the contract. The doctrine of commercial frustration should be limited in its application so as to preserve the certainty of contracts.

[Here, in this case,] New Beginnings alleged that the troubles it faced obtaining its occupancy permit, along with the actions of Alderman Bosley and Director Couty,

combined to rise to commercially frustrate the lease agreement with Adbar. Ultimately, New Beginnings' funding was never rescinded. In this case the intervening event was merely the possibility that the funding may be rescinded. For an organization that receives funding from the State, the possibility that their funding may be reduced or even completely rescinded is foreseeable.

Furthermore, while the zeal with which Alderman Bosley attempted to keep New Beginnings out of his ward may have been surprising to the parties, it is certainly foreseeable that a drug and alcohol abuse treatment facility might encounter neighborhood resistance when attempting to move into a new location. At trial, the CEO of New Beginnings admitted that both the elimination of New Beginnings' funding and opposition from neighborhood groups were foreseeable.

[Citations to analogous cases omitted.]

The possibility that New Beginnings' funding may be threatened was foreseeable. Yet, New Beginnings did not provide for that possibility in the lease. Therefore, New Beginnings assumed the risk that their funding may be threatened and that it might frustrate the purpose of the lease.

In addition to this event being foreseeable, neither the value of the performance nor the purpose of the lease was destroyed. The purpose of the lease was to allow New Beginnings to operate a rehabilitation center at the location of the property. New Beginnings' funding was never rescinded or even restricted. Alderman Bosley's continued interference with New Beginnings efforts to provide rehabilitation treatment to addicts of drugs and alcohol certainly made, and would have continued to make, business difficult for New Beginnings. However, neither the value of the performance nor the object or purpose of the lease was destroyed or nearly destroyed.

Therefore, the doctrine of commercial frustration does not excuse New Beginnings' performance under the lease. Point I is granted.

III. Conclusion

The judgment that New Beginnings is excused from the lease under the defense of commercial frustration is reversed and the cause is remanded for a new trial in accordance with this opinion. The judgment in all other respects is affirmed.

Reflection

The *New Beginnings* case is an example of a foreseeable event that occurred. Since the event was foreseeable, it cannot be grounds for excuse due to frustration of purpose.

Why was it foreseeable in this case that an addiction treatment facility would meet resistance to its operation by local government officials? There is a concept called NIMBY, which stands for "not in my backyard." It refers to local opposition to

development that would be a net positive for society as a whole. The residents who oppose the development are called Nimbys, and their viewpoint is called Nimbyism.

Wikipedia lists a variety of projects that are likely to be opposed by local residents:

- housing development
- bicycle and pedestrian infrastructure
- skyscrapers
- homeless shelters
- oil wells
- chemical plants
- industrial parks
- military bases
- sewage treatment systems
- fracking
- wind turbines
- desalination plants
- landfill sites
- incinerators
- power plants
- quarries
- prisons
- pubs and bars
- adult entertainment clubs
- concert venues
- firearms dealers
- cell towers
- electricity pylons
- abortion clinics
- children's homes
- nursing homes
- youth hostels
- sports stadiums
- shopping malls
- retail parks
- railways
- highway expansions
- airports
- seaports
- nuclear waste repositories
- storage for weapons of mass destruction
- cannabis dispensaries and recreational cannabis shops
- methadone clinics
- accommodation of persons applying for asylum, refugees, and displaced persons

Perhaps you can see some similarities among the items on this list. When a promoter proposes a development that typically engenders a NIMBY reaction, it is reasonably foreseeable that the promoter might not gain local government support for that development project.

Since local government support is often required for development projects such as the addiction treatment clinic in *New Beginnings* to operate, courts generally will not find that the promotor's performance (e.g., paying rent) is excused where operating permits are not forthcoming from the local authorities.

Discussion

1. When an entrepreneur embarks on a business project, such as developing a concert venue or a methadone clinic, should that entrepreneur bear the risk that local governments may oppose the project? Should the person transacting with the entrepreneur bear this risk?
 2. In general, which contractual party should bear the economic risk that government will prevent some activity?
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Problems

Problem 22.1. Super Bowl LV

On January 1, 2020, Alex, who lives in Minnesota, decides she wants to get away from the cold winter and go to Florida to attend Super Bowl LV in Tampa. On that day, she enters into the following transactions:

- Alex agrees to buy from Will two tickets to Super Bowl LV, which is scheduled to be held at the Raymond James Stadium in Tampa Bay, Florida, on Sunday, February 7, 2021, for \$1,000 each.
- Alex purchases two round-trip airplane tickets from Delta Airlines for travel on Friday, February 5, 2021, from Minneapolis-Saint Paul International Airport to Tampa International Airport, for \$125 each.
- Alex agrees to rent from Colin his one-bedroom apartment in Tampa the four nights from Friday, February 5, to Tuesday, February 9, for \$500 per night (\$2,000 total). Colin's apartment is located in Cove Apartments on the Bay at 4003 S. West Shore Blvd., Tampa, FL.

In March 2020, the novel coronavirus known as COVID-19 began infecting people worldwide. Governments responded by shutting down businesses and limiting in-person gatherings throughout that spring and summer. Some airlines canceled flights and refunded passengers for travel in early April and May, though confusion continued through the year.

On December 15, 2020, Alex decided to cancel her trip and asked Will, Colin, and Delta Airlines for a refund. They all refused, noting the following facts:

- Delta Airlines stated that, unless the Florida, Minnesota, or federal government orders another shutdown, it will be flying the MSP-TPA route, so her travel is possible. Alex has purchased a standard-fare ticket, which has a \$200 change fee.
- Colin made plans to stay at his mother's house in West Palm Beach, Florida, in order to make his apartment available to Alex. He did not rent it to others during the Super Bowl period because Alex had reserved it. He also hired a professional cleaning company to sanitize the vacant apartment before her arrival, a service for which he put down a \$100 non-refundable deposit.
- Will cannot resell the Super Bowl LV tickets to someone else for the price Colin agreed to pay because, as of that date, the NFL Commissioner Roger Goodell still has not announced whether in person attendance will be permitted at the game. The Tampa Bay Times quoted Commissioner Goodell as saying, "We will be working with public officials and the health officials to define [the capacity for the game] as we get closer to the game." Will added that he will refund Alex if the NFL refunds him for his ticket.

Note that these are real locations and events, so you can use the internet to learn more about them. Do some online research about things like comparable price,

Problem 22.2. Lot Number 1285

Naomi purchased 3 tons of nitrogen fertilizer for her farm from Grozit, a local feed and fertilizer distributor. Ever careful, before Naomi signed the purchase agreement, she visited the warehouse, inspected the fertilizer, and had 3 tons of it set aside for her and designated as “Lot Number 1285.” The purchase agreement dated March 1 specified that Grozit would deliver “Lot Number 1285” to Naomi on May 1. Unfortunately, a small fire destroyed Lot Number 1285 on April 15. Grozit has other fertilizer of the same type that is available, but the market price has risen, and Grozit insists that the prior agreement is now void and that Naomi must sign a new purchase agreement at a higher price if she wants the fertilizer.

Is Grozit within its rights? Analyze whether Grozit’s performance is excused.

Problem 22.3. Excessive Rain

Bob is a potato broker. Bob entered into a contract with McDonald’s to provide 80 tons of potatoes to be delivered by November 1. There was excessive rain in the Midwest that ruined the potato crop, thus raising the price of potatoes nationwide by 25% and making the contract with McDonald’s relatively unprofitable for Bob. Bob claims that this unforeseen event should excuse his performance under the contract. McDonald’s demands that he either deliver the potatoes or be liable for breach of contract.

All of Bob’s contracts for obtaining potatoes were with farmers in the Midwest, none of whom have any potatoes for sale. McDonald’s was aware of Bob’s regional affiliations with farmers and contracted with potato brokers in many different regions around the country specifically to protect against localized and regional crop failures.

Analyze who wins the breach of contract dispute.

Chapter 23

Modification and Discharge

Imagine you've hired a contractor to renovate your kitchen. Halfway through—after he's ripped out your cabinets and hauled away your stove—he complains that material costs have tripled because of unexpected supply-chain issues. The contractor says he can no longer break even unless you agree to adjust the price. You agree to double his fee, in part because you know it will be impossible to get someone else to finish the job for your original price. Is that fair, given that no one foresaw such drastic cost hikes? Alternatively, what if the contractor is merely taking advantage of your dependence by demanding extra payment after the cabinets are torn out? Where do we draw the line between legitimate, good-faith renegotiation and unfair opportunism?

In contract law, these questions highlight a fundamental tension. On the one hand, we value the certainty of holding people to their promises (*pacta sunt servanda*). On the other, we recognize that circumstances often change in ways that warrant a fresh look at the deal. Contracts should remain flexible enough to handle genuine shifts in market conditions, unanticipated difficulties, or evolving business needs. Sometimes, the most equitable result is a small modification—like adjusting the project timeline or cost. Other times, parties might decide that ending the arrangement entirely (discharging the contract) is best for everyone.

Historically, common law insisted that contract modifications required fresh consideration, thus ensuring that no party gave up a right without something new in return. Modern contract law has relaxed that stance, recognizing that good faith and fairness may allow certain changes even without strict formalities. Still, there are safeguards to prevent one-sided demands—like jacking up a price mid-project purely to exploit another's vulnerability.

This chapter explores how and why parties alter their agreements, the boundaries that courts impose to keep modifications and discharges fair, and the policy debates about balancing stability with adaptability. It also examines how to reassign rights and duties, or entirely substitute new parties, through assignment, delegation, and novation. By the end, students will understand how contract law seeks to preserve the integrity of promises while allowing parties the freedom to address life's inevitable twists and turns.

Rules

A. Changing Contractual Obligations

The term “modification” generally refers to any change in the contract’s terms. Most modifications adjust certain aspects of the original contract while preserving the rest. These changes can involve price, schedule, scope of performance, or even the parties performing the promises or receiving the consideration.

Modifications can be problematic because they create opportunities for coercive conduct. Once parties enter a contractual relationship, they often act in reliance on their counterparty’s promises to perform. This reliance can leave one party vulnerable to exploitation, particularly if obtaining a substitute performance is impractical or costly. Such situations can give the counterparty significant leverage to demand more favorable terms.

For example, imagine you live in Pennsylvania and plan to sell your car. A prospective buyer in California offers you \$12,000 for the car, while similar buyers near you would only pay \$10,000. To deliver the car, you estimate \$500 in gas and tolls, \$300 for two nights in a hotel, and \$200 for a one-way plane ticket home, totaling \$1,000. The extra \$1,000 profit makes the hassle worthwhile, so you accept the offer.

In performance of your promise, you drive the car to California. However, upon arrival, the buyer informs you they will only pay \$10,000. Now what should you do? Driving the car back to Pennsylvania would cost \$800, and you’re already out \$200 for the plane ticket. In Pennsylvania, you could only sell the car for \$10,000 after re-listing it and going through the sales process again. Ultimately, you are better off accepting the \$10,000 offer in California rather than returning home, so you reluctantly agree to modify the contract.

Does something about this situation seem unfair to you? It likely does. The buyer exploited your reliance on their promise to extract more value from the transaction. This scenario illustrates how modifications can sometimes become tools for opportunism. The key question is: how should contract law address situations like this?

The law regulates modifications to balance flexibility and fairness while preventing exploitation. The traditional preexisting duty rule prohibits a party from demanding additional consideration for obligations they are already bound to perform. Modern contract law, however, recognizes the need for flexibility and allows certain modifications if they are made in good faith or are fair and equitable under unforeseen circumstances. By emphasizing commercial reasonableness alongside fairness, the UCC reinforces this balance and ensures that modifications adapt to practical realities without enabling coercion.

1. The Preexisting Duty Rule

Historically, courts addressed coercive contract modifications by applying the preexisting duty rule. According to this rule, doing or promising what a party is already legally obligated to do cannot serve as valid consideration to support another party's promise. The R2d § 73 articulates the rule as follows:

Performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration; but a similar performance is consideration if it differs from what was required by the duty in a way which reflects more than a pretense of bargain.

The preexisting duty rule often arises in situations where one party attempts to renegotiate terms to gain a better deal without providing anything new in exchange. For example, a contractor may promise to complete a construction project in exchange for more money than originally agreed. Similarly, an employee might agree to continue performing their current job duties in exchange for a higher salary. In such cases, unless the new promise significantly differs from what the promisor is already bound to do, it is not valid consideration.

Perhaps the most famous case illustrating the preexisting duty rule is *Alaska Packers' Association v. Domenico*, 117 F. 99 (9th Cir. 1902), which you will read below. In the spring of 1900, Domenico and his associates hired a group of sailors from the Alaska Packers' Association to fish for salmon at Pyramid Harbor, Alaska. The sailors agreed to perform this work in exchange for a specified wage. However, once transported from San Francisco to Alaska, the sailors organized and demanded double pay for the same work they had already agreed to perform. With no practical alternative, Domenico reluctantly agreed to their demand to salvage the fishing season.

Upon returning to San Francisco, Domenico paid the sailors their original wage but refused to pay the additional amount. The sailors sued for breach of contract.

The Ninth Circuit Court of Appeals ruled in favor of Domenico. The court reasoned that contract modification requires sufficient consideration. A promise to perform an existing duty does not involve taking on or relinquishing a legal obligation and, therefore, offers no consideration. Since the sailors' demand involved merely performing their preexisting contractual duties, their promise was insufficient to support Domenico's agreement to pay more. Without new consideration, the modification was unenforceable.

Promising to perform a preexisting duty cannot be consideration because such a promise does not involve relinquishing or taking on a legal duty. The promising party already has the duty to perform, so it is really promising nothing at all. "Nothing" is, of course, insufficient as consideration, since "consideration" is, by definition, something of legal value given in exchange for a promise.

2. Modern Relaxation of the Preexisting Duty Rule

The *Alaska Packers' Association* court applied a strict interpretation of the preexisting duty rule, reasoning that contracts cannot be modified without new consideration. Under this approach, modifications represent new promises that must be supported by a bargained-for exchange of value. If the parties agree to a modification, but no new consideration is given, then the modification will not be enforceable in court.

However, more recent case law highlights the limitations of this rule. The preexisting duty rule was designed to prevent one party from exploiting a counterparty who has placed themselves in a vulnerable position by relying on contractual promises. Yet, the rule itself creates significant issues. It often prohibits contract modifications even when they reflect voluntary, mutually beneficial adjustments to unforeseen circumstances. For example, in a construction project, what if a contractor's costs have risen unexpectedly? If the contractor cannot complete their obligations without additional compensation, would it not be fair to allow the parties to adjust their compensation accordingly?

The preexisting duty rule is both over-inclusive and under-inclusive. It is over-inclusive because it fails to differentiate between justified and unjustified modification requests, often impeding good-faith adjustments to contracts. At the same time, it is under-inclusive because even the most coercive modification might be upheld if supported by nominal consideration—a mere “peppercorn.” This formal requirement can obscure substantive unfairness.

For these reasons, modern courts have dramatically moved away from a strict application of the preexisting duty rule. One common workaround is rescission (discussed below) and recontracting. Courts allow parties who wish to modify their agreement to first mutually rescind the existing contract and then execute a new agreement. This three-step process—entering a contract, rescinding it, and forming a new contract—ensures that each promise is supported by mutual consideration. While the final outcome mirrors a unilateral modification, the formal distinction satisfies the traditional requirement of consideration.

Some courts have simply ignored the preexisting duty rule, while others have explicitly rejected its rigid application. One of the most notable cases illustrating this evolution is *Angel v. Murray* 113 R.I. 482 (1974), which appears later in this chapter. In *Angel*, a garbage collector contracted with the City of Newport for waste disposal services. Mid-contract, he requested additional compensation due to an unexpected population surge, which significantly increased the scope of his work. The court upheld the modification, despite the absence of new consideration from the garbage collector. It reasoned that the modification was fair and equitable because it addressed unforeseen circumstances that altered the fundamental assumptions underlying the original agreement. The court's decision demonstrated a practical approach aligning with modern common law principles that prioritize fairness and adaptability over strict adherence to formalistic rules.

R2d § 89, which cites *Angel v. Murray* in its comments, adopts a flexible approach to contract modifications and allows them to be enforced without additional consideration if certain conditions are met. This modern standard emphasizes fairness and practicality over rigid formalism:

A promise modifying a duty under a contract not fully performed on either side is binding if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made. R2d § 89(a).

Under R2d § 89(a), a modification is binding if it is “fair and equitable” in view of unforeseen circumstances that significantly alter the feasibility or conditions of performance. For example, if a contractor building a house experiences delays due to external factors beyond their control (though not rising to the level of impracticability), an agreed extension of the timeline would be enforceable, provided it reflects good-faith negotiations. Conversely, a buyer’s agreeing to pay more solely because of an unsupported demand by the seller would fail the fairness standard.

R2d § 89(c) provides an alternative basis for enforcing modifications through promissory estoppel. This allows a modification to be binding if one party detrimentally relies on it, even without proof that the modification was fair or based on changed circumstances. (See Chapter 8 for further discussion of promissory estoppel.)

Finally, R2d § 89(b) recognizes that statutes, like the UCC or others, can make modifications enforceable without the need for changed circumstances or reliance. For example, the Uniform Written Obligations Act, as adopted in Pennsylvania, eliminates the requirement for consideration as long as a written contract includes an express intent to be bound. While its application is limited geographically, this act exemplifies the broader move away from strict formalism in contract law.

In sum, the preexisting duty rule created significant barriers to modifying contracts by prioritizing strict formalism over practical realities. The modern approach, as reflected in the common law and R2d § 89, embraces flexibility by acknowledging that unforeseen circumstances and fairness can justify modifications. This evolution demonstrates the law’s effort to balance traditional principles with the practical need for adaptability in contractual relationships.

3. Modifications under the UCC

The UCC is even more permissive of contract modification than both the traditional rule and the R2d. Under the traditional rule, modifications require new consideration to be binding. The R2d relaxes this requirement by allowing modifications without new consideration if they are fair and equitable in light of changed circumstances. The UCC goes further by eliminating the consideration requirement altogether:

An agreement modifying a contract within this Article needs no consideration to be binding. UCC § 2-209(1).

However, while the UCC does not explicitly require changed circumstances, the good-faith requirement may serve a similar purpose. Good faith ensures that modifications are honest, commercially reasonable, and not opportunistic, reflecting an implicit expectation of legitimacy behind any changes to the contract. This standard emphasizes commercial practicality and trust between parties, focusing on the intent and honesty of the modification rather than formalistic rules.

For example, a supplier selling industrial components agrees to lower prices due to reduced manufacturing costs. This modification is enforceable under UCC § 2-209 if the change reflects genuine good faith. Conversely, if a supplier arbitrarily raises prices without justification and the buyer agrees under duress to avoid supply disruption, the modification may be invalidated for lacking good faith.

UCC § 1-201(b)(20) defines good faith as “honesty in fact and the observance of reasonable commercial standards of fair dealing.” This principle acts as a safeguard against opportunistic behavior and ensures that modifications are consistent with ethical and practical norms. Good faith is particularly important in commercial transactions where flexibility is necessary but trust must be preserved.

For instance, if a supplier selling electronics modifies delivery terms due to unexpected shipping delays and genuinely communicates the reasons to the buyer, this reflects good faith. Conversely, raising prices without a legitimate reason, especially if it exploits the buyer’s dependency, demonstrates bad faith and undermines enforceability.

Courts evaluate good faith by considering several factors. They ask whether the modification was proposed with honest intent or motivated by opportunism, and whether it aligns with reasonable industry practices and reflects commercial standards relevant to the agreement. Transparency is also key; courts examine whether the reasons for the change were clearly communicated and adequately justified. Together, these factors ensure that UCC § 2-209 modifications maintain a balance between flexibility and ethical business practices.

For example, imagine a supplier selling industrial-grade steel adjusts the price of goods mid-contract due to a sudden spike in raw material costs caused by global market disruptions. The supplier provides industry reports and invoices to demonstrate the legitimacy of the increase, aligning with reasonable commercial standards. This would represent a good faith modification. However, if the supplier raises prices arbitrarily, citing market fluctuations without providing any documentation or aligning with known industry practices, the price increase would fail to meet commercial standards of fair dealing. The modification might not be enforceable, even if the other party agreed to it.

4. Modification Doctrines

When parties to a contract wish to alter their obligations, they may use modification doctrines to replace, redefine, or discharge their existing duties. These doctrines reflect the law’s flexibility in allowing parties to adapt their agreements while maintaining a structured approach to enforceability.

a. Substituted Contracts

A substituted contract occurs when the parties create a new agreement that entirely replaces the old one. The original contract is discharged, and the substituted contract becomes the operative agreement. To be enforceable, the substituted contract must meet the usual requirements of a valid contract: mutual assent, consideration, and legal purpose.

(1) A substituted contract is a contract that is itself accepted by the obligee in satisfaction of the obligor's existing duty. (2) The substituted contract discharges the original duty and imposes a new one in its place. R2d § 279.

For example, suppose a homeowner and contractor agree to build an addition for \$50,000. Midway through the project, they both decide to expand the addition's scope, which increases the price to \$75,000. They draft and sign a new agreement that fully replaces the original. The original contract is no longer enforceable; only the substituted contract governs their relationship.

b. Substituted Performance

Substituted performance occurs when the parties agree to satisfy an existing duty with a different performance. Unlike substituted contracts, substituted performance keeps the original agreement intact until the agreed substitution is carried out. This doctrine, defined in R2d § 278, ties discharge directly to the completion of the new performance rather than the formation of a new agreement.

(1) Where an obligee accepts, in satisfaction of the obligor's duty, a performance offered by the obligor that differs from what was due, the duty is discharged if the performance is rendered. (2) Where performance is offered by a third person and accepted by the obligee in satisfaction of the obligor's duty, the duty is discharged. R2d § 278.

For example, suppose a tenant owes back rent to a landlord. The parties agree that the tenant will repaint the property instead of paying the rent. If the tenant completes the painting, the landlord's claim for rent is discharged. This illustrates how substituted performance discharges the duty upon execution, which differentiates it from an accord, where the duty is merely suspended until satisfaction occurs.

c. Accord and Satisfaction

Accord and satisfaction is a two-step process for discharging an obligation through substitute performance. An accord is an agreement to accept a different performance in satisfaction of an existing duty, while satisfaction is the execution of that substitute performance, which discharges the original duty. R2d § 281 explains that the original duty is suspended during the accord and fully discharged only upon performance of the satisfaction.

(1) An accord is a contract under which an obligee promises to accept a stated performance in satisfaction of the obligor's existing duty. Performance of the

accord discharges the original duty. (2) Until performance of the accord, the original duty is suspended unless there is a breach of the accord by the obligor that discharges the accord. (3) Breach of the accord by the obligee does not discharge the original duty. R2d § 281

For example, in *Pinnel's Case*, 5 Co. Rep. 117a (1602), Judge Sir Edward Coke held that payment of a lesser sum cannot discharge a greater debt unless accompanied by valid consideration. Exceptions noted by the court, such as a new time or place of payment or non-monetary consideration (e.g., a horse, hawk, or robe), emphasize that alternative benefits can satisfy a debt if they confer unique value to the creditor. Courts have since interpreted these exceptions to reflect the importance of mutual intent and the creditor's ability to derive benefit from alternative performance.

The reasoning in *Pinnel's Case* underscores that an accord must be supported by valid consideration to distinguish it from the original obligation. However, *Foakes v. Beer*, 54 L.J.Q.B. 130 (Queen's Bench 1884), highlighted a nuanced exception: collecting an uncertain or disputed debt can provide new value sufficient to support consideration. This reflects the idea that resolving a dispute itself constitutes a tangible benefit to the creditor. While the strict rule from *Pinnel's Case* remains influential, modern adaptations, including R2d § 281, suggest that changed circumstances or good-faith negotiations may justify enforcement of an accord and satisfaction even without traditional consideration. This approach prioritizes fairness and commercial practicality.

B. Changing Contractual Parties

Parties to contracts have rights and responsibilities. Within limits, contractual rights can be assigned (transferred) to others, and responsibilities to perform can be delegated (transferred) to third parties. In addition, through a process called “novation,” a new party can replace an original party in the contract. These changes let parties adapt to new circumstances while preserving enforceability. Each approach offers a different way to transfer rights, duties, or both, and understanding these distinctions helps ensure smooth transitions in contractual relationships. The primary doctrines of transfer include assignment, delegation, and novation.

1. Assignment

Assignment occurs when a party transfers their contractual rights to a third party. The assignor (the original holder of the rights) relinquishes their claim, and the assignee (the new holder) steps into their position, becoming entitled to enforce those rights against the obligor. R2d § 317(1) defines assignment as:

An assignment of a right is a manifestation of the assignor's intention to transfer it by virtue of which the assignor's right to performance by the obligor is extinguished in whole or in part and the assignee acquires a right to such performance.

Assignments are typically permitted unless the contract states otherwise. For example, a landlord rents an apartment to a tenant under a one-year lease. Halfway through the lease, the tenant assigns their right to occupy the apartment to a subtenant. Upon proper notice to the landlord, the subtenant gains the right to enforce the lease terms against the landlord, such as the right to habitability. However, unless explicitly released, the original tenant (assignor) may remain secondarily liable if the subtenant (assignee) fails to perform.

Assignment helps parties transfer the benefits of a contract, such as payments or services, without altering the underlying obligations. This makes assignment a practical tool in financing or simplifying transactions, as long as it does not materially affect the obligor's performance.

2. Delegation

Delegation occurs when a party transfers their contractual duties to a third party. The delegator (the original obligor) passes primary responsibility for completing that duty to the delegatee (the new obligor). However, under common law, the delegator remains secondarily liable for performance unless the obligee agrees to release them. R2d § 318(1) provides:

An obligor can properly delegate the performance of his duty to another unless the delegation is contrary to public policy or the terms of his promise.

Delegation is generally permissible unless the contract involves personal services or duties requiring specific expertise. For example, a contractor hired to build a house may delegate specific construction tasks, such as framing, to a subcontractor. The subcontractor performs the delegated duty, but the original contractor (delegator) remains liable if the subcontractor fails to meet the contract's requirements. However, if the contract explicitly prohibits delegation, or if the delegation is unreasonable, such as in a personal services agreement with a bespoke artist, it would be unenforceable.

Delegation allows tasks to be reassigned for efficiency while ensuring the original obligor remains accountable. This approach is common in industries like construction, where general contractors rely on subcontractors but stay responsible for overall project performance.

3. Novation

Novation involves substituting a new party into the contract and completely releases the original party from their obligations. This doctrine requires the consent of all three parties: the original obligor, the obligee, and the substituted party. R2d § 280 defines novation as:

A novation is a substituted contract that includes as a party one who was neither the obligor nor the obligee of the original duty.

For example, a lender loans money to Borrower A, who later requests to transfer the debt to Borrower B. If the lender agrees, Borrower B assumes the obligation to repay the loan, and Borrower A is fully discharged. This substitution replaces the original contract, and Borrower B becomes solely liable for performance.

Novation replaces the original obligor with a new party who assumes their rights and duties. It provides a clean break for the original obligor. The process ensures that the obligee's interests are protected while enabling the contract to continue seamlessly with the new party.

While assignment and delegation preserve the original contract's terms and involve partial transfer of rights or duties, novation fully replaces a party and discharges the original obligor. These distinctions reflect the balance between contractual flexibility and the need to maintain clarity and enforceability in obligations.

Assignment and delegation facilitate ongoing contracts by allowing parties to adjust responsibilities without starting over. Novation, by contrast, is suitable for situations requiring a clean break from the original obligor. Together, these doctrines ensure that contracts remain adaptable to evolving circumstances while preserving their integrity and enforceability.

C. Ending Contractual Obligations

The term “modification” generally refers to a specific change to a contract's terms, such as a change to the price, an aspect of performance, or the schedule for performance. Although, conceptually, a modification can include a complete elimination of contractual rights and responsibilities without imposing new ones, this is more typically called “discharge.” This section addresses the four main ways in which parties agree to end contractual obligations.

1. Rescission

Rescission occurs when both parties agree to terminate their contract retroactively, restoring them to their pre-contractual positions. A rescission is the most extreme form of contract discharge because it makes things as if the contract never happened at all. R2d § 283 defines rescission as:

An agreement under which each party promises to discharge all of the other party's remaining duties of performance under an existing contract.

Rescission always requires mutual assent. However, rescission does not require consideration if neither party has performed because the law assumes each party is getting the benefit of being released from that unperformed obligation. (A contract where neither party has yet fully performed is called an “executory contract.”) For example, if a buyer and seller agree to rescind a contract for the sale of a car before either party has performed, the rescission is enforceable without additional

consideration. Or imagine that a landlord and tenant enter a lease agreement. The housing market changes dramatically shortly into the lease term, resulting in the landlord's wishing to rent to someone else and the tenant's wishing to live elsewhere. Here, the parties might mutually agree to rescind their lease, thus restoring them to their pre-contractual positions. Courts may also allow rescission as a remedy in cases involving mistake, misrepresentation, or other equitable grounds.

Like mistake and misrepresentation, a rescission unwinds a contract, as if it never occurred. Rescission ends the contract entirely and restores both parties to their pre-contractual positions. Rescission operates retroactively, undoing the agreement as if it never existed.

An agreement of rescission may be in writing or oral, yet it must be a bilateral act (by both parties) to discharge each other's duties to perform some as-yet unperformed obligation.

2. Release

A release is a unilateral act in which one party relinquishes their right to enforce a contractual obligation, thereby discharging the other party from their duty. Most states require that releases be formalized in writing. Some jurisdictions also require consideration for releases to be enforceable.

A release is a writing providing that a duty owed to the maker of the release is discharged immediately or on the occurrence of a condition. R2d § 284(1).

A release, then, is just a written statement by which one party frees the other party from a contractual duty. Unlike mutual rescission, a release does usually require consideration because it is one-sided and so triggers the preexisting duty rule. In a release, one party is giving up a legal right, but the other party is not necessarily giving anything in exchange.

Traditionally, a release had to be made under seal, which is a type of formal contract that does not require consideration. In modern courts, a release generally must be in writing and supported by consideration. Alternatively, a release may be effective without consideration pursuant to statute or because the released party reasonably relied on the release.

Releases often appear in settlement agreements. For example, imagine that a car accident victim agrees to settle their claim with an at-fault driver for \$50,000. As part of the agreement, the victim signs a release stating that they relinquish any further claims arising from the accident.

3. Renunciation

Renunciation occurs when a party voluntarily abandons or surrenders any right to enforce a contractual claim, effectively discharging the other party's duty to perform with respect to that claim. Under common law, renunciation can be accomplished

without consideration, but the manner in which the renunciation is made determines whether it fully or only partially discharges a duty, per R2d § 277:

(1) A written renunciation signed and delivered by the obligee discharges without consideration a duty arising out of a breach of contract.

(2) A renunciation by the obligee on his acceptance from the obligor of some performance under a contract discharges without consideration a duty to pay damages for a breach that gives rise only to a claim for damages for partial breach of contract.

A written renunciation can thus discharge the obligor's duty arising from a total breach of contract. Even if the obligee receives no additional performance, the signed writing alone suffices to relinquish all claims associated with that breach. For example, if a landlord, after discovering a tenant's violation of the lease, sends a signed letter explicitly stating, "I renounce any right to collect damages for your breach," the landlord's right to recover is discharged in full.

An oral renunciation can only effect a partial breach, meaning that oral renunciation is only effective where the obligee accepts some performance from the obligor. This form of renunciation covers breaches that are not serious enough to constitute a total breach. For instance, if a contractor deviates slightly from building specifications, and the landowner says, "Don't worry about those minor defects—I waive any damages," while still allowing the contractor to complete the job, the landowner's damages claim for partial breach is renounced.

A silent renunciation may be implied in very limited circumstances, particularly if the obligor reasonably relies on such conduct to conclude that the obligee has abandoned the right to enforce damages. If the obligee's words or actions induce the obligor to forego efforts to remedy the breach, a court may treat the obligee's conduct as an enforceable renunciation to avoid injustice.

4. Cancellation

Cancellation refers to the termination of future contractual obligations. It is often exercised unilaterally under specific contractual provisions. The UCC addresses cancellation in the context of goods contracts under § 2-209(4), which states:

A contract modification, rescission, or waiver must meet the requirements of good faith to be binding.

For example, a supplier may cancel a contract with a buyer who fails to make timely payments, provided the contract includes a cancellation clause. Cancellation terminates the parties' future obligations but does not affect rights or duties that have already vested, such as payment for goods delivered before cancellation.

D. Reflections on Modifications and Discharge

By examining how contracts can be altered or discharged through mutual assent, this chapter highlights a central tension in contract law: the desire to honor parties' freedom to bind themselves through promises (*pacta sunt servanda*) while preventing coercive or unjust outcomes. The evolution from strict doctrines like the preexisting duty rule, which once rigidly required new consideration for any modification, to more flexible standards shows how courts have grown sensitive to practical realities. Modern approaches accommodate unforeseeable changes in circumstances and emphasize fairness and good faith. These principles ensure that contracts remain resilient instruments capable of adapting to new conditions without becoming vehicles for exploitation. Ultimately, modification and discharge by assent reflect a broader contract policy, one that values both predictability and flexibility and seeks to foster genuine collaboration between parties rather than blind enforcement of terms that may have become inequitable. Understanding these doctrines not only equips students to navigate contract disputes effectively but also offers insight into the deeper policy considerations that guide courts in shaping a just and efficient legal framework.

Cases

Reading Alaska Packers' Association v. Domenico. Perhaps the most famous case involving the preexisting duty rule is the following one, *Alaska Packers' Association*, in which some sailors refused to work unless they were paid more than they originally bargained for. As you read this case, think about what the preexisting duty rule is and whether it makes sense.

Spoiler alert! The *Alaska Packers' Association* case makes a compelling argument for a strict application of the preexisting duty rule, which states that contracts cannot be modified without new consideration. But more recent case law shows why this rule creates problems of its own. The cases that follow will sharpen your understanding of why the preexisting duty rule has more recently fallen out of favor. But, for now, enjoy this classic case.

Alaska Packers' Association v. Domenico

117 F. 99 (9th Cir. 1902)

ROSS, Circuit Judge.

The libel in this case was based upon a contract alleged to have been entered into between the libelants and the appellant corporation on the 22d day of May, 1900, at

Pyramid Harbor, Alaska, by which it is claimed the appellant promised to pay each of the libelants, among other things, the sum of \$100 for services rendered and to be rendered. In its answer the respondent denied the execution, on its part, of the contract sued upon, averred that it was without consideration, and for a third defense alleged that the work performed by the libelants for it was performed under other and different contracts than that sued on, and that, prior to the filing of the libel, each of the libelants was paid by the respondent the full amount due him thereunder, in consideration of which each of them executed a full release of all his claims and demands against the respondent.

The evidence shows without conflict that on March 26, 1900, at the city and county of San Francisco, the libelants entered into a written contract with the appellants, whereby they agreed to go from San Francisco to Pyramid Harbor, Alaska, and return, on board such vessel as might be designated by the appellant, and to work for the appellant during the fishing season of 1900, at Pyramid Harbor, as sailors and fishermen, agreeing to do "regular ship's duty, both up and down, discharging and loading; and to do any other work whatsoever when requested to do so by the captain or agent of the Alaska Packers' Association." By the terms of this agreement, the appellant was to pay each of the libelants \$50 for the season, and two cents for each red salmon in the catching of which he took part.

On the 15th day of April, 1900, 21 of the libelants signed shipping articles by which they shipped as seamen on the *Two Brothers*, a vessel chartered by the appellant for the voyage between San Francisco and Pyramid Harbor, and also bound themselves to perform the same work for the appellant provided for by the previous contract of March 26th; the appellant agreeing to pay them therefor the sum of \$60 for the season, and two cents each for each red salmon in the catching of which they should respectively take part.

Under these contracts, the libelants sailed on board the *Two Brothers* for Pyramid Harbor, where the appellants had about \$150,000 invested in a salmon cannery. The



Figure 23.1. Cannery at Pyramid Harbor, 1899. Public domain work.

libelants arrived there early in April of the year mentioned, and began to unload the vessel and fit up the cannery.

A few days thereafter, to wit, May 19th, they stopped work in a body, and demanded of the company's superintendent there in charge \$100 for services in operating the vessel to and from Pyramid Harbor, instead of the sums stipulated for in and by the contracts; stating that unless they were paid this additional wage they would stop work entirely, and return to San Francisco.

The evidence showed, and the court below found, that it was impossible for the appellant to get other men to take the places of the libelants, the place being remote, the season short and just opening; so that, after endeavoring for several days without success to induce the libelants to proceed with their work in accordance with their contracts, the company's superintendent, on the 22d day of May, so far yielded to their demands as to instruct his clerk to copy the contracts executed in San Francisco, including the words "Alaska Packer's Association" the end, substituting, for the \$50 and \$60 payments, respectively, of those contracts, the sum of \$100, which document, so prepared, was signed by the libelants before a shipping commissioner whom they had requested to be brought from Northeast Point; the superintendent, however, testifying that he at the time told the libelants that he was without authority to enter into any such contract, or to in any way alter the contracts made between them and the company in San Francisco.

Upon the return of the libelants to San Francisco at the close of the fishing season, they demanded pay in accordance with the terms of the alleged contract of May 22d, when the company denied its validity, and refused to pay other than as provided for by the contracts of March 26th and April 5th, respectively. Some of the libelants, at least, consulted counsel, and, after receiving his advice, those of them who had signed the shipping articles before the shipping commissioner at San Francisco went before that officer, and received the amount due them thereunder, executing in consideration thereof a release in full, and the others paid at the office of the company, also receipting in full for their demands.

...

The real questions in the case as brought here are questions of law, and, in the view that we take of the case, it will be necessary to consider but one of those. Assuming that the appellant's superintendent at Pyramid Harbor was authorized to make the alleged contract of May 22d, and that he executed it on behalf of the appellant, was it supported by a sufficient consideration?

From the foregoing statement of the case, it will have been seen that the libelants agreed in writing, for certain stated compensation, to render their services to the appellant in remote waters where the season for conducting fishing operations is extremely short, and in which enterprise the appellant had a large amount of money invested; and, after having entered upon the discharge of their contract, and at a time when it was impossible for the appellant to secure other men in their places, the libelants, without any valid cause, absolutely refused to continue the services

they were under contract to perform unless the appellant would consent to pay them more money.

Consent to such a demand, under such circumstances, if given, was, in our opinion, without consideration, for the reason that it was based solely upon the libelants' agreement to render the exact services, and none other, that they were already under contract to render.

The case shows that they willfully and arbitrarily broke that obligation. As a matter of course, they were liable to the appellant in damages, and it is quite probable, as suggested by the court below in its opinion, that they may have been unable to respond in damages. But we are unable to agree with the conclusions there drawn, from these facts, in these words:

Under such circumstances, it would be strange, indeed, if the law would not permit the defendant to waive the damages caused by the libelants' breach, and enter into the contract sued upon,—a contract mutually beneficial to all the parties thereto, in that it gave to the libelants reasonable compensation for their labor, and enabled the defendant to employ to advantage the large capital it had invested in its canning and fishing plant.

Certainly, it cannot be justly held, upon the record in this case, that there was any voluntary waiver on the part of the appellant of the breach of the original contract. The company itself knew nothing of such breach until the expedition returned to San Francisco, and the testimony is uncontradicted that its superintendent at Pyramid Harbor, who, it is claimed, made on its behalf the contract sued on, distinctly informed the libelants that he had no power to alter the original or to make a new contract, and it would, of course, follow that, if he had no power to change the original, he would have no authority to waive any rights thereunder. The circumstances of the present case bring it, we think, directly within the sound and just observations of the supreme court of Minnesota in the case of *King v. Railway Co.*:¹

No astute reasoning can change the plain fact that the party who refuses to perform, and thereby coerces a promise from the other party to the contract to pay him an increased compensation for doing that which he is legally bound to do, takes an unjustifiable advantage of the necessities of the other party. Surely it would be a travesty on justice to hold that the party so making the promise for extra pay was estopped from asserting that the promise was without consideration. A party cannot lay the foundation of an estoppel by his own wrong, where the promise is simply a repetition of a subsisting legal promise. There can be no consideration for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their

1. 61 Minn. 482 (1895).

contract. The promise cannot be legally enforced, although the other party has completed his contract in reliance upon it.

In *Lingenfelder v. Brewing Co.*, 103 Mo. 578, 15 S.W. 844, the court, in holding void a contract by which the owner of a building agreed to pay its architect an additional sum because of his refusal to otherwise proceed with the contract, said:

It is urged upon us by respondents that this was a new contract. New in what? Jungenfeld was bound by his contract to design and supervise this building. Under the new promise, he was not to do anything more or anything different.

What benefit was to accrue to Wainwright? He was to receive the same service from Jungenfeld under the new, that Jungenfeld was bound to tender under the original, contract.

What loss, trouble, or inconvenience could result to Jungenfeld that he had not already assumed? No amount of metaphysical reasoning can change the plain fact that Jungenfeld took advantage of Wainwright's necessities, and extorted the promise of five per cent on the refrigerator plant as the condition of his complying with his contract already entered into.

Nor had he even the flimsy pretext that Wainwright had violated any of the conditions of the contract on his part. Jungenfeld himself put it upon the simple proposition that 'if he, as an architect, put up the brewery, and another company put up the refrigerating machinery, it would be a detriment to the Empire Refrigerating Company,' of which Jungenfeld was president.

To permit plaintiff to recover under such circumstances would be to offer a premium upon bad faith, and invite men to violate their most sacred contracts that they may profit by their own wrong.

That a promise to pay a man for doing that which he is already under contract to do is without consideration is conceded by respondents.

The rule has been so long imbedded in the common law and decisions of the highest courts of the various states that nothing but the most cogent reasons ought to shake it. [Citing a long list of authorities.]

...

What we hold is that, when a party merely does what he has already obligated himself to do, he cannot demand an additional compensation therefor; and although, by taking advantage of the necessities of his adversary, he obtains a promise for more, the law will regard it as nudum pactum, and will not lend its process to aid in the wrong.

...

It results from the views above expressed that the judgment must be reversed, and the cause remanded, with directions to the court below to enter judgment for the respondent, with costs. It is so ordered.

Reflection

Alaska Packers' Association is a famous case that is frequently read in law school even though it does not reflect current law. We read this case in part to show how law evolves. In this instance, the law may have evolved because one rule proved to be more costly than an alternative rule. While many different types of costs exist within our legal system, this case illuminates two important ones in particular. First, there are litigation costs, which include the time and money that parties and society spend on attorneys, courtrooms, juries, judges, expert witnesses, consultants, paralegals, etc. Litigation costs are generally lower when rules are simpler because fewer facts are required to evaluate simpler rules. But simpler rules may produce a different type of cost, known as an “error costs.” If a rule is too simple, it may generate what are called Type I and Type II errors. Type I errors, or “false positive” errors, occur when courts find for plaintiffs and require a remedy even where there was no harm. Type II errors, or “false negative” errors, occur when courts find for defendants and refuse a remedy even where there was some harm. Both types of errors result in error costs.

In this case, the simple rule “any contract modification requires new consideration” can result in Type I errors where the party extorted some modification in return for nominal consideration, and it can result in Type II errors where the parties freely and fairly agreed to some modification but did not stipulate any consideration. A more complex standard, such as the modern “fair and reasonable modification” standard found in the R2d and the cases and problems below, may result in fewer error costs. But more complex standards may also require more litigation costs.

There are many costs to consider when evaluating the efficiency of legal rules and systems. When you evaluate legal change, consider whether a new rule probably produces more costs or fewer costs than an old one. A rule which on its face appears to be fairer in theory can turn out to be harsher in practice if it raises costs upon litigants and skews decisions in favor of the rich and powerful. A rule that appears good on its face can be detrimental for society if it generates social costs that exceed its benefits. While efficiency is certainly not the only goal of a legal system, efficiencies merit some consideration, especially in the context of commercial law, such as contract law.

Discussion

1. Do you think that the sailors took unfair advantage of circumstances in this case? If so, why was this case not decided as a matter of breach of the implied duty of good faith and fair dealing?
 2. What does the preexisting duty rule add to the duty of good faith and fair dealing?
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Reading Angel v. Murray. In this next case, a waste disposal company contracted with the City of Newport, Rhode Island, for waste disposal services. Pursuant to the five-year agreement, the waste disposal company was entitled to receive a set amount of money in return for removing all the waste materials generated within the city limits. However, the city's population grew surprisingly and substantially during the contract term. The waste disposal company petitioned the city council for a pay increase to compensate for the additional waste, and the council agreed.

A citizen of Newport named Alfred L. Angel brought a civil action against the city Director of Finance, John E. Murray, Jr., alleging that the city official wrongfully overpaid the waste disposal company. The citizen's argument was based on the preexisting duty rule: the agreement to increase the disposal company's pay was invalid because it was unsupported by new consideration; therefore, the city wrongfully paid the additional amount.

The Supreme Court of Rhode Island disagreed. It found that the contract modification was fair and reasonable under the circumstances of a dramatic and unforeseen population increase that resulted in much greater expense and less profit for the waste disposal company. The council was not coerced or subject to any undue influence. Unlike in *Alaska Packers' Association*, where the Alaska Packers' Association had no commercial alternative but to agree to pay the sailors more than they originally agreed to work for, the city could have hired some other waste disposal company. In this case, there was no coercion or duress.

Moreover, the *Angel* court expressly disavowed the preexisting duty rule:

Although the preexisting duty rule has served a useful purpose insofar as it deters parties from using coercion and duress to obtain additional compensation, it has been widely criticized as a general rule of law.

The *Angel* court goes on to cite the 1963 edition of *Corbin on Contracts*, upon which the R2d was substantially based.

There has been a growing doubt as to the soundness of this doctrine as a matter of social policy. In certain classes of cases, this doubt has influenced courts to refuse to apply the rule, or to ignore it, in their actual decisions. Like other legal rules, this rule is in process of growth and change, the process being more active here than in most instances. The result of this is that a court should no longer accept this rule as fully established. It should never use it as the major premise of a decision, at least without giving careful thought to the circumstances of the particular case, to the moral deserts of the parties, and to the

social feelings and interests that are involved. It is certain that the rule, stated in general and all-inclusive terms, is no longer so well-settled that a court must apply it though the heavens fall.

The UCC, which was principally authored by Corbin's protégé, Llewellyn, completely dispenses with the requirement of consideration for an agreement to modify a contract for the sale of goods.

An agreement modifying a contract within this Article needs no consideration to be binding. NH UCC § 2-209(1).

The R2d contemplates this statutory section, again showing its tendency toward the relaxation of the preexisting duty rule:

A promise modifying a duty under a contract not fully performed on either side is binding to the extent provided by statute. R2d § 89(2).

Harmony between the R2d and UCC continues, with both including an additional exception to the preexisting duty rule where one party reasonably relied on the modification:

A promise modifying a duty under a contract not fully performed on either side is binding to the extent that justice requires enforcement in view of material change of position in reliance on the promise. R2d § 89(3).

The UCC's language is different, but its impact is similar:

A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver. NH UCC § 2-209(5).

We thus see that both the common law and the UCC are moving away from a hardline preexisting duty rule and toward a more flexible standard that allows for greater degrees of freedom regarding mutual assent for contract modification.

Angel v. Murray

113 R.I. 482 (1974)

ROBERTS, C.J.

This is a civil action brought by Alfred L. Angel and others against John E. Murray, Jr., Director of Finance of the City of Newport, the city of Newport, and James L. Maher, alleging that Maher had illegally been paid the sum of \$20,000 by the Director of Finance and praying that the defendant Maher be ordered to repay the city such



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Maher was not entitled to extra compensation because the original contract already required him to collect all refuse generated within the city and, therefore, included the 400 additional units. The trial justice further found that these 400 additional units were within the contemplation of the parties when they entered into the contract. It appears that he based this portion of the decision upon the rule that Maher had a preexisting duty to collect the refuse generated by the 400 additional units, and thus there was no consideration for the two additional payments.

I.

[Part I discusses the first basis for the trial court's decision, that the payment increase was unlawful because it was not requested in writing, but this is not relevant to the contract issue. The appellate court ruled that a written request was not required as a matter of law. Although a statute literally stated that such increases must be in writing, "this court will not undertake to read an enactment literally if to do so would result in attributing to the Legislature an intention that is contradictory of or inconsistent with the evident purposes of the act."]

II.

Having found that the city council had the power to modify the 1964 contract without the written recommendation of the city manager, we are still confronted with the question of whether the additional payments were illegal because they were not supported by consideration.

A

[Omitted.]

B

It is generally held that a modification of a contract is itself a contract, which is unenforceable unless supported by consideration. . . . In *Rose v. Daniels*,² this court held that an agreement by a debtor with a creditor to discharge a debt for a sum of money less than the amount due is unenforceable because it was not supported by consideration.

Rose is a perfect example of the preexisting duty rule. Under this rule an agreement modifying a contract is not supported by consideration if one of the parties to the agreement does or promises to do something that he is legally obligated to do or refrains or promises to refrain from doing something he is not legally privileged to do. In *Rose* there was no consideration for the new agreement because the debtor was already legally obligated to repay the full amount of the debt.

Although the preexisting duty rule is followed by most jurisdictions, a small minority of jurisdictions, Massachusetts, for example, find that there is consideration for a promise to perform what one is already legally obligated to do because the new

2. 8 R.I. 381 (1866)

promise is given in place of an action for damages to secure performance. See *Swartz v. Lieberman*, 323 Mass. 109 (1948) . . . *Swartz* is premised on the theory that a promisor's forbearance of the power to breach his original agreement and be sued in an action for damages is consideration for a subsequent agreement by the promisee to pay extra compensation. This rule, however, has been widely criticized as an anomaly.

The primary purpose of the preexisting duty rule is to prevent what has been referred to as the "hold-up game." [Citing Corbin.] A classic example of the "hold-up game" is found in *Alaska Packers' Ass'n v. Domenico*, 117 F. 99 (9th Cir. 1902). [See *Alaska Packers' Association* case, above.]

Another example of the "hold-up game" is found in the area of construction contracts. Frequently, a contractor will refuse to complete work under an unprofitable contract unless he is awarded additional compensation. The courts have generally held that a subsequent agreement to award additional compensation is unenforceable if the contractor is only performing work which would have been required of him under the original contract. See, e.g., *Lingenfelder v. Wainwright Brewery Co.*, 103 Mo. 578 (1891), which is a leading case in this area.

These examples clearly illustrate that the courts will not enforce an agreement that has been procured by coercion or duress and will hold the parties to their original contract regardless of whether it is profitable or unprofitable. However, the courts have been reluctant to apply the preexisting duty rule when a party to a contract encounters unanticipated difficulties and the other party, not influenced by coercion or duress, voluntarily agrees to pay additional compensation for work already required to be performed under the contract. For example, the courts have found that the original contract was rescinded, *Linz v. Schuck*, 106 Md. 220, 67 A. 286 (1907); abandoned, *Connelly v. Devoe*, 37 Conn. 570 (1871), or waived, *Michaud v. McGregor*, 61 Minn. 198, 63 N.W. 479 (1895).

Although the preexisting duty rule has served a useful purpose insofar as it deters parties from using coercion and duress to obtain additional compensation, it has been widely criticized as a general rule of law. With regard to the preexisting duty rule, one legal scholar [Corbin] has stated:

There has been a growing doubt as to the soundness of this doctrine as a matter of social policy. . . . In certain classes of cases, this doubt has influenced courts to refuse to apply the rule, or to ignore it, in their actual decisions. Like other legal rules, this rule is in process of growth and change, the process being more active here than in most instances. The result of this is that a court should no longer accept this rule as fully established. It should never use it as the major premise of a decision, at least without giving careful thought to the circumstances of the particular case, to the moral deserts of the parties, and to the social feelings and interests that are involved. It is certain that the rule, stated in general and all-inclusive terms, is no longer so well-settled that a court must apply it though the heavens fall.

The modern trend appears to recognize the necessity that courts should enforce agreements modifying contracts when unexpected or unanticipated difficulties arise during the course of the performance of a contract, even though there is no consideration for the modification, as long as the parties agree voluntarily.

Under the Uniform Commercial Code, s 2-209(1) . . . "(a)n agreement modifying a contract (for the sale of goods) needs no consideration to be binding." Although at first blush this section appears to validate modifications obtained by coercion and duress, the comments to this section indicate that a modification under this section must meet the test of good faith imposed by the Code, and a modification obtained by extortion without a legitimate commercial reason is unenforceable.

The modern trend away from a rigid application of the preexisting duty rule is reflected by s 89D(a) of the American Law Institute's Restatement Second of the Law of Contracts, which provides "A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made."

We believe that s 89D(a) is the proper rule of law and find it applicable to the facts of this case. It not only prohibits modifications obtained by coercion, duress, or extortion but also fulfills society's expectation that agreements entered into voluntarily will be enforced by the courts. See generally Horwitz, *The Historical Foundations of Modern Contract Law*, 87 Harv.L.Rev. 917 (1974). Section 89D(a), of course, does not compel a modification of an unprofitable or unfair contract; it only enforces a modification if the parties voluntarily agree and if (1) the promise modifying the original contract was made before the contract was fully performed on either side, (2) the underlying circumstances which prompted the modification were unanticipated by the parties, and (3) the modification is fair and equitable.

The evidence, which is uncontradicted, reveals that in June of 1968 Maher requested the city council to pay him an additional \$10,000 for the year beginning on July 1, 1968, and ending on June 30, 1969. This request was made at a public meeting of the city council, where Maher explained in detail his reasons for making the request. Thereafter, the city council voted to authorize the Mayor to sign an amendment to the 1964 contract which provided that Maher would receive an additional \$10,000 per year for the duration of the contract. Under such circumstances we have no doubt that the city voluntarily agreed to modify the 1964 contract.

Having determined the voluntariness of this agreement, we turn our attention to the three criteria delineated above. First, the modification was made in June of 1968 at a time when the five-year contract which was made in 1964 had not been fully performed by either party. Second, although the 1964 contract provided that Maher collect all refuse generated within the city, it appears this contract was premised on Maher's past experience that the number of refuse-generating units would increase at a rate of 20 to 25 per year. Furthermore, the evidence is uncontradicted that the

1967–1968 increase of 400 units “went beyond any previous expectation.” Clearly the circumstances which prompted the city council to modify the 1964 contract were unanticipated. Third, although the evidence does not indicate what proportion of the total this increase comprised, the evidence does indicate that it was a “substantial” increase. In light of this, we cannot say that the council’s agreement to pay Maher the \$10,000 increase was not fair and equitable in the circumstances.

The judgment appealed from is reversed, and the cause is remanded to the Superior Court for entry of judgment for the defendants.

Reflection

Angel presents a somewhat unusual procedural posture. Note who the parties are in the case: a citizen is suing the director of finance of a governmental entity and a waste management service. The government entity and the waste management service were the parties to the contract. Thus, the parties to the case are not the same as the parties to the contract. In fact, both parties to the contract appear on the same side of the “v.”

The court does not explicitly address whether this unusual posture impacted its disposition, but it stands to reason that it does. The simple fact that both parties to the contract want it to be enforceable tends to show that the alteration to that agreement was not only mutual but reasonable.

Discussion

1. Some scholars say that *Angel* abrogated the preexisting duty rule. Others say that *Angel* merely followed precedent that had already abrogated it. As you read the court’s opinion in *Angel*, did you find that the court was changing the law, or does the court merely recognize that the law about the preexisting duty rule has already changed?
 2. There are similar discussions about whether the R2d (which was drafted around the time that *Angel* was decided) modified the preexisting duty rule in an activist attempt to change judicial outcomes, or whether the R2d was simply restating the law as it had changed. Notably, R2d § 89 (“Modification of an Executory Contract”) is new. The first Restatement of Contracts does not have a parallel provision. Read the comments to R2d § 89 and discuss whether the R2d is merely restating the law as it has changed since *Alaska Packers’ Association*, or whether the R2d is pushing the law in a new direction.
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Reading Birdsall v. Saucier. Remember that contract parties are often not lawyers. They may not even become aware of the legal consequences of some of their actions until their agreement turns into a dispute in court, at which point lawyers and judges have to figure out how the parties' intentions map onto legal concepts.

One concept that parties rarely consider in advance of agreeing to modify a contract is whether they intend to make a substituted contract or an accord and satisfaction. It is the lawyer's job to recognize that the law presumes parties to be making accords, not substitutions, even where the parties do not plainly express their intention to merely suspend, not supersede, a prior agreement.

Birdsall v. Saucier, 1992 WL 37731 (Conn. Super. Ct. Feb. 24, 1992), involves a relatively common situation where a creditor provides its debtor with an alternative way to repay the debt. Such situations are generally regarded as accords, not substitutions, but the reasoning in this case will help you to understand why courts would find one or the other. Admittedly, the *Birdsall* case is a bit long, but it relates the pertinent details of the famous *Pinnel's Case*, and, in this author's opinion, this modern court's discussion of those facts is much more readable than the original case from 1602.

A second concept is distinguishing between a novation, on the one hand, and an assignment or a delegation on the other. This issue will be discussed after the *Birdsall* case.

Birdsall v. Saucier

1992 WL 37731 (Conn. Super. Ct. Feb. 24), *aff'd*, 29 Conn. App. 921 (1992)

JOHN M. BAILEY, Judge.

One of the peculiarities of the common law is that a creditor may accept anything in satisfaction of a liquidated debt except a lesser sum of money. Almost four centuries ago, Sir Edward Coke opined that a creditor might take "a horse, hawk, or robe" if he chose and that would be accord and satisfaction in *Pinnel's Case*.³ The only thing that he may not take is ninety cents on the dollar. The present case involves a modern debtor who did not have a horse, hawk, or robe but did settle a debt with the assignment of a promissory note of a third party. The court holds that this assignment, which was satisfactory to the creditor at the time (much to her present chagrin), was sufficient consideration to satisfy the debt.

Virginia Birdsall is a real estate broker who does business under the names of Birdsall Agency and Birdsall Realty in Middlebury. Roy Birdsall ("Birdsall") is a real estate

3. 77 Eng.Rep. 237 (C.P. 1602).

broker in her employ. Fernando Saucier (“Saucier”) is a real estate entrepreneur who at the time of the events in question was the president and sole shareholder of B & S Realty of Bristol, Inc. (“B & S”). The only substantial asset of B & S, a now-dissolved corporation, was a large office and restaurant building in Bristol. The Birdsalls are the plaintiffs in this action; Saucier and B & S are the defendants. Their dispute was tried to the court on October 17–18, 1991. From the evidence submitted at the hearing, the court finds the following facts.

In the spring of 1985, Saucier wanted to sell the building owned by B & S. He had previously met Birdsall in connection with the sale of some Bristol apartments and, on May 1, 1985, entered into an open listing agreement with the Birdsall Agency to sell the building owned by B & S. This agreement is a written contract signed by Birdsall and Saucier (signing for B & S). The agreement states that “In consideration of your efforts to sell said property, I/we agree that if you are able to procure a customer ready, willing and able to buy said property at a sale price of \$1,275,000 or at a price or terms acceptable to me/us, I/we will pay you a commission of ten % of the gross sale price.” The open listing was to remain in effect for 180 days.

Armed with this agreement, Birdsall went to work. Eventually he found two buyers for the building, Mark Silverstein and Aryeh Shander. On August 6, 1985, Silverstein and Shander signed an agreement with B & S, agreeing to purchase the building for \$1,150,000. The closing was to take place within thirty days. B & S was to pay the Birdsall Agency “whatever commission is due to the broker.”

The closing occurred on August 15, 1985. At some point between August 6 and August 15, Saucier met with Birdsall. Although extensive documentation has been submitted on most aspects of the case, the details of this meeting have been lost in the vague memories of the participants. Birdsall testified that Saucier asked him to take some of his commission (which at 10% of the purchase price would have been \$115,000) in “paper” and some in cash. According to Birdsall it was understood that about half of the commission would be in “paper,” but the terms were not otherwise discussed. Saucier testified in somewhat greater detail. A few days before the closing he realized that very little cash would be left after closing costs. He approached Birdsall and told him that if the closing were to go through, arrangements would have to be made. Birdsall said (according to Saucier) “I don’t need money. I’d rather take payments.” He said that he would take a third mortgage on the property in question. He (Birdsall) further said that he felt very comfortable and confident taking payment from the doctors. (Silverstein and Shander were physicians.) Saucier agreed with Birdsall’s testimony that the exact terms of payment were not discussed. Saucier’s testimony was amply corroborated by the events about to be described. The court finds it credible.

Birdsall and Saucier were both present at the closing. The building, of course, was purchased by Silverstein and Shander for \$1,150,000. As part of this purchase price, they assumed a mortgage to one Nathan Mafale in the amount of \$560,000. A second mortgage was given to Saucier in the amount of \$295,000. (For reasons never

explained to the court, the proceeds of the sale were paid to Saucier personally rather than to B & S.) The Birdsall Agency received a check in the amount of \$29,500, which it subsequently endorsed and deposited. The balance of Birdsall's compensation was what the parties termed "paper." The documents constituting this compensation must be described in some detail.

Silverstein and Shander gave a third mortgage to Saucier in the amount of \$73,000. This was accompanied by a mortgage note in the same amount. The note provided for quarterly payments of interest for five years commencing on January 1, 1986. The interest specified was ten percent per annum, and the quarterly interest payments were consequently \$1,825. At the end of this period, on August 1, 1991, the unpaid principal balance was to be paid in full. The note expressly provides that its obligations "shall be without personal recourse against any individual, partnership or corporate maker and the mortgagee's sole recourse in the event of a default shall be against the mortgaged property." At the closing, Saucier assigned his entire interest in this note to Birdsall.

At or shortly after the closing (Saucier testified that it was within a week) Birdsall gave B & S a written receipt. The receipt acknowledges the payment of \$29,500 as a commission for the sale to Silverstein and Shander and the assignment of the \$73,000 note. It concludes with the words "Commission paid in full." It is signed by Birdsall.

Birdsall thus received a cash payment of \$29,500 and a \$73,000 note. The sum of these two amounts is \$102,500. This is not the sum that was originally to have been Birdsall's fee. That original sum was to have been \$115,000 (ten percent of the \$1,150,000 purchase price).

In other words, Birdsall, on the face of it, received \$12,500 less than he was due.

On the stand, however, Birdsall expressly disavowed any claim to the \$12,500 difference. He certainly registered no complaint at the time. As just recounted, he gave B & S a receipt stating that his commission had been "paid in full." There is no evidence whatsoever of any contemporaneous dissatisfaction with this arrangement. The court finds that Birdsall—and, by inference, his employer, Virginia Birdsall (who did not testify)—was satisfied with what he received.

Perhaps the reason for this lies in simple mathematics. Had the note from Silverstein and Shander been fully paid, Birdsall would have received \$22,500 in interest payments plus \$73,000 in principal (admittedly after a delay of five and a half years). These payments when added to the \$29,500 check that Birdsall received at the closing, would have equaled \$125,000, or \$10,000 more than he was originally entitled to receive. Of course, Birdsall was also aware from his previous meeting with Saucier that, if he had not been willing to take part of his compensation in "paper," the closing would not have gone through and his practical ability to collect the fee he was legally owed might well have been seriously impaired. It is a fair inference from these facts that there was a meeting of the minds between Birdsall and Saucier that the \$29,500 in cash and the assignment of the \$73,000 note were to constitute full satisfaction of any claim for commission against Saucier that Birdsall might have.

In any event, the building was sold, and Birdsall had his check and his “paper.” Birdsall proceeded to contentedly collect his interest payments from Silverstein and Shander for three years. Then, Birdsall’s bargain melted into the air. The last interest payment paid was that of January 1, 1989 (apparently paid sometime in December 1988). On April 1, 1989, Birdsall’s mailbox was as bare as Mother Hubbard’s cupboard. So, for that matter, was Saucier’s. (Saucier was owed a substantially greater amount on his second mortgage.) Demands to Silverstein and Shander from all quarters proved fruitless. Nothing was paid thereafter.

At some point after the default, Saucier asked Birdsall to find a new buyer for the building. Birdsall was eager to do this since a sale of the building might result in the payment of his \$73,000 note. Nothing, however, was put in writing between Saucier and Birdsall, and as far as the record indicates, the owners of the building, Silverstein and Shander, were wholly unaware of this arrangement at the time. Birdsall eventually found an interested purchaser, one Anthony Rugens. On October 25, 1989, Rugens signed a written offer to purchase the building for \$25,000 plus the assumption of all indebtedness (including the indebtedness to Birdsall). Silverstein and Shander, however, never signed the offer. On October 27, 1989, Saucier’s attorney signed a complaint commencing a foreclosure action against them. *Saucier v. Silverstein*, No. CV-89-0437356S (Hartford-New Britain J.D.).

The Birdsalls allege in their complaint that Saucier told Birdsall that he did not wish to have the building sold during or after the foreclosure action and that if Birdsall stopped his effort to sell the property, Saucier would pay him the \$73,000. No credible evidence has been advanced to support this claim. On the contrary, Saucier testified that he planned the foreclosure action independently, and that Rugens independently decided not to pursue his bid until the foreclosure was over so that Birdsall would be out of the picture. Rugens did not testify. The court finds Saucier’s testimony on this matter credible.

Because of his interest in the premises, Birdsall was named as a co-defendant in the foreclosure action. On June 18, 1990, a judgment of strict foreclosure was entered. Because the value of the property was by now greatly diminished, Birdsall’s note and mortgage were rendered worthless. His mortgage was not redeemed. On March 22, 1991, the Birdsalls commenced the present action.

The complaint is in three counts. The first count seeks recovery of \$73,000 as the allegedly unpaid balance of the plaintiffs’ commission for their services under the open listing agreement of May 1, 1985. The second count alleges that Saucier is liable for the unpaid debts of B & S (which dissolved shortly after the 1985 closing) and that one of these debts is the \$73,000 owed to the plaintiffs. The third count alleges that Saucier breached his agreement to pay Birdsall \$73,000 if Birdsall dropped his efforts to sell the building at the time of the foreclosure. As already noted, the factual basis of the third count has simply not been established, and that count will not be further discussed. Because the first two counts involve the same underlying debt, they can be conveniently discussed together. As an affirmative defense to the first two counts,

the defendants have pleaded accord and satisfaction. The court finds that defense to be established.

“An accord is a contract between creditor and debtor for the settlement of a claim by some performance other than that which is due. Satisfaction takes place when the accord is executed.” An accord, however, is an agreement, and an agreement will not be considered binding by the courts unless it is supported by consideration.

At an early date in English history it was held that a creditor could not take five pounds in satisfaction of a fifteen pound debt because he received no consideration for the other ten pounds. *Cumber v. Wane*, 93 Eng.Rep. 613 (1718); *Pinnel's Case*, *supra*. From the day this rule was announced, however, it has been recognized that dictates of fairness and considerations of business require that the rule be subject to certain exceptions. One well known exception is that an accord may be made “when there is a good faith dispute about the existence of a debt or about the amount that is owed.” That exception is not applicable here. There are, however, other well-established exceptions that are highly relevant to the instant case.

It was, in the first place, recognized in *Pinnel's Case* itself that, while a lesser sum cannot be satisfaction for a greater sum, “the gift of a horse, hawk, or robe . . . in satisfaction is good.” 77 Eng.Rep. at 237. From that day to this, it has not been doubted that,

A liquidated money demand may, with the consent of the parties, be discharged by the delivery of property in payment thereof or by delivery of part money and part property; if the latter is received by the creditor in full discharge of the indebtedness, there is a good accord and satisfaction. The relative value of the property is immaterial as affecting the validity of the accord and satisfaction.

1 Am.Jur.2d Accord and Satisfaction Sect. 40 (1962).

This exception has long been acknowledged in Connecticut. In *Warren v. Skinner*, 20 Conn. 559 (1850), which recognized both the ancient English rule and its traditional exceptions, it was stated that an agreement in satisfaction of a debt will be recognized when it “rests on a new and adequate consideration; as where the debtor pays a part of the debt . . . in a collateral article, agreed to be received in full payment.” The Connecticut Supreme Court subsequently found this exception applicable in *Rose v. Hall*, 26 Conn. 392 (1857) (holding a combination of bills of exchange and cloth to be adequate consideration), and *Bull v. Bull*, 43 Conn. 455 (1876) (holding a debt to be satisfied by the payment of some pictures).

Of course, not every debtor has a stock of cloth or pictures handy to pay off his debts. Commercially sensible arrangements are acceptable as well. In particular, it is well established that “[t]he acceptance, by a creditor, of the note of a third person, in satisfaction of an existing debt, is an extinguishment of such original indebtedness, and constitutes a good accord and satisfaction thereof, whether the note be for the full amount of the debt, or for a lesser sum.”

This latter exception has been recognized in Connecticut for over a hundred years. In *Argall v. Cook*, 43 Conn. 160, 166 (1875), it was held that a note endorsed by a third person may be taken in accord and satisfaction of a debt even when the note is for a lesser amount. The Supreme Court [of Connecticut] explained that, “The additional security which [the creditor] received by the indorsement was a sufficient legal consideration for the discharge.” *Id.*

Birdsall argues that the assignment here cannot extinguish the underlying debt unless it amounts to a novation. This is not, however, the case.

“‘Novation’ is a term usually used to refer to instances in which a new party is introduced into a new contract.” A novation “creates a new contractual duty.” 15 Samuel Willison, *A Treatise on the Law of Contracts* Sect. 1865 at 590 (3d ed. 1972). A substitution of a new creditor brought about by an assignment “is seldom referred to as a novation.” 6 Arthur Corbin, *Corbin on Contracts* Sect. 1297 at 216 (1962). “Thus,” as Corbin explains, “if we suppose that A owes B \$100, B can assign his right to C, without A’s assent.” *Id.* That is exactly what happened here.

The real question here is a factual one: did the parties—i.e. Birdsall and Saucier—agree that the settlement agreement itself constituted satisfaction of the original cause of action or did they instead agree that the performance of the agreement was to be the satisfaction. This depends entirely “upon the intention of the parties.” While there is “a strong presumption that the plaintiff would not, claiming a substantially undisputed amount to be due her, accept a mere promise to pay a much smaller sum in discharge of the larger amount,” *id.*, that presumption is not applicable here, and to the extent that it is applicable, it is overcome by the facts.

Here, Birdsall did not “accept a mere promise to pay a much smaller sum in discharge of the larger amount.” As explained above, the note that he accepted, had it been fully paid, would have given him a larger sum at the end. In any event, there is no credible evidence that either party intended that the original debt of Saucier to Birdsall was to continue after the assignment of the note. There is, in contrast, credible evidence that both parties intended that the original debt was to be extinguished by the assignment. Were the facts otherwise, Birdsall—an experienced real estate broker—would not have given Saucier a written receipt stating “commission paid in full.” It bears repeating that Birdsall was willing to do this because he wanted to save the deal and knew that a bird in the hand was worth two in the bush.

Birdsall was satisfied with the monetary payment of \$29,500 and the note assigned to him by Saucier. He took money from Silverstein and Shander for three years without complaint. The debt that B & S owed to Birdsall was extinguished, and both parties intended it to be so. By any measure, the assignment of the note constituted a new and valid consideration. When Birdsall signed his receipt “commission paid in full,” there was accord and satisfaction. Because of this he cannot now recover against the defendants no matter how bad his bargain has turned out to be.

Judgment shall enter for the defendants.

Reflection

A substituted contract immediately replaces an old obligation with a new one. An accord and satisfaction, on the other hand, does not immediately destroy the old obligation but merely suspends it until the promised accord has either been performed, in which case the remaining duties are discharged, or breached, in which case the obligee can select to sue either for breach of the new accord or for breach of the old obligation.

The *Birdsall* court assumes that parties in this case intend an accord, not a substitution. This is the default assumption when a debtor agrees to be paid something less than the full amount claimed. The thinking is that obligees do not reduce their rights for no reason, so courts should interpret purported contractual modification as intended to make the obligee better off in some way.

Discussion

1. The law of contracts purports to codify reasonable parties' intentions when bargaining. The law of sales, in particular, is said to have developed from custom amid merchants' guilds. In this way, contracts rules such as the presumption that parties generally intend to make an accord and satisfaction instead of a substituted contract function as default rules. But does this rule reflect ordinary intentions?
2. Consider whether you had any notion of "accord and satisfaction" before taking this course. If you were Saucier and had no knowledge of the R2d's default presumption, would you have presumed that you were entitled to payment on the old note until you received payment of the new one? Or would you have intended to give up your rights to the old note in exchange for rights to the new one?

Problems

Problem 23.1. Fair and Reasonable Modification

Angel dismisses the preexisting duty rule and replaces it with the ability to modify a contract on fair and equitable terms. Do you think this case moves the law in the right or wrong direction? Discuss and explain your position.

Problem 23.2. Accord and Satisfaction

Birdsall explains why the court believed parties generally intend an accord and satisfaction, and not a substituted contract, when one party agrees to take less than

it was owed under the original contract. Do you agree with this presumption, or is it misplaced? In answering this question, make sure to explain the difference in form and function between a substituted contract, on the one hand, and accord and satisfaction, on the other. Then discuss what merits a presumption that the parties intended to engage in one of these two forms.

MODULE VI

Remedies

What happens when promises fail? The term “remedy” comes from the Anglo-French concept of curing a wrong, and in contract law, remedies restore balance when expectations are broken. Imagine a contractor who vanishes before completing a project or a supplier who fails to deliver essential goods. Courts use remedies to address these breaches.

In crafting remedies, courts have significant discretion and seek to balance a variety of interests. On the one hand, courts seek to compensate the injured party and deter future promise breaking by providing a remedy that approximates the loss the injured party suffered due to the breach. On the other hand, courts strive to ensure a fair outcome overall and grant just remuneration to both parties for any benefits they conferred, to the extent possible.

At its core, contract law aims to protect three interests. First, the **expectation interest** is the injured party’s interest in receiving the benefit of their bargain. Second, the **reliance interest** is the injured party’s interest in being reimbursed for losses they incurred as a result of relying on a promise. Third, the **restitution interest** is either party’s interest in having returned to them the value of benefits they conferred on the other party, in order to avoid **unjust enrichment**.

The R2d spells out the three interests protected through contract remedies:

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

- (a) his “expectation interest,” which is his interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed,*
- (b) his “reliance interest,” which is his interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as he would have been in had the contract not been made, or*
- (c) his “restitution interest,” which is his interest in having restored to him any benefit that he has conferred on the other party. R2d § 344.*

Crucially, even though they overlap, these three interests are typically mutually exclusive. A court typically designs a remedy to protect only one of them. The expectation interest usually takes precedence. If courts tried to protect all three interests at the same time, they would likely end up giving the plaintiff a windfall (overcompensation) by awarding the plaintiff multiple recoveries for the same harm.

Even though ordering a breaching party to perform their promise might seem like the most natural way to remediate a breach of contract, courts rarely grant **specific performance**. Instead, contract law typically protects these interests by awarding money damages. The purpose of contract damages is usually to protect the injured party's expectation interest by giving them the financial benefit, though not the literal benefit, of their bargain. That said, courts are empowered to grant a variety of remedies, ranging from ordering a party to pay money due under a contract to ordering a party to perform their promises (specific performance).

The judicial remedies available for the protection of the interests stated in § 344 include a judgment or order

- (a) awarding a sum of money due under the contract or as damages,*
- (b) requiring specific performance of a contract or enjoining its non-performance,*
- (c) requiring restoration of a specific thing to prevent unjust enrichment,*
- (d) awarding a sum of money to prevent unjust enrichment,*
- (e) declaring the rights of the parties, and*
- (f) enforcing an arbitration award. R2d § 345.*

This module systematically explores the primary judicial remedies in contract law. Chapter 24 introduces students to contract remedies by analyzing what happens when one party completely fails to perform. **Expectation damages** are the primary remedy for nonperformance; they are calculated based on the expectation interest (the net benefit of the bargain). However, in some cases, the injured party may seek **reliance damages** as an alternative, especially when expectation damages are difficult to prove. When awarding damages for the breach of contract, courts must ensure that the injured party is fairly compensated for the total collapse of the contract.

Chapter 25 deepens the analysis by exploring scenarios where performance is defective but not entirely absent. In these cases, where promises are partially fulfilled, courts must determine how to compensate the injured party for the loss in value due to the defective performance. Expectation damages in defective performance cases usually take the form of either the cost of repair or completion, or the diminished value of the performance. You will learn how to assess which of these measures is most appropriate in various situations.

Chapter 26 shifts to the legal limits on damages. Not all damages are recoverable, and this chapter examines how the law has evolved to impose limits on a plaintiff's damages for breach of contract. Doctrines such as foreseeability, certainty, and avoidability (also known as the "duty to mitigate") are explored. These limits are critical in practice because they can significantly reduce the amount of damages a party can recover.

Chapter 27 examines non-monetary remedies. It explores how courts use remedies such as specific performance, rescission, and restitution to address situations where financial compensation alone is insufficient. Although monetary remedies are the most common, this chapter equips students with the tools to recognize when a non-monetary remedy may be warranted.

Finally, Chapter 28 discusses remedies for third parties. Under traditional contract law, the **privity rule** held that only parties to a contract had rights to sue under it. The rationale was that contracts are private agreements, and only parties who explicitly agreed to be bound by the terms should have rights to enforce them. However, modern contract law has developed exceptions to this rule, occasionally granting remedies to third parties whom the contract parties intended to benefit. The modern rationale is that when parties manifest mutual assent to confer rights on third parties, those intended beneficiaries should be able to seek remedies under the contract.

Together, these chapters provide a comprehensive understanding of contract remedies. By examining how courts balance compensation, predictability, and fairness, students will gain insight into how contract law resolves disputes while upholding its central goal of ensuring that agreements are enforceable.

Chapter 24

Money Damages for Nonperformance

Imagine you entered a contract with the city to rent its largest event hall for your annual charity gala. You arrive on the agreed-upon date only to find the venue locked and deserted—no staff, no explanation, and no alternate arrangement. Your event is set to begin within hours, so your losses are significant: you may have to scramble for a last-minute venue at a much higher price or cancel the gala outright, which would render meaningless your months of planning as well as jeopardize ticket sales and donor goodwill.

This situation exemplifies total nonperformance, where the breaching party provides nothing that they promised under the contract. In response, courts typically award expectation damages, which aim to give you the benefit of the bargain—the position you would have occupied had the city fully performed. For instance, you might recover the difference in cost between the agreed-upon event hall and whatever “cover” arrangement you manage to secure at the eleventh hour, along with any lost profits you can reasonably demonstrate (such as refunded ticket sales). But if your expected gains are too uncertain to calculate, you might instead pursue reliance damages, which reimburse out-of-pocket expenses like marketing fees or deposits you paid in reliance on the city’s promise.

Because expectation damages protect the expectation interest, they stand as the default remedy in contract law. Yet the law stops short of allowing recovery beyond the economic value of the contract itself. Punitive damages, designed to punish wrongdoing, generally do not apply, even if the breach is deliberate or feels morally troubling. One notable outgrowth of this limit is the idea of efficient breach: a party might choose to breach deliberately when a more lucrative opportunity arises, provided that it pays the injured party’s expectation damages. Returning to the gala example, if the city rents the hall to a major corporate client offering ten times your rental fee, the law permits that *efficient* outcome as long as you are fully compensated for foreseeable losses—though many find this notion *morally* unsettling.

This chapter explains in detail how courts calculate expectation damages in cases of total nonperformance, including direct losses (like the increased price you pay for a last-minute venue) and indirect or consequential losses (such as rush service fees or lost donations). It then examines reliance damages as an alternative when the benefit

of the bargain is too speculative to prove. Finally, it discusses how the UCC frames these same concepts in the sale-of-goods context, using formulas that apply when a buyer or seller fails to perform. By understanding how money damages address a complete failure to perform, students will develop a strong foundation for examining incomplete or defective performance, limitations on damages, and the possibility of non-monetary remedies, which are covered in the chapters that follow.

Rules

A. Expectation Damages

Expectation damages compensate the injured party for the value of the performance they reasonably anticipated. The goal is to place the injured party in the same position they would have occupied if the contract had been performed without breach.

Courts calculate expectation damages by combining four components: **loss in value**, **incidental damages**, **consequential damages**, and **costs avoided**. The sum of the first three components, minus any costs avoided, yields the final damages award.

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. R2d § 347.

Expectation damages are typically divided into **direct damages**, the direct loss in value the plaintiff suffers due to the nonperformance, and **indirect damages**, the indirect losses flowing from the breach, including both incidental and consequential damages.

1. Direct Expectation Damages (Direct Loss in Value)

Direct damages, also called “general damages,” encompass the direct loss in value plaintiff experiences as a result of the breach. Direct damages approximate the gap between the performance promised under the contract and what the injured party actually received. If no performance occurs at all, the loss in value is total because the plaintiff received nothing.

Importantly, though, this does not mean the plaintiff gets the full value of what was promised. The reason is that plaintiffs typically find a substitute performance—meaning that they “cover” by finding another contractor to deliver the same or equivalent goods or services. And the law typically imputes on plaintiffs a duty to cover (mitigation is addressed in Chapter 26.) Thus, even if a plaintiff does not cover, their damages

will typically be subtracted by the **market price** of the same or equivalent goods or services.

As a result, the way courts usually calculate direct expectation damages due to total nonperformance is by giving the plaintiff the difference between the contract price and the price of a substitute performance. The substitute performance is either the cost of the cover that the plaintiff actually secures or the cost of the cover that the plaintiff could reasonably secure on the open market.

For example, suppose that Landowner hires Builder, a construction company, to construct a barn for a total price of \$100,000. Builder breaches by unjustifiably terminating the contract before any work is done. Landowner is able to find a new contractor to build the barn for \$120,000. What amount would put Landowner in the same position Landowner would occupy if the contract had been performed? The answer is \$20,000, the difference between Landowner's cost of cover (\$120,000) and the contract price (\$100,000).

Note that even if Landowner did *not* cover by hiring this substitute builder, Landowner's damages would still likely have been subtracted by \$120,000, assuming that a substitute contractor were reasonably available at that price on the open market.

If Landowner finds a substitute Builder at the same \$100,000 price—meaning that Landowner manages to cover at the contract price—then the loss in value is *zero*, though Landowner may still recover other damages if they incur additional costs tied to the breach.

What if Landowner finds a substitute Builder for only \$90,000 on the open market? If so, Landowner's damages may be negative, so zero. Landowner entered what is called a “losing contract.” Landowner might obtain “nominal damages”—symbolic damages in the amount of, say, \$10—in order to demonstrate that a party prevailed. But Landowner cannot recover more as a result of the breach than they could have recovered had the contract been performed.

2. Incidental Damages

Incidental damages cover reasonable expenses the injured party incurs while reacting to the breach, such as costs for arranging substitute performance, storing rejected goods, or expediting delivery. In other words, incidental damages are expenses that the injured party incurs from mitigating (reducing) the harm caused by the breach. As you will learn in Chapter 26, plaintiffs are required to use reasonable efforts to mitigate the breach, or else their recovery will be reduced accordingly. Thus, the law compensates plaintiffs for those mitigation efforts.

Imagine that Landowner, who owns several horses, incurs \$2,000 renting a space to house the horses while the building of a new barn is delayed due to the Builder's breach. These costs qualify as incidental damages if they are reasonable and directly related to the breach. However, if the Landowner spent \$10,000 sending the horses on

a tour of the world, those costs would not be incidental damages, as they lack a direct connection to the breach.

3. Consequential Damages

Consequential damages address losses resulting from the injured party's special circumstances, provided that the breaching party had reason to foresee those losses at the time of contracting. For example, if a homeowner contracts to fix a leak in her roof prior to the rainy season, and the roofing company breaches, the homeowner might seek compensation for damage to her wooden floors when rain seeps into her home.

A common form of consequential damages is lost profits, meaning the profits a party loses as a result of the breach due to particular circumstances of which the breaching party is aware. The famous case *Hadley v. Baxendale*, 56 Eng. Rep. 145, 9 Exch. 341 (1854), which deals with lost profits, appears in Chapter 26. In *Hadley*, a mill was stopped due to a broken shaft. The mill owner contracted with a transportation company to arrange delivery of a replacement shaft, but the delivery was delayed. The question in the case was whether the mill could obtain the lost profits caused by the mill being stopped during the period of the delay.

As you will learn in Chapter 26, consequential damages—and indeed all forms of contract damages—are limited by the doctrine of foreseeability. The damages must have been reasonably foreseeable to the breaching party at the time of contracting or else they cannot be recovered. In *Hadley*, the court held that the lost profits due to the delay in delivering the mill shaft were not recoverable because the transportation company had no reason to know the mill was stopped.

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. R2d § 351.

If the injured party is able to cover by finding a substitute performance, then they are unlikely to suffer lost profits. Indeed, parties have a duty to mitigate their losses by covering where it is reasonably feasible to do so. But sometimes, it is not possible to obtain a substitute performance or there is an unavoidable delay in finding a substitute performance, and the injured party suffers losses as a result.

Return to the example of the landowner who is seeking to build a barn. Imagine Landowner informed Builder at contract formation that the barn was going to be used as the base for Landowner's new walnut farming operation and that the farm was scheduled to begin operations in October. Builder's failure to build the barn delays the opening of the farm until December, and Landowner is unable to sell nearly as many walnuts as planned. Landowner's lost profits from the missed walnut sales may be recoverable as consequential damages. However, if Landowner never mentions the walnut farming operation or that the barn was essential for making walnut sales, the lost profits would be too unforeseeable to be recoverable as consequential damages.

Moreover, if Landowner could easily have covered (for instance, by hiring another contractor to build the barn), then these avoidable losses would not be recoverable.

4. *Costs Avoided*

Costs avoided reduce the final damages award by accounting for expenses the injured party saved as a result of the breach. This prevents overcompensation. Parties should not gain a windfall due to a breach. The non-breaching party is entitled only to the expected benefit of the bargain.

Damages based on the injured party's expectation interest are reduced by any cost or other loss that he has avoided by not having to perform. R2d § 347(c).

You already saw this principle at work in the direct “loss in value” calculation above. Remember that the injured party in a breach of contract case does not typically get the full value of the lost performance. They get the value of the lost performance *minus* the contract price they would have had to pay. Thus, the loss in value formula typically automatically incorporates avoided costs by subtracting out the contract price.

However, sometimes, there are additional avoided costs to consider. For example, imagine Landowner would have had to spend the contract price of \$100,000 plus an extra \$3,000 to hire a bulldozer to clear the land around the barn. Because Builder breaches, Landowner does not have to pay Builder the contract price of \$100,000 or the extra \$3,000 for the bulldozer. Instead, Landowner is able to cover by hiring a different contractor, who is willing to do the whole job for \$120,000, including the bulldozing for no extra fee. Landowner's damages would be \$120,000, minus the contract price of \$100,000 and minus the \$3,000 saved on bulldozing. The result is \$17,000 in expectation damages. This example shows how avoided costs can significantly reduce recovery and must be accounted for in the damages formula.

The burden is on the defendant to prove costs avoided. Thus, in this example, the burden would be on *Builder* to prove these save costs. If Builder is unable to provide supporting evidence, the court is unlikely to treat this as a cost avoided because it is too speculative.

In sum, the formula for calculating expectation damages can be stated as:

$$\text{Expectation Damages} = \text{Loss in Value} + \text{Incidental Damages} \\ + \text{Consequential Damages} - \text{Costs Avoided}$$

Let us apply this formula to the case. Assume Landowner contracted with Builder to build the barn at a price of \$100,000. Builder fails to show up. Landowner eventually is able to find another contractor to do the job for \$120,000. Landowner incurs an additional \$2,000 in housing the horses during the period of the delay. Landowner does not, however, incur the \$3,000 cost to hire a bulldozing company, since this service is now included in the new cover contract. Additionally, Builder knew the barn was to be used for Landowner's walnut farming operation and that Landowner

would lose walnut sales if the barn's construction were delayed. Landowner can prove the farm lost \$5,000 in walnut sales as a result of the delay.

The damages calculation would be:

Loss in Value: \$20,000 above contract price for substitute contractor
 ("cost of cover" minus contract price)
+ Incidental Damages: \$2,000 (housing the horses)
+ Consequential Damages: \$5,000 (lost walnut sales, if foreseeable)
– Costs Avoided: \$3,000 (canceled bulldozing costs)
= Total Damages = \$20,000 + \$2,000 + \$5,000 – \$3,000 = \$ 24,000

This formula ensures that the injured party is fully compensated for the loss of their bargain while avoiding overcompensation. By addressing each component systematically, courts aim to replicate the position the injured party would have occupied if the contract had been fully performed.

B. Reliance Damages

Reliance damages offer an alternative route for recovery when expectation damages are difficult to measure. These damages focus on reimbursing the injured party for costs incurred in preparing for or partially performing under the contract. Crucially, plaintiffs cannot typically get both reliance and expectation damages. Instead, reliance damages are utilized as an alternative, when the plaintiff cannot prove their expectation damages or when, for some reason, none are recoverable under the contract.

Reliance damages aim to restore the injured party to their pre-contract position. They do not attempt to provide the benefit of the bargain but instead focus on undoing losses incurred while relying on the other party's promise. This makes them particularly useful when expectation damages are speculative or impossible to calculate.

Damages based on reliance interest include expenditures made in preparation for performance or in performance, minus any loss the injured party would have suffered if the contract had been fully performed. R2d § 349.

Consider a homebuyer who spends \$5,000 hiring an interior decorator to draw up plans for decorating a new home after signing a contract for the purchase of a house. Seller fails to deliver the house, leaving Homebuyer without need of the interior decorator's plans. No money has changed hands, and Homebuyer could purchase a nearly identical property on the open market, so her expectation damages are zero. But Homebuyer may in the alternative seek reliance damages for her \$5,000 decorator costs. These expenses are directly tied to Homebuyer's reliance on Seller's promise to deliver the home.

On the other hand, suppose Homebuyer spends \$20,000 on an unrelated interior design project that has no connection to the promised house. Since this expenditure

does not arise from the supplier's breach, it is not recoverable as reliance damages. Courts require a clear causal link between the costs incurred and the breached promise. The injured party must prove causation by showing that the expenditures resulted directly from the contract.

Importantly, reliance damages are subject to the same limitations as expectation damages. As discussed Chapter 26, in order to prevent overcompensation, courts do not award damages that are not foreseeable, that are not provable with reasonable certainty, or that the plaintiff could have avoided by taking reasonable steps to mitigate their losses. Thus, reliance costs must be foreseeable, provable, and not easily avoidable.

For example, in the illustration above, if Homebuyer could easily have obtained a refund from the decorator, then the decorator's fees would not be recoverable from Seller. Or imagine that the decorator's plans were easily salvageable because they could just as well have been used in a substitute home. These losses might not be recoverable from Seller either. The injured party has a duty to mitigate their losses by taking reasonable steps to salvage or recoup their expenditures.

A final point to understand is that, in general, courts hold that reliance damages cannot exceed the benefit that the injured party would have received if the contract had been fully performed. This limitation ensures that reliance damages do not create a windfall for the injured party.

Damages are not recoverable for loss that the injured party would have suffered even if the contract had been performed. R2d § 349.

For instance, if Homebuyer, in anticipation of the home sale contract, spent \$100,000 on new furniture for the new home, and the value of the house itself was \$50,000, the Homebuyer's reliance damages would not encompass the full \$100,000. Even assuming this expenditure on furniture were foreseeable, provable, and not easily salvaged (such as through returning or reselling the new furniture), a recovery of \$100,000 would overcompensate the plaintiff because it would put the plaintiff in a better position than if the contract were performed. Instead, Homebuyer would obtain a maximum of \$50,000—the expenditures made in reliance on the contract (\$100,000), less the contract price which the Homebuyer no longer has to pay (\$50,000).

Reliance damages aim to restore the injured party to the position they would have been in had the contract not been made, without granting them more than they reasonably anticipated gaining. This formula can be expressed as:

$$\text{Reliance Damages} = \text{Expenditures Made} - \text{Loss Avoided}$$

Reliance damages offer a practical solution when expectation damages are uncertain, focusing on fairness and the actual costs incurred by the injured party. By ensuring that recovery is closely tied to the breach, courts prevent overcompensation while providing meaningful relief.

C. UCC Remedies

When a contract involves the sale of goods, the UCC refines expectation and reliance principles to address the realities of commercial transactions. This section translates those core concepts into specific remedies for buyers and sellers. It explains how aggrieved buyers may recover damages through cover, market price damages, and incidental/consequential damages. It then discusses how breaching buyers may be liable for the seller's resale damages, market price damages, or lost profits.

1. Buyer's Remedies

The remedies available to buyers under the UCC ensure buyers can secure substitute goods or recover financial losses directly tied to the breach. Tools like cover and market price damages are designed to reflect the buyer's need to mitigate damages by obtaining substitutes, while incidental and consequential damages account for the broader impacts of the seller's failure to perform.

a. Cover

Buyers who do not receive goods may obtain substitutes in a reasonable manner and then recover the difference in cost, if any, from the breaching seller.

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. 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, but less expenses saved in consequence of the seller's breach. NH UCC § 2-712.

For example, suppose a clothing retailer contracts to purchase one hundred hand-made scarves at \$25 each. When the seller fails to deliver the scarves, the retailer covers by paying \$30 each to secure the same scarves from another supplier. The loss in value is \$5 per scarf, resulting in \$500 total.

If the retailer finds substitute scarves at the same \$25 price—meaning that the retailer manages to cover at the contract price—then the loss in value is *zero*, though the retailer may still recover other damages if they incur additional costs tied to the breach.

What if the retailer finds substitute scarves for only \$20 on the open market? If so, the retailer's damages may be *negative*. The retailer entered what is called a "**losing contract**." The retailer might obtain nominal damages, or symbolic damages, in the amount of, say, \$10, in order to demonstrate that a party prevailed. But the retailer cannot recover more as a result of the breach than she could have recovered had the contract been performed.

**Cover Damages = Cost of Cover – Contract Price + Incidental Damages
+ Consequential Damages – Expenses Saved**

Here is a hypothetical that demonstrates this calculation. A bakery orders 100 pounds of specialty flour at \$3.00 per pound from a mill. The mill fails to deliver, so the bakery quickly purchases the same flour from another supplier at \$3.50 per pound, plus \$50 in expedited shipping. The bakery did not need to pay \$20 for standing shipping via the miller's third-party carrier. The cover damages calculation is as follows:

$$\begin{aligned}
 &\text{Cost of Cover: } \$3.50 \text{ per pound} \times 100 \text{ pounds} = \$350 \\
 &- \text{Contract Price: } \$3.00 \text{ per pound} \times 100 \text{ pounds} = \$300 \\
 &+ \text{Incidental Damages: } \$50 \text{ (expedited shipping)} \\
 &- \text{Expenses Saved: } \$20 \text{ (standard shipping not required)} \\
 &= \text{Cover Damages} = \$350 - \$300 + \$50 - \$20 = \$80
 \end{aligned}$$

Assuming it acted reasonably, the bakery can recover \$80 in cover damages from the mill. If the bakery had chosen an unreasonably expensive substitute (e.g., purchasing artisanal flour for \$6 per pound), however, the recovery might have been limited to the cost of reasonable alternatives.

b. Market Price Damages

If the buyer decides not to or cannot cover, it may still recover damages based on the difference between the contract price and the relevant market price.

The measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages, but less expenses saved. NH UCC § 2-713.

What if the bakery could not find a substitute supplier for less than \$3.25 per pound, so it reasonably chooses not to buy at all? If the local market price at the time of breach is \$3.25, the bakery may recover \$0.25 per pound, multiplied by the 100 pounds it expected.

Alternatively, if the market price drops to \$2.80 after the breach, the buyer's recovery diminishes accordingly. A falling market reduces damages because the gap between the contract price and market price narrows.

$$\begin{aligned}
 &\text{Market Price Damages} = \text{Market Price at Time of Breach} - \text{Contract Price} \\
 &+ \text{Incidental Damages} + \text{Consequential Damages} - \text{Expenses Saved}
 \end{aligned}$$

Since the bakery could not find a substitute supplier for less than \$3.25 per pound and decides not to buy at all, cover damages are inapplicable. The local market price at the time of breach is \$3.25, and the contract price was \$3.00 per pound. Further assume that the bakery incurs \$50 in incidental storage costs for yeast it could not use and had to store until suitable wheat arrived. In addition, the bakery saved \$20 that it did not spend on shipping the wheat. Here is how the damages calculate:

Market Price: \$3.25 per pound × 100 pounds = \$325
– **Contract Price:** \$3.00 per pound × 100 pounds = \$300
+ **Incidental Damages:** \$50 (storage costs)
– **Expenses Saved:** \$20 (standard shipping not required)
= **Market Price Damages** = \$325 – \$300 + \$50 – \$20 = \$55

The bakery may recover \$55 in market price damages.

c. Incidental and Consequential Damages

Buyers may also recover incidental and consequential damages that arise directly from the breach, so long as these damages are foreseeable. The UCC codifies common law concepts:

Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected. Consequential damages include any loss resulting from general or particular requirements and needs of which the seller had reason to know and which could not reasonably be prevented by cover or otherwise. NH UCC § 2-715(1)–(2).

For example, the bakery pays \$100 to store partial shipments of flour delivered late by its miller. Because these extra storage fees directly result from the breach, they count as incidental damages.

Similarly, if the bakery informs the miller that timely delivery is critical for a profitable holiday event, and the breach causes the bakery to miss those holiday sales, it might recover lost profits as consequential damages—assuming the miller knew or should have known about the significance of the holiday timing.

By contrast, if the bakery never mentioned any special timing or events, a major loss of holiday profits may not be recoverable, as the miller could not foresee the significance of the missed date. (As you will learn in Chapter 26, unforeseeable damages are generally not recoverable.)

2. Seller's Remedies

Seller's remedies under the UCC address the specific financial risks sellers face when buyers breach contracts. These remedies are designed to restore the seller to the position they would have been in if the buyer had performed. Resale damages allow sellers to recover the gap between the contract price and a reasonable resale price, while market price damages provide a substitute when resale is not feasible. In cases where these remedies fall short, sellers can recover lost profits by demonstrating that the breach deprived them of additional sales opportunities. By focusing on commercially reasonable actions and actual financial harm, the UCC ensures that sellers receive fair compensation tailored to the nature of their business losses.

a. Resale Damages

When the buyer repudiates or fails to pay, the seller may resell the goods in good faith and recover the difference between the resale price and the original contract price.

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, but less expenses saved in consequence of the buyer's breach. NH UCC § 2-706.

For instance, the bakery orders 100 pounds of specialty flour for \$3.00 per pound from its miller, then wrongfully refuses delivery. The miller resells it at \$2.75 per pound on the open market. The miller can recover \$0.25 per pound plus any incidental resale costs (such as a small fee for listing on an online marketplace).

Conversely, if the miller waits months for a better price and stores the flour in substandard conditions that lead to spoilage, a court may deem its resale commercially unreasonable, which could limit or negate recovery.

$$\text{Resale Damages} = \text{Contract Price} - \text{Resale Price} + \text{Incidental Damages} - \text{Expenses Saved}$$

If the miller reasonably incurs \$25 in incidental costs for listing the goods on an online marketplace and saves \$10 on avoided packaging expenses, then here is the calculation:

$$\begin{aligned} &\text{Contract Price: } \$3.00 \text{ per pound} \times 100 \text{ pounds} = \$300 \\ &- \text{Resale Price: } \$2.75 \text{ per pound} \times 100 \text{ pounds} = \$275 \\ &+ \text{Incidental Damages: } \$25 \text{ (listing costs)} \\ &- \text{Expenses Saved: } \$10 \text{ (avoided packaging)} \\ &= \text{Resale Damages} = (\$300 - \$275 + \$25 - \$10) = \$40 \end{aligned}$$

The miller may recover \$40 in resale damages.

b. Market Price Damages

If the seller opts not to resell, or if a resale would require commercially unreasonable effort, or if the seller attempts to resell but cannot find a buyer willing to pay a reasonable price, the seller may recover the difference between the contract price and the market price at the time and place for tender.

The measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price, together with any incidental damages, but less expenses saved. NH UCC § 2-708(1).

For example, if the miller's original contract with the bakery was \$3.00 per pound, but the market price is \$2.75 at the time of tender, the miller may recover \$0.25 per pound.

Alternatively, if the local market price for specialty flour soars to \$3.25, and the miller does not resell, its damages might be negative or zero. It loses the opportunity to capitalize on a favorable market, and the court's calculation of \$3.25 minus the contract price of \$3.00 may not yield meaningful damages.

**Market Price Damages = Contract Price – Market Price at Time of Tender
+ Incidental Damages – Expenses Saved**

If the contract price was \$3.00 per pound and the market price at the time and place of tender is \$2.75 per pound, and if the miller incurs \$20 in incidental storage costs for holding the goods and saves \$15 on avoided delivery expenses, here is the calculation:

$$\begin{aligned} &\text{Contract Price: } \$3.00 \text{ per pound} \times 100 \text{ pounds} = \$300 \\ &- \text{Market Price: } \$2.75 \text{ per pound} \times 100 \text{ pounds} = \$275 \\ &+ \text{Incidental Damages: } \$20 \text{ (storage costs)} \\ &- \text{Expenses Saved: } \$15 \text{ (avoided delivery expenses)} \\ &= \text{Market Price Damages} = \$300 - \$275 + \$20 - \$15 = \$30 \end{aligned}$$

The miller may recover \$30 in market price damages.

c. Lost Profits

A seller may recover lost profits when neither resale damages nor market price damages fully compensate it, especially if the seller could have sold additional goods despite the buyer's breach. This situation only arises where the seller is a volume seller, which means the seller could have sold additional units to other buyers but for this buyer's breach.

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, the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance, together with any incidental damages, due allowance for costs reasonably incurred, and due credit for payments or proceeds of resale. NH UCC § 2-708(2).

For instance, a particular miller has a vast capacity to mill flour. Even if it resells a buyer's 100-pound order to another buyer, it remains a lost volume seller because it could have sold an additional 100 pounds to that new buyer. That miller can therefore recover the profit it would have earned under the breached sales contract—provided it proves its surplus capacity and actual lost volume.

Conversely, if the miller is a small-scale operation that produces a fixed amount of flour per season, and it resells the same 100 pounds it would otherwise have sold, then it cannot claim lost profits. It has no extra capacity, so the breach did not cost it a second sale.

$$\begin{aligned} \text{Lost Profits} &= \text{Profit on the Breached Sale} \\ &+ \text{Incidental Damages} - \text{Costs Avoided} \end{aligned}$$

Here is the calculation for a lost-volume seller:

$$\begin{aligned} \text{Profit on the Breached Sale: } &\$0.50 \text{ per pound} \times 100 \text{ pounds} = \$50 \\ + \text{Incidental Damages: } &\$30 \text{ (advertising costs)} \\ - \text{Costs Avoided: } &\$10 \text{ (avoided packaging expenses)} \\ = \text{Lost Profits} &= \$50 + \$30 - \$10 = \$70 \end{aligned}$$

The high-capacity miller may recover \$70 in lost profits.

D. Reflections on Money Damages for Nonperformance

Viewed in the broader landscape of contract law, money damages for nonperformance serve not only to compensate the injured party but also to influence each side's decision-making long before a breach ever occurs. By promising compensation for lost value when one party fails to perform at all, the law encourages potential breachers to carefully weigh the costs and benefits of reneging on their promises. In many ways, the right to recover damages functions as a built-in deterrent that raises the "price" of walking away and incentivizes parties to honor their obligations or, at the very least, negotiate a mutually acceptable modification.

Yet, as we've seen with the notion of an efficient breach, the law doesn't insist on performance at any cost. A party may decide that (risking) paying the other side's expectation damages is worthwhile if a more lucrative opportunity arises. This balance between deterrence and flexibility underscores a key principle of modern contract law: rather than punishing every breach, the system focuses on ensuring that injured parties are made whole. In turn, this enables a dynamic marketplace where parties can reallocate resources when doing so might benefit both sides economically (even if it feels unsettling from a moral standpoint).

Ultimately, the doctrines explored in this chapter reinforce the core idea that damages shape behavior—by guiding when parties choose to perform, renegotiate, or breach. In understanding how courts calculate expectation and reliance damages, students gain insight into the subtle pressures at work in every deal. This sets the stage for examining more nuanced breaches in subsequent chapters, where partial or defective performance and non-monetary remedies further illustrate how the law balances fairness, predictability, and economic efficiency.

Cases

Reading Hawkins v. McGee. At first glance, this case might look like a quaint footnote in legal history, but don't let its age or odd nickname—the “Hairy Hand” case—fool you. This brief dispute has captivated generations of law students precisely because it weaves together the principles of contract formation, the subtleties of promise versus puffery, and the core concept of expectation damages in a way few other cases do. In fact, it even stole the spotlight in the famous opening scene of *The Paper Chase* (1973). You might imagine there was something delightfully dramatic about a doctor who supposedly promised his patient a “100% perfect hand,” only to end up giving the patient something unexpectedly covered in hair. But once you dig deeper, you'll see that beneath the tantalizing facts lies a lesson about how far the courts will go to protect (or refuse to protect) a contracting party's grand assurances.

As you read the court's opinion, look for how the judges distinguish between a statement of opinion and a legally enforceable guarantee. Ask yourself whether it truly makes sense for a reasonable person to have taken the doctor literally when he pledged to make the plaintiff's hand “100% perfect.” Is there a meaningful difference, in the world of contract law, between a surgeon's hopeful prognosis and an actual promise? Notice, too, how the court discusses damages: it neither measures them by how terrible the operation turned out to be, nor by the pain the patient endured. Notably, pain and suffering was expected in such surgery, so that cannot be part of expectation damages. Instead, expectation focuses on the difference between what was promised and how the outcome fell short of that promise—a core hallmark of how damages work in contract disputes.

Don't worry if some parts seem puzzling or incomplete at first glance. Contracts cases often leave loose threads that students have the chance to tie up in subsequent readings or reflections on the case. For now, concentrate on the court's approach to the doctor's words and the nature of the disappointment the plaintiff experienced. Keep a mental note of the quirks of language, context, and presumed knowledge that pop up along the way. By focusing on those details, you'll begin to see how contract law addresses the gaps between what people say, what they mean, and what they deliver. And if you find your mind wandering to the bizarre image of a hairy hand, let that be a reminder that contract law—though sometimes seen as abstract—can have very tangible, and occasionally unforgettable, consequences.

Hawkins v. McGee

84 N.H. 114 (1929)

Opinion by JUDGE MARBLE.

The operation in question consisted in the removal of a considerable quantity of scar tissue from the palm of the plaintiff's right hand and the grafting of skin taken from the plaintiff's chest in place thereof. The scar tissue was the result of a severe burn caused by contact with an electric wire, which the plaintiff received about nine years before the time of the transactions here involved.

There was evidence to the effect that before the operation was performed the plaintiff and his father went to the defendant's office and that the defendant in answer to the question, "How long will the boy be in the hospital?" replied, "Three or four days . . . not over four; then the boy can go home, and it will be just a few days when he will be able to go back to work with a perfect hand."

Clearly this and other testimony to the same effect would not justify a finding that the doctor contracted to complete the hospital treatment in three or four days or that the plaintiff would be able to go back to work within a few days thereafter. The above statements could only be construed as expressions of opinion or predictions as to the probable duration of the treatment and plaintiff's resulting disability, and the fact that these estimates were exceeded would impose no contractual liability upon the defendant.

The only substantial basis for the plaintiff's claim is the testimony that the defendant also said before the operation was decided upon, "I will guarantee to make the hand a hundred per cent perfect hand" or "a hundred per cent good hand." The plaintiff was present when these words were alleged to have been spoken, and if they are to be taken at their face value, it seems obvious that proof of their utterance would establish the giving of a warranty in accordance with his contention.

The defendant argues, however, that even if these words were uttered by him, no reasonable man would understand that they were used with the intention of entering into any "contractual relation whatever," and that they could reasonably be understood only "as his expression in strong language that he believed and expected that as a result of the operation he would give the plaintiff a very good hand." It may be conceded, as the defendant contends, that before the question of the making of a contract should be submitted to a jury, there is a preliminary question of law for the trial court to pass upon, i.e. "whether the words could possibly have the meaning imputed to them by the party who founds his case upon a certain interpretation," but it cannot be held that the trial court decided this question erroneously in the present case.

It is unnecessary to determine at this time whether the argument of the defendant based upon "common knowledge of the uncertainty which attends all surgical operations" and the improbability that a surgeon would ever contract to make a damaged part of the human body "one hundred per cent perfect" would, in the absence of

countervailing considerations, be regarded as conclusive, for there were other factors in the present case which tended to support the contention of the plaintiff. There was evidence that the defendant repeatedly solicited from the plaintiff's father the opportunity to perform this operation, and the theory was advanced by plaintiff's counsel in cross-examination of defendant, that he sought an opportunity to "experiment on skin grafting" in which he had had little previous experience. If the jury accepted this part of plaintiff's contention, there would be a reasonable basis for the further conclusion that if defendant spoke the words attributed to him, he did so with the intention that they should be accepted at their face value, as an inducement for the granting of consent to the operation by the plaintiff and his father, and there was ample evidence that they were so accepted by them. The question of the making of the alleged contract was properly submitted to the jury.

The substance of the charge to the jury on the question of damages appears in the following quotation: "If you find the plaintiff entitled to anything, he is entitled to recover for what pain and suffering he has been made to endure and what injury he has sustained over and above the injury that he had before." To this instruction the defendant seasonably excepted. By it, the jury was permitted to consider two elements of damage, (1) pain and suffering due to the operation, and (2) positive ill effects of the operation upon the plaintiff's hand. Authority for any specific rule of damages in cases of this kind seems to be lacking, but when tested by general principle and by analogy, it appears that the foregoing instruction was erroneous.

By "damages" as that term is used in the law of contracts, is intended compensation for a breach, measured in the terms of the contract. The purpose of the law is to put the plaintiff in as good a position as he would have been in had the defendant kept his contract. The measure of recovery is based upon what the defendant should have given the plaintiff, not what the plaintiff has given the defendant or otherwise expended. The only losses that can be said fairly to come within the terms of a contract are such as the parties must have had in mind when the contract was made, or such as they either knew or ought to have known would probably result from a failure to comply with its terms.

The present case is closely analogous to one in which a machine is built for a certain purpose and warranted to do certain work. In such cases, the usual rule of damages for breach of warranty in the sale of chattels is applied and it is held that the measure of damages is the difference between the value of the machine if it had corresponded with the warranty and its actual value, together with such incidental losses as the parties knew or ought to have known would probably result from a failure to comply with its terms.

The rule thus applied is well settled in this state. As a general rule, the measure of the vendee's damages is the difference between the value of the goods as they would have been if the warranty as to quality had been true, and the actual value at the time of the sale, including gains prevented and losses sustained, and such other damages as could be reasonably anticipated by the parties as likely to be caused by the vendor's

failure to keep his agreement, and could not by reasonable care on the part of the vendee have been avoided.

We, therefore, conclude that the true measure of the plaintiff's damage in the present case is the difference between the value to him of a perfect hand or a good hand, such as the jury found the defendant promised him, and the value of his hand in its present condition, including any incidental consequences fairly within the contemplation of the parties when they made their contract. Damages not thus limited, although naturally resulting, are not to be given.

The extent of the plaintiff's suffering does not measure this difference in value. The pain necessarily incident to a serious surgical operation was a part of the contribution which the plaintiff was willing to make to his joint undertaking with the defendant to produce a good hand. It was a legal detriment suffered by him which constituted a part of the consideration given by him for the contract. It represented a part of the price which he was willing to pay for a good hand, but it furnished no test of the value of a good hand or the difference between the value of the hand which the defendant promised and the one which resulted from the operation.

It was also erroneous and misleading to submit to the jury as a separate element of damage any change for the worse in the condition of the plaintiff's hand resulting from the operation, although this error was probably more prejudicial to the plaintiff than to the defendant. Any such ill effect of the operation would be included under the true rule of damages set forth above, but damages might properly be assessed for the defendant's failure to improve the condition of the hand even if there were no evidence that its condition was made worse as a result of the operation.

It must be assumed that the trial court, in setting aside the verdict, undertook to apply the same rule of damages which he had previously given to the jury, and since this rule was erroneous, it is unnecessary for us to consider whether there was any evidence to justify his finding that all damages awarded by the jury above \$500 were excessive.

Defendant's requests for instructions were loosely drawn and were properly denied. A considerable number of issues of fact were raised by the evidence, and it would have been extremely misleading to instruct the jury in accordance with defendant's request number 2, that "The only issue on which you have to pass is whether or not there was a special contract between the plaintiff and the defendant to produce a perfect hand." Equally inaccurate was defendant's request number 5, which reads as follows: "You would have to find, in order to hold the defendant liable in this case, that Dr. McGee and the plaintiff both understood that the doctor was guaranteeing a perfect result from this operation." If the defendant said that he would guarantee a perfect result and the plaintiff relied upon that promise, any mental reservations which he may have had are immaterial. The standard by which his conduct is to be judged is not internal but external.

Defendant's request number 7 was as follows: "If you should get so far as to find that there was a special contract guaranteeing a perfect result, you would still have to find for the defendant unless you further found that a further operation would

not correct the disability claimed by the plaintiff.” In view of the testimony that the defendant had refused to perform a further operation, it would clearly have been erroneous to give this instruction. The evidence would have justified a verdict for an amount sufficient to cover the cost of such an operation, even if the theory underlying this request were correct.

It is unlikely that the questions now presented in regard to the argument of plaintiff’s counsel will arise at another trial, and, therefore, they have not been considered.

New trial.

Reflection

Reading *Hawkins v. McGee* reminds us how powerfully the law of contracts can shape our understanding of promises, hopes, and actual outcomes. The lawsuit arose out of a doctor’s bold “guarantee,” a statement that might have been nothing more than rosy optimism in everyday life but here carried real legal implications once a court interpreted it as a binding promise. The case underscores that contract damages generally seek to give the injured party the economic benefit of what was promised rather than to punish the breaching party or to address every harm that might follow. That’s why the court focused on the difference between a “100% perfect hand” and the imperfect result the plaintiff ultimately received rather than on the pain endured during surgery. From the court’s vantage point, that pain was part of the deal—something the plaintiff was willing to exchange for the hand he bargained for.

Though the doctor performed the surgery, the court treated the failure to deliver the promised outcome—a perfect hand—as the equivalent of a complete failure to perform the contract. By framing the doctor’s guarantee as the core obligation, the court justified viewing the promise as unmet, even though some effort was made. This is why *Hawkins v. McGee* fits into this chapter on nonperformance: the essence of this contract was the result promised (a perfect hand), and the failure to achieve that result amounted to nonperformance of the primary obligation. This framing reinforces a key concept of contract law: a breach can be so fundamental that it effectively nullifies the partial actions taken toward fulfilling the contract.

If you’re scratching your head over how to price the expectation interest in a “perfect” hand (or a hairy one, for that matter), that’s partly the point: contract law has to contend with some rather odd calculations. And yet, *Hawkins* shows that these abstract-seeming measures of value have very real effects on people’s lives and decisions. Would you feel comfortable making a grand promise to a prospective patient if you knew that a court might later hold you strictly accountable for it? Or, would you couch your words more carefully, knowing that someone might take your promises at face value?

In contract disputes, it often boils down to how courts define “expectation.” If you promise someone the moon—whether that means a guaranteed surgical outcome or a fail-proof product—you might pay handsomely if you fall short. Still, reading about this hairy hand might leave you wondering whether tort law (or common sense) could

have handled the doctor's responsibility differently. For our purposes, that's part of the lesson. You've now seen that contract law's singular focus on the promised bargain can sometimes produce interesting—if not downright bizarre—results. And as the next chapters explore more intricate ways that damages are measured and limited, keep in mind how seemingly simple deals can become complicated once human expectations and disappointments come into play.

Discussion

1. In *Hawkins v. McGee*, the court awarded expectation damages. How did it calculate those damages, and why did the court reject awarding damages for pain and suffering? What does this tell us about the difference between contract and tort damages?
 2. The court analogized the hairy hand to a machine that failed to perform as warranted. How does this analogy help clarify the measure of damages? Are there limits to this analogy when applied to cases involving human bodies?
 3. Suppose the jury had awarded damages for the plaintiff's emotional distress resulting from the operation. Would that align with the principles of expectation damages in contract law? Why or why not?
 4. Consider the idea of "efficient breach." If Dr. McGee had knowingly promised more than he could deliver, would awarding only expectation damages still deter this kind of overpromising? Should the law allow punitive damages in such cases to discourage reckless guarantees?
 5. If Hawkins had been unable to prove the exact difference in value between the promised "100% perfect hand" and the actual "hairy hand," how might reliance or restitution damages have served as alternatives? Would they have been easier or harder to calculate in this case??
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Problems

Problem 24.1. Dynamo Products

Dynamo Products entered into a contract to sell Republic Manufacturing a large-scale lithium wall battery for Republic's new factory, for a price of \$130,000. The battery was delivered to Republic. Republic inspected the battery fully and accepted it. Under the contract, Republic was to pay Dynamo for the battery thirty days after delivery; however, Republic failed to make payment.

Assuming that Republic thereby breached, what damages should a court order Republic to pay to Dynamo?

Problem 24.2. Joe the Plumber

Samuel Joseph “Joe” Wurzelbacher, a plumber, had a contract with the Bistro Hotel to replace the old cast iron pipes in the hotel with copper pipes. The agreed-upon contract price was \$20,000. Before Joe started work, Bistro repudiated the contract. Bistro had paid nothing in advance. Joe had expected to pay workers and suppliers \$15,000 and expected to earn a profit of \$5,000 from the contract.

Assuming that Bistro’s repudiation is a total breach, what damages should a court order Bistro to pay to Joe?

Problem 24.3. Gateway Packaging

Gateway Packaging of Scranton, Pennsylvania, signed a contract with Xanadu Freight Lines to take 14,000 unfolded cardboard boxes to Pennington’s Online Sales Company in Youngstown, Ohio, with a shipping date of June 18. Gateway informed Xanadu that “time was of the essence” and that the shipment must occur on that date, or Pennington’s would refuse the shipment. Gateway was to pay \$1,000 to Xanadu to carry the freight to Youngstown.

On June 17, Xanadu informed Gateway that it had entered into too many shipping contracts and that it would not be able to take the boxes to Youngstown. Gateway then contacted another company, Cassiopeia Trucking, and had to pay them \$1,600 to take the boxes to Youngstown the next day.

What damages should a court order Xanadu to pay to Gateway?

Problem 24.4. The Oysters

Haverfield Aquatic Farms raises various shellfish, including oysters. Angstrom Food Distributors buys food from producers and sells it to restaurants and food processors. Angstrom placed an order with Haverfield for 400 pounds of oysters to be delivered on August 1; the agreed-upon price was \$6 per pound. Angstrom then entered into contracts with six restaurants and a food processor to resell the oysters at \$10 per pound. During July, the market price for oysters was rising, and when the market price reached \$7 per pound, Haverfield sent Angstrom an email stating that Haverfield was repudiating the contract. Haverfield resold the oysters to another distributor for \$7 per pound.

a. What is Angstrom’s remedy if it is able to cover by purchasing oysters from another source for \$6.50 per pound, and it also spent an extra \$100 arranging for the substitute purchase?

b. What is Angstrom’s remedy if it is unable to cover?

c. What is Angstrom’s remedy if it could have covered by purchasing oysters from another source but chose not to?

Chapter 25

Money Damages for Defective Performance

What if you hire a contractor to build a sleek new deck? You imagine summer cookouts and long conversations under the stars. But, unfortunately, the resulting construction does not comply with safety codes. At first glance, you have something: a deck. Yet, it is riddled with flaws. Should the contractor bear the full cost of tearing everything out and starting over, or is it sufficient to pay you the difference between a perfect deck and the wobbly one you received? Would the analysis differ if the deck passed inspection but was smaller than you bargained for, or, in your view, less aesthetically pleasing?

These questions frame the law's approach to defective performance. When a contract is partially performed—but not well performed—courts must determine how to compensate the injured party without imposing wasteful costs on the breaching party. This chapter builds on the discussion of total nonperformance from Chapter 24. That chapter addressed scenarios where no aspect of the bargain was fulfilled, leaving the injured party empty-handed. Here, the analysis becomes more nuanced. Something has been delivered—a structure, a product, or a service—but it falls short of the contractual standard. Courts must decide whether to classify the defect as minor or material, whether repair costs are reasonable, and whether economic waste justifies opting for financial compensation instead of physical remediation.

This balance between the expectation interest of the injured party and the avoidance of waste reflects key goals of contract law: fairness, efficiency, and ensuring predictable outcomes. The principles that courts apply in these situations, such as the cost of completion versus diminution in value, ensure that remedies align with the specifics of the defect and the broader economic implications.

This chapter explores doctrines developed by courts and legislators under both the common law and the UCC to address defective performance. It examines when it is appropriate to award damages for the cost of completing or repairing the work versus paying the difference in value. The UCC's emphasis on the value of defective goods contrasts with the common law's flexibility in accounting for material defects. The chapter also considers practical factors, including the feasibility of repairs, foreseeability of the defect, and the policy imperative to avoid windfall gains or crushing

liabilities. By the end of the chapter, students will have a structured framework for assessing whether an injured party should receive funds for repair, accept a value-based award, or claim additional incidental and consequential damages arising from incomplete or faulty performance.

Rules

A. Loss in Value Revisited

Defective performance differs from total nonperformance in one critical way: something has been delivered, but it falls short of the contract's standards. Imagine hiring a contractor to remodel your home's kitchen. The contractor installs new cabinets and appliances, but the countertops are poorly constructed, and the flooring looks misaligned. You have a kitchen—yet it isn't the kitchen you bargained for. How should a court remedy that shortfall?

This chapter builds on the core idea of expectation damages discussed in Chapter 24. Recall the equation for determining expectation damages:

$$\text{Expectation Damages} = \text{Loss in Value} + \text{Incidental Damages} \\ + \text{Consequential Damages} - \text{Costs Avoided}$$

The focus in this chapter is on how to measure loss in value. Recall that in nonperformance cases, the loss in value is typically the cost of obtaining a substitute performance, or other losses that flow from the breach. However, in defective performance cases, courts must choose between awarding the cost of completion—essentially, ordering the defendant to pay to fix the flaws—or awarding the diminution in value—damages approximating how much less the performance is worth due to the defects. Each approach has its place. Sometimes, the injured party deserves enough money to make the work perfect. Other times, awarding the full repair cost would be so expensive and disproportionate that it amounts to economic waste. In those scenarios, courts may award only the difference in value.

1. Cost of Completion

Cost of completion awards a monetary amount equivalent to the cost of completing the performance or the cost of repairing the defects. This measure of damages aims to give the injured party exactly what they had envisioned. If replacing defective items or redoing shoddy work makes practical sense, courts often favor this measure.

R2d § 348(2) provides courts with the initial option to award the reasonable cost of remedying a defect or completing performance, if the owner elects this option.

If a breach results in defective or unfinished construction . . . [the owner] may recover damages based on . . . the reasonable cost of completing performance

or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him. R2d § 348(2)(b).

However, as you can see above, this option is not generally available if the cost of remedying the defect or completing performance is “clearly disproportionate to the probable loss in value” of the project.

Consider a scenario in which a construction company uses the wrong grade of roofing material in a high-end home. If the owner paid for a roof designed to last fifty years, awarding the cost to remove the subpar materials and install the correct ones might be appropriate. This remedy restores the owner’s original bargain. Courts look for a genuine need, however. If the fix is outrageously expensive relative to the benefit it brings, judges hesitate to impose that cost on the breaching party. If the same roof was installed on a run-down shack that would likely not stand for 10 years anyway, then courts might deem the cost of completion to be economic waste and instead measure expectation damages in terms of diminution in value.

2. Diminution in Value

Diminution in value awards a monetary sum equivalent to the difference in value between what was promised and what was delivered. Sometimes the full cost of repair or completion requires more dollars than common sense would allow. In those cases, courts turn to diminution in value, which compensates the owner for the drop in market value caused by the defect.

R2d § 348(2) explains that if repairing a flaw would cost far more than it adds in value, courts should instead award the “diminution in the market price of the property”—i.e., the diminution in market value.

If a breach results in defective or unfinished construction . . . [the owner] may recover damages based on (a) the diminution in the market price of the property caused by the breach, or (b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him. R2d § 348(2).

The landmark case *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1962), appearing later in this chapter, illustrates this principle. In *Peevyhouse*, a coal company promised to restore the Peevyhouses’ property after the Peevyhouses leased it to the coal company for the purpose of “strip mining.” The coal company refused to perform the promised restorations to the property. Doing so would have cost tens of thousands of dollars but enhanced the land’s market value by only a few hundred dollars. The court concluded that awarding those steep cleanup costs would be unreasonably wasteful. The court thus granted the Peevyhouses only a modest sum to reflect the diminished value of their land. Critics still debate whether this outcome shortchanged the Peevyhouses, but the case underscores how courts strive to balance fairness to the injured party with proportionality.

3. Economic Waste

Courts label it “economic waste” when a fix is so expensive that it makes little sense in light of the project’s goal.

Recall the case of *Jacob & Youngs v. Kent* in Chapter 20, above, where the contractor, Jacob & Youngs, installed the wrong brand of pipes in the mansion that the owner, Kent, had contracted to be built. The brand of pipes barely altered the market value of the house, if at all. Requiring the contractor to tear up the pipes or demolish the entire house to make this minor adjustment would have been absurd. Courts do not want to impose crushing costs for minimal benefits.

Imagine that the court in *Jacob & Youngs* had awarded Kent the full cost of repair that he requested. Ask yourself, would Kent really have torn down his freshly built mansion just to eliminate a minor defect? If the answer is “no,” then awarding Kent the cost of completion would hand him a windfall resulting in overcompensation without justification.

Remember: contract law only seeks to give parties the benefit of what they bargained for, not more. If the owner were awarded the full cost of completion and chose to simply use that money to build, say, a fancy gazebo, this would not reflect the goal of contract remedies. The owner would get far more than he bargained for—a new gazebo plus a new mansion.

At the same time, courts do not want to reward a breaching party that makes a truly unmarketable construction or deliberately employs substandard materials. The diminution in value measure can be effective here. Granting a monetary sum that approximates the difference between what was promised and what was actually delivered can provide sufficient compensation to the injured party without encouraging wasteful reconstruction or supplying an unjustified windfall.

You can apply this thought experiment to the *Peevyhouse* case. You might think the result was unfair. After all, the plaintiffs obtained an award of only \$300, even though the cost of restoring their land would have been \$29,000. But imagine that the court had instead ordered Garland Coal to pay the full \$29,000 that the Peevyhouses requested. Would they really have spent that money restoring a far corner of their unfarmable land to be flat again? This seems unlikely. Thus, the Peevyhouses would have been handed a bucket of cash to do with as they please.

At the same time, it also would have been economically wasteful to require Garland Coal to do this work by awarding specific performance, as the dissent proposed. Garland Coal would have spent \$29,000, but the land’s market price would have gone up only by around \$300.

This is not how contract law remedies work. Contract law aims to fulfill the parties’ expectation interest by providing the benefit of the bargain, not by handing out windfalls or by encouraging wasteful projects.

4. *Substantial Performance and Material Breach*

In many defective performance disputes, the question of substantial performance arises. Recall that a breaching party who delivers a substantial performance is still owed their compensation under the contract. The breach is deemed “minor.” The injured party can seek damages but must pay the contract price. On the other hand, a breaching party who fails to deliver substantial performance is in material breach. The counterparty’s duty to perform and compensate the breacher under the contract is discharged. The injured party can withhold their performance and also seek damages.

In defective performance scenarios, it is often necessary to determine whether the defect amounts to a material breach or a minor breach. If the breaching party mostly completed the job but slipped on a few details, courts may well view the breach as minor. If the breach is minor, the injured party will still owe their compensation under the contract, though this sum will be offset by any damages owed to compensate for the breach. If the court decides the breach was minor, the court is more likely to select the diminution in value measure, thus allowing the injured party to recover the difference in value between what they got and what was promised, rather than the full repair cost.

Recall, again, *Jacob & Youngs*, where Judge Cardozo found that using the wrong brand of pipes in a mansion was a minor breach and awarded the homeowner only the difference in value, which was “either nominal or nothing,” rather than awarding the full cost of tearing up the house to replace the pipes.

If, however, the defect crosses into material breach territory—say, a structural flaw that endangers the integrity of a building—a court may be more inclined to award the full cost of repair, i.e., the money needed for a complete overhaul.

Thus, the distinction between material and minor breach can help judges, and law students, tailor damages to the severity of the defect. When a defect is minor, the injured party still receives most of the promised value. In such cases, awarding full repair costs could lead to overcompensation and economic waste, and the cost of repair is likely to be disproportionate to the actual harm caused by the defect. Redoing the piping in a mansion because the brand of pipe is “Cohoes” rather than “Reading” might cost many thousands of dollars, even though the market value of the house is virtually unchanged. Courts will likely seek to avoid awarding excessive damages in “minor breach” cases. In such cases, courts are more likely to award the difference in value reflecting the actual impact of the defect.

When a defect is severe, however, this undermines the essential purpose of the contract. In these cases, diminished value often underestimates the harm caused by the breach. A structurally unsound roof that leaks or poses safety risks is not just a cosmetic issue; it prevents the property from being usable or safe as promised. In these “material breach” cases, a court is more likely to award the full cost of repair to ensure the injured party can restore the promised functionality and safety.

5. Conclusion: Deciding between “Diminution in Value” or “Cost of Repair”

Determining which measure of loss in value is appropriate for defective performance scenarios boils down to a few essential questions. Does the defect amount to a material breach? How central is the defect to the project’s purpose? Is the repair feasible or so massive that it strains common sense? Will granting the cost of completion yield a windfall or simply get the injured party what it genuinely needs? Judges weigh these questions by considering the facts and recalling broader contract policies—especially the goal of securing the injured party’s expectation interest (that is, delivering the value of the promised performance), while also avoiding economic waste when repair would cost far more than the value it adds. They also consider foreseeability rules to ensure that the breaching party is not blindsided by extreme liability for issues it could not have anticipated.

Ultimately, cost of completion and diminution in value both protect the same interest: ensuring that the nonbreaching party receives the benefit of the bargain—or its monetary equivalent. Which of these remedies a court chooses depends on its determination of how thoroughly a nonbreaching should be restored. If full restoration is possible and not absurd, cost of completion will prevail. If full restoration will destroy disproportionate resources, a diminution award will suffice. By threading this needle, courts strive to promote fairness, encourage careful performance, and prevent the needless destruction of labor and materials.

B. UCC Provisions for Defective Performance

Defective performance under the UCC presents distinct challenges. Recall that in the nonperformance scenario, the seller fails to deliver goods as promised, or the buyer refuses to accept or pay for goods as promised. Under the UCC, direct expectation damages in the nonperformance scenario generally amount to the difference between the substitute performance, based on the cover or the market price, and the contract price.

Defective performance is different. With defective performance, goods are delivered, but they are “nonconforming,” meaning that they fail to conform to the contract’s terms. The UCC, you’ll recall, is exceptionally strict. It does not distinguish between material and minor breach. Instead, the UCC adopts the perfect tender rule, which holds that any divergence from the contract specification is a breach that justifies the counterparty in withholding payment. The goods may also be in breach of a warranty, meaning that they do not live up to the standard expressly or impliedly promised by the seller. Either way, the seller is in breach, and under the UCC, the buyer has significant rights and remedies.

When a buyer receives defective goods, the buyer must make a decision. On the one hand, assuming the defect is caught in time, the buyer can reject the goods. If

the buyer already accepted the goods but later discovers a defect that substantially impairs the goods' value, the buyer can revoke their acceptance and reject the goods thereafter. Sellers, you'll recall, may have a right to cure the defect, depending on the situation. See UCC § 2-508. But in general, a buyer who rejects goods does not have to pay for them and can get back any money paid. On the other hand, the buyer may choose to accept the goods and seek damages for breach of contract. These damages will take the form of defective performance damages, which the UCC refers to simply as "breach of warranty" damages. UCC § 2-714.

Take the following example. Imagine a logistics company orders a fleet of trucks and receives vehicles with faulty brakes. Unlike total nonperformance, where nothing is delivered, defective performance leaves the buyer with nonconforming goods that require strategic choices. Should the buyer reject the trucks entirely? Or, should the buyer accept the trucks and demand compensation for the cost of brake repairs? What if the buyer does not discover the defect until after the time for rejection has passed? Can the buyer revoke acceptance upon discovering latent defects in the brakes that substantially impair the trucks' value—even though the trucks may have been used for hundreds or thousands of miles? If the buyer accepts the defective fleet, what will the buyer's damages be?

This section explores how the UCC addresses these scenarios through tailored remedies for buyers and sellers, thus ensuring that both parties have tools to mitigate their losses and achieve fairness. Some of this content will be familiar to you from Chapter 20 on performance and breach. This is a good opportunity to consolidate your understanding.

1. Buyer's Remedies for Defective Performance by Seller

"Defective performance" under the UCC generally refers only to a *seller's* breach. The buyer's duty is generally to accept and pay for conforming goods. Incomplete payment by a buyer does not present special challenges in determining loss in value to the seller. The buyer simply must complete the payment owed under the contract.

The far more challenging defective performance situation is where the seller delivers nonconforming goods, and the buyer is confronted with a variety of choices and potential remedies. The UCC specifically addresses buyers' remedies for defective performance. We will review these rules now.

a. Buyer's Right to Reject Nonconforming Goods

Recall that buyers have the right to immediately reject goods if the goods "fail in any respect to conform to the contract." UCC § 2-601. This is known as the **perfect tender rule**.

Subject to the provisions of this Article on breach in installment contracts (§2-612) and unless otherwise agreed under the sections on contractual

limitations of remedy (§§ 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.* NH UCC § 2-601.

To take advantage of this option, the buyer must reject the goods within a reasonable time, and buyers must notify sellers promptly. Once goods are rejected, buyers are responsible for holding them with reasonable care to allow the seller an opportunity to retrieve them. UCC § 2-602.

Let's say that a manufacturer orders 1,000 steel bolts designed to withstand 100 Newton-meters. Upon testing, the bolts fail when 95 Newton-meters is applied to them; thus, the goods are nonconforming. The buyer may immediately reject the entire shipment and demand a refund of any of the price that has been paid, in addition to obtaining cover or market damages, as appropriate. UCC § 2-711.

However, if the buyer delays rejection for months while using some of the bolts in production, the right to reject may be forfeited, as the delay undermines the seller's ability to mitigate the breach. At this point, the buyer's options shift: the buyer can either seek to revoke acceptance, as discussed below, or alternatively keep the goods and sue for breach of contract based on the seller's delivery of nonconforming goods.

Note, too, that the seller is likely in breach of an express warranty because the seller promised that the bolts would withstand 100 Newton-meters, when they did not. There is thus significant, if not complete, overlap between the buyer's remedy for a seller's delivery of nonconforming goods and the buyer's remedy for breach of warranty.

b. Revocation of Acceptance

Revocation applies when buyers initially accept goods but later discover a defect that substantially impairs their value. UCC § 2-608. A buyer can revoke acceptance if the defect was not initially apparent, or if the buyer accepted the goods based on the seller's assurances that the defect would be cured. Revocation must occur within a reasonable time after discovering the defect, and the buyer must notify the seller promptly. This option allows the buyer to treat the transaction as if the goods were rejected from the outset.

Importantly, the perfect tender rule does not apply to revocation of acceptance, as it does to initial rejection of goods. Buyers can only revoke acceptance upon discovering a defect that substantially impairs the value of the goods to the buyer. This is similar to the common law's conception of a material breach.

Returning to the bolts example in the previous subsection, let's say it's not typical to test the bolts in this manner. Standard bolts are supposed to comply with International Organization for Standardization (ISO) standards for such bolts. This compliance probably constitutes a warranty or an implied term in the bolts contract, even if it

was not expressly stated. If a retailer like Home Depot purchases these bolts, it would not usually test them before selling them. After selling these bolts for a few months, a customer who used them in a high-torque application reports that they broke prematurely. Home Depot then tests a random sample of the bolts and finds that about 30% do not meet spec. What then?

A buyer who discovers some goods are defective after accepting them has two options. The buyer's first option is to revoke acceptance. This would turn this situation into a *nonperformance* situation. The buyer's remedy would usually take the form of a refund of any of the purchase price paid, plus either cover damages, if the buyer chooses to cover by purchasing reasonably similar goods, or market damages, if the buyer does not choose to cover. The damages would be the difference between the contract price and either the buyer's cost of cover or the market price, as appropriate. UCC §§ 2-711, 2-712, 2-713.

The buyer's second option is to keep the goods and seek damages based on the defect. This can be considered, in essence, a price adjustment. The UCC's default remedy in this situation, pursuant to UCC § 2-714, is damages based on diminution in value, meaning the difference between the value of the goods as promised and the value of the goods as delivered. The buyer keeps the goods but effectively obtains a reduction in price. (This "price adjustment" remedy is described further in the next section.)

In the hypothetical above, Home Depot's ability to revoke acceptance of the bolts hinges on whether the bolts' failure to meet the required standards substantially impairs their value. If the bolts are intended for high-torque applications where failure could result in safety risks or operational inefficiencies, the defect might qualify as a substantial impairment. The buyer could revoke acceptance and collect nonperformance damages—a refund, plus cover or market damages. However, if the bolts are suitable for the vast majority of applications that Home Depot consumers use them for, the impairment may not rise to the level required for revocation. The buyer would still be able to sue for damages to compensate for the defect. (This same remedy would apply if the buyer did not even try to revoke acceptance and simply sued for damages.) The details of this remedy are addressed directly below.

c. Difference-in-Value Damages (Price Adjustment)

A buyer who could otherwise reject or revoke acceptance of goods also maintains the option to keep the goods and recover damages based on the difference between the goods' value as delivered and the goods' value as promised. As mentioned above, these damages are, in effect, a price adjustment. The buyer gets to keep the goods, but at a lower price that reflects their actual value.

UCC § 2-714 provides the framework for this "difference in value" measure.

(1) Where the buyer has accepted goods and given notification . . . he may recover as damages for any non-conformity of tender the loss resulting in the

ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered. NH UCC § 2-714.

The formula can be expressed as:

Difference in Value Damages (Price Adjustment) = Promised Value – Actual Value + Incidental Damages + Consequential Damages – Expenses Saved

For example, Mike's Mechanical purchases 10,000 bolts for \$1 per bolt, under the assumption that the bolts meet a standard of withstanding 100 Nm. Before selling any of them, Mike tests them and finds that the bolts fail to meet this standard, substantially reducing their value to \$0.50 per bolt.

Mike incurs \$500 in incidental damages for testing the bolts and loses \$300 in profit for orders he could not ship until receiving compliant bolts. Mike saves \$200 by not shipping the defective bolts to customers. Using the UCC price adjustment formula:

$$\begin{aligned}
 &\text{Promised Value: } 10,000 \text{ bolts} \times \$1.00 = \$10,000 \\
 &\text{–Actual Value: } 10,000 \text{ bolts} \times \$0.50 = \$5,000 \\
 &+ \text{Incidental Damages: } \$500 \text{ (testing bolts)} \\
 &+ \text{Consequential Damages: } \$300 \text{ (lost orders)} \\
 &\text{–Expenses Saved: } \$200 \text{ (shipping expenses saved)} \\
 &= \text{Price Adjustment Damages} = \$10,000 - \$5,000 + \$500 + \$300 - \$200 \\
 &= \$5,600
 \end{aligned}$$

Mike would be entitled to \$5,600 in price adjustment damages under UCC § 2-714.

d. Incidental and Consequential Damages

As demonstrated above, buyers may also recover incidental and consequential damages stemming from the seller's breach. These concepts are the same as when applied to money damages for nonperformance, a topic discussed in Chapter 24.

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

- (2) *Consequential damages resulting from the seller's breach include*
- (a) *any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and*
 - (b) *injury to person or property proximately resulting from any breach of warranty.* NH UCC § 2-715.

2. Seller's Ability to Provide for Alternative Remedies through Contract

You may be wondering why, when you receive defective goods from a seller, the outcome is *not* usually a lawsuit for damages. Usually, you notify the seller that something is wrong, and they send you a replacement or a refund.

This is mainly because parties typically resort to self-help. Sellers are aware of buyers' rights to a remedy, so when sellers ship defective goods, they are likely to do what they can to make it right. If there is an opportunity to cure or take some other action that will make buyers happy, like a price adjustment, sellers will likely take it without the threat of a lawsuit.

The other reason is that, as with most of contract law, these rules are only default rules. Sellers can "contract around" the UCC's remedies and provide their own remedies through contract. For example, the seller of a cellphone might indicate in the contract of sale that the buyer's remedies in the case of a defect are limited to a refund or replacement of parts.

The UCC provides for this possibility in UCC § 2-719, which states:

the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. NH UCC § 2-719.

These alternative remedies are generally *optional*, meaning that buyers can choose to sue for damages instead. But the contract can potentially make an alternative remedy "exclusive, in which case it is the sole remedy." If a seller chooses to limit buyers' remedies or eliminate buyers' options to sue for damages altogether, then this will likely require additional analysis. As you learned in Chapter 18 on warranties, if sellers include disclaimers of warranties, sellers have to give buyers appropriate notice and follow the UCC's rules. The next chapter, on limitations on money damages, addresses additional restrictions and instances where courts might not enforce limitations on buyers' remedies.

C. Reflections on Money Damages for Defective Performance

Defective performance forces us to confront the essence of contract law: balancing the injured party's right to the benefit of their bargain with the practical realities of addressing what went wrong. Remedies in these cases do more than compensate for losses; they embody deeper values of efficiency, fairness, and the integrity of agreements.

Consider the classic tension between cost of completion and diminution in value. On the surface, it seems like a straightforward issue: should the law demand a full fix, or is financial compensation enough? These questions reveal the law's nuanced balancing act between justice and pragmatism. Cost of completion might restore what was promised, but it can also lead to absurd outcomes, such as tearing down a house to replace a hidden pipe that neither diminishes value nor affects functionality. Courts must decide when fulfilling a literal promise is worth the cost, and when a proportional monetary award better achieves fairness.

The concept of economic waste captures this tension. Contract law does not exist to punish breaches or enforce perfection at any cost. Instead, it seeks to avoid waste while holding breaching parties accountable. Cases like *Peevyhouse v. Garland Coal & Mining Co.* illustrate this principle vividly, even as their outcomes spark debate. They prompt a crucial question: what does fairness look like when a defect is vital to one party but trivial to another?

Under the UCC, buyers' remedies for defective goods add further complexity. The right to reject, revoke acceptance, or adjust the price offers flexibility but also opens the door to disputes. How severe must a defect be to justify rejection? How much time should sellers have to cure defects? These are practical questions that courts must answer while balancing the enforcement of contracts with the realities of commercial relationships. Sellers are not without recourse either. Remedies like resale damages and lost profits ensure they are not unfairly penalized, reflecting the law's commitment to equity on both sides of a breach.

At its core, defective performance reminds us that remedies are not just about dollars and cents. They also safeguard fairness, reliance, and trust. Courts must enforce agreements in ways that are reasonable and proportionate, without demanding unattainable perfection. The trust underpinning the legal system—and the relationships it protects—depends on its ability to balance competing interests and foster cooperation. By adhering to principles like foreseeability, proportionality, and avoiding windfalls, contract law creates a framework that not only resolves disputes but sustains the broader system of trade and commerce.

Cases

Reading Peevyhouse v. Garland Coal & Mining Co. This famous case, *Peevyhouse*, is arguably the most powerful illustration of the of the rule you learned above: Courts will not generally require the breaching party to pay the full cost remedying a defective performance if doing so would be economically wasteful. When the cost of completion is clearly disproportionate to the reduction in market value of the land or project, courts instead use the diminution-in-value measure. This generally takes the form of the diminution in the market price of the property or project caused by the breach.

Peevyhouse v. Garland Coal & Mining Co.

382 P.2d 109 (Okla. 1962)

W.R. WALLACE, JR., Judge.

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.

In the briefs on appeal, the parties present their argument and contentions under several propositions; however, they all stem from the basic question of whether the trial court properly instructed the jury on the measure of damages.

Briefly stated, the facts are as follows: plaintiffs owned a farm containing coal deposits, and in November, 1954, leased the premises to defendant for a period of five years for coal mining purposes. A “stripmining” operation was contemplated in which the coal would be taken from pits on the surface of the ground, instead of from underground mine shafts. In addition to the usual covenants found in a coal mining lease, defendant specifically agreed to perform certain restorative and remedial work at the end of the lease period. It is unnecessary to set out the details of the work to be done, other than to say that it would involve the moving of many thousands of cubic yards of dirt, at a cost estimated by expert witnesses at about \$29,000.00. However, plaintiffs sued for only \$25,000.00.

....

Plaintiffs contend that the true measure of damages in this case is what it will cost plaintiffs to obtain performance of the work that was not done because of defendant’s default. Defendant argues that the measure of damages is the cost of performance “limited, however, to the total difference in the market value before and after the work was performed.”

....

We therefore hold that where, in a coal mining lease, lessee agrees to perform certain remedial work on the premises concerned at the end of the lease period, and thereafter the contract is fully performed by both parties except that the remedial work is not done, the measure of damages in an action by lessor against lessee for damages for breach of contract is ordinarily the reasonable cost of performance of the work; however, where the contract provision breached was merely incidental to the main purpose in view, and where the economic benefit which would result to lessor by full performance of the work is grossly disproportionate to the cost of performance, the damages which lessor may recover are limited to the diminution in value resulting to the premises because of the non-performance.

....

Under the most liberal view of the evidence herein, the diminution in value resulting to the premises because of non-performance of the remedial work was \$300.00. After a careful search of the record, we have found no evidence of a higher figure, and plaintiffs do not argue in their briefs that a greater diminution in value was sustained. It thus appears that the judgment was clearly excessive, and that the amount for which judgment should have been rendered is definitely and satisfactorily shown by the record.

IRWIN, J (dissenting).

By the specific provisions in the coal mining lease under consideration, the defendant agreed as follows:

7b Lessee agrees to make fills in the pits dug on said premises on the property line in such manner that fences can be placed thereon and access had to opposite sides of the pits.

7c Lessee agrees to smooth off the top of the spoil banks on the above premises.

7d Lessee agrees to leave the creek crossing the above premises in such a condition that it will not interfere with the crossings to be made in pits as set out in 7b.

7f Lessee further agrees to leave no shale or dirt on the high wall of said pits.

....

Defendant admits that it failed to perform its obligations that it agreed and contracted to perform under the lease contract and there is nothing in the record which indicates that defendant could not perform its obligations. Therefore, in my opinion defendant's breach of the contract was wilfull and not in good faith.

....

Defendant has received its benefits under the contract and now urges, in substance, that plaintiffs' measure of damages for its failure to perform should be the economic value of performance to the plaintiffs and not the cost of performance.

....

In the instant action defendant has made no attempt to even substantially perform. The contract in question is not immoral, is not tainted with fraud, and was not entered into through mistake or accident and is not contrary to public policy. It is clear and unambiguous and the parties understood the terms thereof, and the approximate cost of fulfilling the obligations could have been approximately ascertained. There are no conditions existing now which could not have been reasonably anticipated when the contract was negotiated and executed. The defendant could have performed the contract if it desired. It has accepted and reaped the benefits of its contract and now urges that plaintiffs' benefits under the contract be denied. If plaintiffs' benefits are denied, such benefits would inure to the direct benefit of the defendant.

Therefore, in my opinion, the plaintiffs were entitled to specific performance of the contract and since defendant has failed to perform, the proper measure of damages should be the cost of performance. Any other measure of damage would be holding for naught the express provisions of the contract; would be taking from the plaintiffs the benefits of the contract and placing those benefits in defendant which has failed to perform its obligations; would be granting benefits to defendant without a resulting obligation; and would be completely rescinding the solemn obligation of the contract for the benefit of the defendant to the detriment of the plaintiffs by making an entirely new contract for the parties.

Reflection

The court in *Peevyhouse* effectively said that that the defendant breached its contract and in doing so made plaintiffs' land uglier. That appears to be true. The image below shows how mining terraforms flat land into hills. Note that the process also stopped a small river from flowing through the land.

The question was whether defendant had to pay for restoration of the land to its prior state—which, as you can imagine, would be a considerable expense—or merely for the diminution of its value. The latter, diminution of value, was selected because it more closely approximated the financial deal the parties struck or would have struck.

Given that some damage was foreseeable, the extent of the damage was beyond what the *Peevyhouses* bargained for. The court therefore awarded them the difference between what they got (some cash and totally destroyed land) and what they had bargained for (some cash and moderately damaged land) according to the reasonably foreseeable outcome of their agreement.

The court's business about "reasonable cost" and "unreasonable economic waste" is a poetic way of identifying this as a commercial agreement, whereas courts dealing with noncommercial agreements might instead use the concept of a reasonable person. But this distinction also makes cases somewhat easier to resolve because we have a sharper view of the reasonable person in commercial contexts than we do in non-commercial contexts: we generally presume that commercial parties are economically



Figure 25.2. “Garland Coal sure left a lot of hills behind.” Credit: Tim Root, “Case of the Day—Monday, June 15, 2020,” Tree and Neighbor Blog.

rational, i.e., they want to make money. Parties to commercial agreements allocate risk and reward in the manner that they deem most likely to generate the most profit for themselves. Here, the court effectively found that a commercially reasonable bargain could have been struck in exchange for the total destruction of Peevyhouse’s land, but no commercially reasonable strip miner would have bargained for the cost of totally restoring land to perfect condition after it had mined the resources out of it. The court then enforced the terms of the commercially reasonable bargain, thus putting commercial reality in line with contractual obligations.

Discussion

1. The Peevyhouses were paid for use of their land by a strip-mining company. Was some damage to the land foreseeable?
 2. How do you square the commercial reality of strip mining with the plain meaning of the written term to restore the land?
 3. If the court made Garland Coal pay the Peevyhouses the estimated cost to restore the land to its original condition, would the Peevyhouses spend the money on doing that? Does your answer to this question impact whether courts should award this remedy? If so, why?
-

Reading North American Foreign Trading Corp. v. Direct Mail Specialist.

Once a court determines that a party breached an agreement, it usually must assess damages. Plaintiffs generally seek maximal damages, but such an award is not always in the interests of justice. The following case regards an aggrieved seller who seeks direct damages in the form of lost profits plus incidental damages in the form of storage fees and interest costs. It is these incidental damages which here are more questionable.

Before delving into the case, consider the bigger picture of why incidental damages are awarded to sellers. The purpose of incidental damage awards is to encourage sellers to make the best use of goods that buyers refused to take. Sellers are incentivized to retrieve, store, and resell these goods because they can, in theory, collect damages for reasonable costs so incurred. If these incentives work, then breaches are less likely to result in wasted and ruined goods. Not wasting valuable goods is generally positive for social welfare, but the rule can also be abused by sellers who spend unreasonable time or costs with regard to repudiated, rejected, or revoked goods. The next case discusses how courts should apply the rule in a manner that strikes the appropriate balance.

**North American Foreign Trading Corp. v.
Direct Mail Specialist**

697 F. Supp. 163 (S.D.N.Y. 1988)

KRAM, Judge.

In this breach of contract action, plaintiffs are suing to recover on a contract through which they were to provide certain goods to defendant. Defendant and the additional counterclaim defendant have counterclaimed for breach of contract and fraud. Presently before the Court is plaintiffs' motion *in limine* for a determination of the proper method of calculating the appropriate amount of statutory pre-judgment interest in this action. The dispute over this legal issue has stymied the parties' attempts at a negotiated settlement.

Background

Based on an affirmation submitted by plaintiffs, the following appear to be the facts relevant to the present motion. In May, 1983, the parties met to discuss the sale of a blackjack game to defendant DMS, Inc. ("DMS"). Through an exchange of correspondence, the parties agreed that plaintiff North American Foreign Trading Corporation ("NAFTC") would supply defendant with a total 164,968 units in minimum monthly installments of 15,000 units at a cost of \$12 per unit. Defendant provided plaintiffs with a deposit of \$100,000 to be applied only to the last shipment.

NAFTC made monthly shipments of 15,000 units to defendant from May, 1983 through August, 1983. DMS paid the contract price of \$ 12 per unit for each of these shipments. In September, 1983, DMS requested NAFTC to delay the monthly shipments until February or March, 1984 to allow DMS to consume its current inventories. By letter dated September 15, 1983, Gordon Nelms, defendant's representative, stated the reasons for requesting the delay, noted that plaintiffs had refused to delay shipments and then proceeded to cancel the outstanding purchase order for that month. Nelms concluded the letter by stating that "no further shipments will be accepted by this organization."

Plaintiffs commenced this action shortly thereafter. Plaintiffs state that they attempted to sell the remaining 104,968 units, but only managed to sell small quantities during the period from September, 1983 through mid-1986. In mid-1986, plaintiffs began selling the product in bulk to a single purchaser at a price of \$11 per unit. All of the units were eventually sold. Plaintiffs still have possession of defendant's \$100,000 deposit.

Discussion

On the assumption that plaintiffs would prevail on all issues, plaintiffs argue that it would be entitled to recover: (1) the contract price of the goods less the amount realized by NAFTC upon resale of the goods, (2) storage and insurance costs and (3) interest at the statutory rate of nine percent (9%) on the full contract price and the storage and insurance costs for the period September, 1983 through the time of resale in mid-1986 and interest on the contract price less the amount received upon resale for the period of mid-1986 through the time of judgment. Defendant counters that plaintiffs would only be entitled to interest on the net amount of damages, i.e., the contract price plus storage and insurance costs less the amount received upon resale.

Since jurisdiction in this action is premised on diversity of citizenship, the Court will apply New York law. Section 5001(a) of the Civil Practice Law and Rules ("CPLR") of New York states that "Interest shall be recovered upon a sum awarded because of a breach of performance of a contract." (McKinney's 1963). Section 5001(b) states that

Interest shall be computed from the earliest ascertainable date the cause of action existed, except that interest upon damages incurred thereafter shall be computed from the date incurred. Where such damages were incurred at various times, interest shall be computed upon each item from the date it was incurred or upon all of the damages from a single reasonable intermediate date.

Defendant argues that the statute speaks for itself and restricts any computation of interest to the net amount of damages, or the "sum awarded" for breach of performance. Plaintiffs, choosing not to discuss the nuances of this limiting language, stresses that the purpose behind this section and the damage sections of the Uniform Commercial Code as applied in New York is to put a party in the same position it would have enjoyed but for the breach. The Court finds merit in each parties' argument.

Each side calls the Court's attention to a few cases, none of which directly reaches the question presently before the Court. In *Intermeat, Inc. v. American Poultry, Inc.*, the Court awarded the seller interest on the full contract price for the period from the date of breach until the buyer remitted further monies to seller, and thereafter, on the difference between the contract price and the monies remitted. Although the Court awarded interest consistent with plaintiffs' position in this case, one important difference must be noted. In *Intermeat*, the seller had shipped the goods to the buyer who then repudiated the contract but retained possession of the goods.

Similarly, in *Bulk Oil (U.S.A.), Inc. v. Sun Oil Trading Co.*, the buyer accepted delivery of the goods and thereafter repudiated the contract. In this case, on the other hand, the seller retained possession of the goods before and after the alleged repudiation. Thus, any argument made that interest should be awarded on the full contract price makes greater sense in the cases cited by plaintiffs in light of the fact that the seller had already delivered the goods to the buyer.

Defendant's cases are also distinguishable, though for different reasons. Defendant cites *Pro-Specialties, Inc. v. Thomas Funding Corp.*, for the proposition that interest should be awarded only on the net amount recovered. In that case, the seller sought damages from a third-party guarantor. The buyer defaulted in August, 1982 and the guarantor made only one payment of \$5000 in October, 1982. The District Court awarded damages to the seller in the amount of the outstanding invoices less the \$5000 received from the guarantor, and then awarded interest on this net amount of damages from the date of breach in August, 1982.

Although the Court awarded interest in a manner consistent with defendant's position in this case, the Court believes that the cases are factually distinguishable. In *Pro-Specialties*, the delay between the time of breach and the time the seller received the \$5000 was only two to three months, and the \$5000 received was only a fraction of the amount due. The seller thus received interest on the bulk of the contract price from the date of breach, and the lost time-value of the \$5000 for the three months was relatively minuscule. In this case, on the other hand, plaintiffs claim that they had to wait some three years before receiving any significant amount of money due on the contract. Defendant's theory of the appropriate interest recovery would deny plaintiffs any substantial recovery for the funds not received during those three years.

Under the provisions of New York's Uniform Commercial Code seller's damages can be calculated in a few ways, depending on the circumstances. See N.Y. U.C.C. §§ 2-703 et seq. The seller may resell the goods and recover the difference between the contract price and the resale price, plus incidental damages, assuming the resale was accomplished in a commercially reasonable time. *Id.* § 2-706.

An aggrieved party must mitigate damages by resale if feasible. If the aggrieved seller fails to resell in a commercially reasonable time, then damages can be calculated as the difference between the unpaid contract price and the market price of the goods at the time and place of tender, plus incidental damages. N.Y. U.C.C. § 2-708(1). If that amount is inadequate to put the seller in as good a position as performance would

have done, then damages may be calculated by awarding the seller the lost profit, including reasonable overhead and incidental damages. *Id.* § 2-708(2). The seller may also sue for the price of the goods, plus incidental damages, either for goods accepted by the seller or for “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.” *Id.* § 2-709.

The damages provisions are designed to put the seller in the same position he would have enjoyed had the buyer not breached the contract. N.Y. U.C.C. § 1-106 (U.C.C. provisions should be construed liberally so that the aggrieved party may be put in the position he would have enjoyed had the other party fully performed). Defendant’s proposed method of interest calculation would not put plaintiffs in the same position they would have enjoyed had defendant performed—if resale during the three-year period between the time of breach and mid-1986, when the goods were in fact resold, was not reasonably feasible at a reasonable price. If resale was not reasonably feasible, then plaintiffs suffered losses during the three-year period for the lost time value of the money they would have received had defendant fully performed.

In *Bulk Oil*, the Second Circuit recognized that an aggrieved seller could recover as incidental damages interest payments made to a bank that would not have been made had the buyer performed. Similarly, in *Intermeat*, the Court awarded as incidental damages finance charges the seller incurred as a result of the buyer’s breach. The Second Circuit intimated that the time value of money is recoverable in noting that “the rate used in computing statutory interest is an assumption about the value of the use of money.” The Court thus decides that plaintiffs would be entitled to recover interest at the statutory rate on the contract price (less the \$100,000 deposit) from the date of breach until the time at which the seller could reasonably have resold the goods with reasonable effort for a reasonable price. Plaintiffs are entitled to such interest only if the delay was reasonable under the circumstances. If the delay were unreasonable, plaintiff would be entitled to interest on damages based on the difference between the contract price and the market price at the time of breach or some reasonable time thereafter, see N.Y. U.C.C. § 2-708(1), or on the lost profit, see N.Y. U.C.C. § 2-708(2). Whether the three-year delay before the goods were resold was reasonable is a question that remains to be resolved at trial.

SO ORDERED.

Reflection

North American demonstrates how courts will evaluate sellers’ remedies under the UCC. Recall that sellers are not entitled to consequential damages, but incidental damages may be available to sellers who expect costs in dealing appropriately with repudiated, rejected, or revoked goods. *North American* thus provides an effective review of the rules regarding UCC damages for sellers.

This case also brings up a new concept that is worth highlighting: time value of money. The simple version of this idea is that, in ordinary economic conditions, a dollar today is worth more than a dollar tomorrow. For one thing, you can spend a dollar that you have presently, but you cannot spend a dollar you do not yet have, and this alone tends to make having the dollar sooner more valuable. Also, the future is inherently uncertain, and there is some risk that dollars promised in the future never arrive, whereas the one in your wallet is already in your possession. Time value of money is related to the interest rate, which is the amount one pays to borrow money. The fact that people pay interest to borrow money shows that having money now is worth more than having that money later, and that value is measurable by the interest paid for the privilege of having that money sooner.

Another way to think of the time value of money is as a discount rate: money in the future is (generally) worth less than money today, and the longer into the future one expects to receive money, the greater the diminution in its value. For this reason, we say that future dollars are “discounted” in relation to present value. For example, if we can determine that receiving a dollar in a week is worth ninety cents today—meaning, you would be indifferent between receiving a dollar in a week or ninety cents today—we can say that that future dollar is subject to a 10% discount.

For present purposes, it is critical to note that courts must take economic reality into account when measuring damages. Lawyers and law professors (who have a reputation for being averse to mathematics in general) tend to overlook such economic complexities as time value of money. The *North American* court itself laments this point in a footnote not included in the excerpt. The court criticizes a 1984 law review article titled *An Economic Analysis of the Lost-Volume Retail Seller*, 49 ALBANY L. REV. 889 (1985), observing that “This Comment, though quite complete in most respects, does not discuss the time value of money as an element of economic damages, reflecting a lack of discussion of this topic generally in this area.”

Fortunately, the law and economics movement has made great progress in the past forty years. Courts, academics, and even practicing attorneys have greater knowledge of economic principles, and these principles are applied to render judicial decisions that reflect business reality. Students who plan to practice commercial law should likewise consider how to expand their knowledge of and comfort with using economic concepts and analysis to make legal arguments.

Discussion

1. The *North American* court remands the question of whether the three-year period before reselling the goods at issue was reasonable. What factors should the trial court consider when determining what constitutes a reasonable time to resell goods?

2. What is the logical connection between the economic concept of time value of money and the legal concept of awarding incidental damages for interest?

Reading Ramirez v. Autosport. *Ramirez* is a relatively modern classic. The case is popular in part because the Supreme Court of New Jersey takes the time and effort to extensively discuss and describe the meaning and purpose of UCC remedies. In addition, its subject matter—the purchase and sale of an RV—is not especially technical. The court also does an excellent job analyzing the readily comprehensible facts of this case under the UCC rules. You can thus derive two benefits from reading *Ramirez*. First, the case reviews the UCC remedies and explains them by integrating case law and commentary from a variety of leading authorities, thus helping you understand what this complex area of law involves and requires. Second, it analyzes an understandable (albeit unfortunate) situation under these rules, thus helping you to see how UCC remedies analysis should be conducted. As you read *Ramirez*, take the opportunity to refine your knowledge of UCC remedies and to learn, by example, how to analyze facts and craft balanced arguments under these rules.

Ramirez v. Autosport

88 N.J. 277 (1982)

POLLACK, J.

This case raises several issues under the Uniform Commercial Code (“the Code” and “UCC”) concerning whether a buyer may reject a tender of goods with minor defects and whether a seller may cure the defects. We consider also the remedies available to the buyer, including cancellation of the contract. The main issue is whether plaintiffs, Mr. and Mrs. Ramirez, could reject the tender by defendant, Autosport, of a camper van with minor defects and cancel the contract for the purchase of the van.

The trial court ruled that Mr. and Mrs. Ramirez rightfully rejected the van and awarded them the fair market value of their trade-in van. The Appellate Division affirmed in a brief *per curiam* decision which, like the trial court opinion, was unreported. We affirm the judgment of the Appellate Division.

I

Following a mobile home show at the Meadowlands Sports Complex, Mr. and Mrs. Ramirez visited Autosport’s showroom in Somerville. On July 20, 1978 the Ramirezes and Donald Graff, a salesman for Autosport, agreed on the sale of a new camper and the trade-in of the van owned by Mr. and Mrs. Ramirez. Autosport and the Ramirezes signed a simple contract reflecting a \$14,100 purchase price for the new

van with a \$4,700 trade-in allowance for the Ramirez van, which Mr. and Mrs. Ramirez left with Autosport. After further allowance for taxes, title and documentary fees, the net price was \$9,902. Because Autosport needed two weeks to prepare the new van, the contract provided for delivery on or about August 3, 1978.

On that date, Mr. and Mrs. Ramirez returned with their checks to Autosport to pick up the new van. Graff was not there so Mr. White, another salesman, met them. Inspection disclosed several defects in the van. The paint was scratched, both the electric and sewer hookups were missing, and the hubcaps were not installed. White advised the Ramirezes not to accept the camper because it was not ready.

Mr. and Mrs. Ramirez wanted the van for a summer vacation and called Graff several times. Each time Graff told them it was not ready for delivery. Finally, Graff called to notify them that the camper was ready. On August 14 Mr. and Mrs. Ramirez went to Autosport to accept delivery, but workers were still touching up the outside paint. Also, the camper windows were open, and the dining area cushions were soaking wet. Mr. and Mrs. Ramirez could not use the camper in that condition, but Mr. Leis, Autosport's manager, suggested that they take the van and that Autosport would replace the cushions later. Mrs. Ramirez counteroffered to accept the van if they could withhold \$2,000, but Leis agreed to no more than \$250, which she refused. Leis then agreed to replace the cushions and to call them when the van was ready.

On August 15, 1978 Autosport transferred title to the van to Mr. and Mrs. Ramirez, a fact unknown to them until the summer of 1979. Between August 15 and September 1, 1978 Mrs. Ramirez called Graff several times urging him to complete the preparation of the van, but Graff constantly advised her that the van was not ready. He finally informed her that they could pick it up on September 1.

When Mr. and Mrs. Ramirez went to the showroom on September 1, Graff asked them to wait. And wait they did—for one and a half hours. No one from Autosport came forward to talk with them, and the Ramirezes left in disgust.

On October 5, 1978 Mr. and Mrs. Ramirez went to Autosport with an attorney friend. Although the parties disagreed on what occurred, the general topic was whether they should proceed with the deal or Autosport should return to the Ramirezes their trade-in van. Mrs. Ramirez claimed they rejected the new van and requested the return of their trade-in. Mr. Lustig, the owner of Autosport, thought, however, that the deal could be salvaged if the parties could agree on the dollar amount of a credit for the Ramirezes. Mr. and Mrs. Ramirez never took possession of the new van and repeated their request for the return of their trade-in. Later in October, however, Autosport sold the trade-in to an innocent third party for \$4,995. Autosport claimed that the Ramirez' van had a book value of \$3,200 and claimed further that it spent \$1,159.62 to repair their van. By subtracting the total of those two figures, \$4,159.62, from the \$4,995.00 sale price, Autosport claimed a \$600-700 profit on the sale.

On November 20, 1978 the Ramirezes sued Autosport seeking, among other things, rescission of the contract. Autosport counterclaimed for breach of contract.

II

Our initial inquiry is whether a consumer may reject defective goods that do not conform to the contract of sale. The basic issue is whether under the UCC, adopted in New Jersey as N.J.S.A. 12A:1-101 et seq., a seller has the duty to deliver goods that conform precisely to the contract. We conclude that the seller is under such a duty to make a “perfect tender” and that a buyer has the right to reject goods that do not conform to the contract. That conclusion, however, does not resolve the entire dispute between buyer and seller. A more complete answer requires a brief statement of the history of the mutual obligations of buyers and sellers of commercial goods.

In the nineteenth century, sellers were required to deliver goods that complied exactly with the sales agreement. That rule, known as the “perfect tender” rule, remained part of the law of sales well into the twentieth century. By the 1920’s the doctrine was so entrenched in the law that Judge Learned Hand declared “[t]here is no room in commercial contracts for the doctrine of substantial performance.”

The harshness of the rule led courts to seek to ameliorate its effect and to bring the law of sales in closer harmony with the law of contracts, which allows rescission only for material breaches. Nevertheless, a variation of the perfect tender rule appeared in the Uniform Sales Act.

The chief objection to the continuation of the perfect tender rule was that buyers in a declining market would reject goods for minor nonconformities and force the loss on surprised sellers.

To the extent that a buyer can reject goods for any nonconformity, the UCC retains the perfect tender rule. Section 2-106 states that goods conform to a contract “when they are in accordance with the obligations under the contract.” Section 2-601 authorizes a buyer to reject goods if they “or the tender of delivery fail in any respect to conform to the contract.” The Code, however, mitigates the harshness of the perfect tender rule and balances the interests of buyer and seller. See R2d §241 cmt. b. The Code achieves that result through its provisions for revocation of acceptance and cure.

Initially, the rights of the parties vary depending on whether the rejection occurs before or after acceptance of the goods. Before acceptance, the buyer may reject goods for any nonconformity. Because of the seller’s right to cure, however, the buyer’s rejection does not necessarily discharge the contract. Within the time set for performance in the contract, the seller’s right to cure is unconditional. Some authorities recommend granting a breaching party a right to cure in all contracts, not merely those for the sale of goods. See R2d ch. 10, especially §§ 237 and 241. Underlying the right to cure in both kinds of contracts is the recognition that parties should be encouraged to communicate with each other and to resolve their own problems.

The rights of the parties also vary if rejection occurs after the time set for performance. After expiration of that time, the seller has a further reasonable time to cure if he believed reasonably that the goods would be acceptable with or without a money allowance. The determination of what constitutes a further reasonable time

depends on the surrounding circumstances, which include the change of position by and the amount of inconvenience to the buyer. Those circumstances also include the length of time needed by the seller to correct the nonconformity and his ability to salvage the goods by resale to others. Thus, the Code balances the buyer's right to reject nonconforming goods with a "second chance" for the seller to conform the goods to the contract under certain limited circumstances.

After acceptance, the Code strikes a different balance: the buyer may revoke acceptance only if the nonconformity substantially impairs the value of the goods to him. This provision protects the seller from revocation for trivial defects. It also prevents the buyer from taking undue advantage of the seller by allowing goods to depreciate and then returning them because of asserted minor defects. Because this case involves rejection of goods, we need not decide whether a seller has a right to cure substantial defects that justify revocation of acceptance.

Other courts agree that the buyer has a right of rejection for any nonconformity, but that the seller has a countervailing right to cure within a reasonable time.

We conclude that the perfect tender rule is preserved to the extent of permitting a buyer to reject goods for any defects. Because of the seller's right to cure, rejection does not terminate the contract.

A further problem, however, is identifying the remedy available to a buyer who rejects goods with insubstantial defects that the seller fails to cure within a reasonable time. The Code provides expressly that when "the buyer rightfully rejects, then with respect to the goods involved, the buyer may cancel."

"Cancellation" occurs when either party puts an end to the contract for breach by the other. Nonetheless, some confusion exists whether the equitable remedy of rescission survives under the Code.

The Code eschews the word "rescission" and substitutes the terms "cancellation," "revocation of acceptance," and "rightful rejection." Although neither "rejection" nor "revocation of acceptance" is defined in the Code, rejection includes both the buyer's refusal to accept or keep delivered goods and his notification to the seller that he will not keep them. Revocation of acceptance is like rejection, but occurs after the buyer has accepted the goods. Nonetheless, revocation of acceptance is intended to provide the same relief as rescission of a contract of sale of goods.

In brief, revocation is tantamount to rescission. Similarly, subject to the seller's right to cure, a buyer who rightfully rejects goods, like one who revokes his acceptance, may cancel the contract. We need not resolve the extent to which rescission for reasons other than rejection or revocation of acceptance, e.g. fraud and mistake, survives as a remedy outside the Code. Accordingly, we recognize that explicit Code remedies replace rescission, and disapprove suggestions the UCC expressly recognizes rescission as a remedy.

Although the complaint requested rescission of the contract, plaintiffs actually sought not only the end of their contractual obligations, but also restoration to their

pre-contractual position. That request incorporated the equitable doctrine of restitution, the purpose of which is to restore plaintiff to as good a position as he occupied before the contract. In UCC parlance, plaintiffs' request was for the cancellation of the contract and recovery of the price paid.

General contract law permits rescission only for material breaches, and the Code restates "materiality" in terms of "substantial impairment." The Code permits a buyer who rightfully rejects goods to cancel a contract of sale. Because a buyer may reject goods with insubstantial defects, he also may cancel the contract if those defects remain uncured. Otherwise, a seller's failure to cure minor defects would compel a buyer to accept imperfect goods and collect for any loss caused by the nonconformity.

Although the Code permits cancellation by rejection for minor defects, it permits revocation of acceptance only for substantial impairments. That distinction is consistent with other Code provisions that depend on whether the buyer has accepted the goods. Acceptance creates liability in the buyer for the price, and precludes rejection. Also, once a buyer accepts goods, he has the burden to prove any defect. By contrast, where goods are rejected for not conforming to the contract, the burden is on the seller to prove that the nonconformity was corrected.

Underlying the Code provisions is the recognition of the revolutionary change in business practices in this century. The purchase of goods is no longer a simple transaction in which a buyer purchases individually-made goods from a seller in a face-to-face transaction. Our economy depends on a complex system for the manufacture, distribution, and sale of goods, a system in which manufacturers and consumers rarely meet. Faceless manufacturers mass-produce goods for unknown consumers who purchase those goods from merchants exercising little or no control over the quality of their production. In an age of assembly lines, we are accustomed to cars with scratches, television sets without knobs and other products with all kinds of defects. Buyers no longer expect a "perfect tender." If a merchant sells defective goods, the reasonable expectation of the parties is that the buyer will return those goods and that the seller will repair or replace them.

Recognizing this commercial reality, the Code permits a seller to cure imperfect tenders. Should the seller fail to cure the defects, whether substantial or not, the balance shifts again in favor of the buyer, who has the right to cancel or seek damages. In general, economic considerations would induce sellers to cure minor defects. Assuming the seller does not cure, however, the buyer should be permitted to exercise his remedies under the Code. The Code remedies for consumers are to be liberally construed, and the buyer should have the option of canceling if the seller does not provide conforming goods.

To summarize, the UCC preserves the perfect tender rule to the extent of permitting a buyer to reject goods for any nonconformity. Nonetheless, that rejection does not automatically terminate the contract. A seller may still effect a cure and preclude unfair rejection and cancellation by the buyer.

III

The trial court found that Mr. and Mrs. Ramirez had rejected the van within a reasonable time. The court found that on August 3, 1978, Autosport's salesman advised the Ramirezes not to accept the van and that on August 14, they rejected delivery and Autosport agreed to replace the cushions. Those findings are supported by substantial credible evidence, and we sustain them. Although the trial court did not find whether Autosport cured the defects within a reasonable time, we find that Autosport did not effect a cure. Clearly the van was not ready for delivery during August, 1978 when Mr. and Mrs. Ramirez rejected it, and Autosport had the burden of proving that it had corrected the defects. Although the Ramirezes gave Autosport ample time to correct the defects, Autosport did not demonstrate that the van conformed to the contract on September 1. In fact, on that date, when Mr. and Mrs. Ramirez returned at Autosport's invitation, all they received was discourtesy.

On the assumption that substantial impairment is necessary only when a purchaser seeks to revoke acceptance, the trial court correctly refrained from deciding whether the defects substantially impaired the van. The court properly concluded that plaintiffs were entitled to "rescind"—i.e., to "cancel"—the contract.

Because Autosport had sold the trade-in to an innocent third party, the trial court determined that the Ramirezes were entitled not to the return of the trade-in, but to its fair market value, which the court set at the contract price of \$4,700. A buyer who rightfully rejects goods and cancels the contract may, among other possible remedies, recover so much of the purchase price as has been paid.

The Code, however, does not define "pay" and does not require payment to be made in cash.

A common method of partial payment for vans, cars, boats and other items of personal property is by a "trade-in." When concerned with used vans and the like, the trade-in market is an acceptable, and perhaps the most appropriate, market in which to measure damages. It is the market in which the parties dealt; by their voluntary act they have established the value of the traded-in article. In other circumstances, a measure of damages other than the trade-in value might be appropriate.

The ultimate issue is determining the fair market value of the trade-in. This Court has defined fair market value as "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." Although the value of the trade-in van as set forth in the sales contract was not the only possible standard, it is an appropriate measure of fair market value.

For the preceding reasons, we affirm the judgment of the Appellate Division.

Reflection

Part II of *Ramirez* effectively functions as a mini-treatise on UCC buyers' remedies. It makes two critical points regarding UCC remedies. First, the UCC nominally has a perfect tender rule, but this does not give buyers the right to reject goods willy-nilly. Rather, buyers have a good-faith obligation which extends to their rejection rights. Sellers, meanwhile, have some right to cure, and buyers have some obligation to give them time to cure. Remember, the goal of contract law is not to meet venial faults with harsh oppression but rather to ensure that parties receive the mutual benefits of their commercial agreements. The UCC, in particular, encourages behavior that maximizes social welfare by encouraging parties to work things out before litigating their issues.

Discussion

1. Is substantial performance or perfect tender the more appropriate standard? Why should this standard be different in contracts for services versus contracts for goods?
 2. Does the UCC really require perfect tender in the first instance? Or must the rule be read more softly such that there is room for sellers to err without forfeiting their right to payment?
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Problems

Problem 25.1. Yugo Motors

Blake ordered a luxury automobile loaded with accessories from Yugo Motors for a contract price of \$66,000. When the car arrived, Blake discovered that it lacked four of the features that Blake had ordered. Yugo refused to take back the car and order a new one.

What damages should be awarded to Blake?

Problem 25.2. Not-So-Elite Builders

Maria contracts with Elite Builders to renovate her kitchen for \$50,000. Elite finishes the renovation, but the new countertops are misaligned, and the backsplash is uneven. Fixing these issues would cost \$10,000, but the defects reduce the home's value by only \$2,000.

What damages should Maria recover if she values the aesthetic improvements?

Would the remedy change if the defects were merely cosmetic and did not affect the home's functionality?

Problem 25.3. Ace Printing

Ace Printing contracts to buy a high-speed printer from TechMach for \$120,000. The printer is delivered and functions, but it produces smudges on every tenth page, which violates the contract's specifications. Repairing the printer would cost \$30,000, but the diminished value due to the smudges is \$15,000. Ace also spent \$2,000 in testing the printer to ensure it meets industry standards.

Should the court award Ace the cost of repair or diminution in value? Why?

What incidental damages, if any, is Ace entitled to recover?

Problem 25.4. Faulty Lift

A luxury apartment developer purchases four high-end elevators from RapidLift for \$1.2 million. Following installation, two of the elevators occasionally malfunction and stop between floors. The repair costs for the elevators would total \$400,000, while the diminished value of the building due to unreliable elevators is \$200,000. RapidLift offers to repair the elevators within two months at no cost, but the developer refuses the offer.

Can the developer refuse RapidLift's offer to cure the defects?

If the court awards damages, should it award the cost of repair or the diminished value?

Chapter 26

Limitations on Money Damages

Money damages, designed to make injured parties whole, are the cornerstone of contract law remedies. Yet even this fundamental principle has limits. Imagine agreeing to deliver machine parts to a factory for \$10,000, with a 1% penalty for each day of delay. You deliver ten days late and expect to pay a \$1,000 penalty. Instead, you're hit with a \$10 million lawsuit because the factory claims they lost a government contract. They never told you about this deal during negotiations. Should you really bear the burden of such extraordinary losses? This scenario highlights the central challenge of balancing fair compensation for injured parties with reasonable limits on liability for breaching parties.

This example underscores a critical challenge in contract law: balancing fair compensation for injured parties with reasonable protection for breaching parties. Without clear boundaries, damages can become wildly disproportionate to the harm caused. Such risks of disproportionate liability could undermine predictability and discourage commercial agreements. To address this, contract law employs doctrines that keep money damages aligned with actual harm while preventing speculative or excessive recoveries. These doctrines help to ensure that remedies remain fair and practical, which supports trust in contracts as reliable tools for commerce.

This chapter explores three key doctrines that limit money damages: foreseeability, certainty, and mitigation. Each ties closely to the core interests contract law seeks to protect.

Foreseeability, as the cornerstone of the expectation interest, ensures that damages reflect only those risks the breaching party reasonably expected at the time of contracting. This protects the integrity of the bargain by aligning compensation with what the parties actually agreed to give and get.

Certainty also supports the expectation interest by requiring damages to be grounded in concrete, provable harm, thus ensuring that compensation is accurate and not speculative. This prevents courts from awarding damages based on guesswork or hypothetical losses.

Mitigation, on the other hand, connects primarily to the reliance interest. It prevents injured parties from passively allowing damages to grow and instead encourages them to minimize their losses. This doctrine provides a legal incentive for parties to act responsibly, even in the event of breach, while fostering fairness and economic efficiency.

Together, these doctrines create a framework that balances fair compensation with reasonable limits on liability, thus enabling contracts to remain reliable tools for economic exchange. By examining these doctrines, you will see how courts navigate the tension between fairness and efficiency. Through clear rules that align money damages with provable harm, contract law provides parties with predictable outcomes and encourages them to engage in reasonable risk management. Understanding these limitations not only helps one to anticipate the results of litigation but also to draft agreements that minimize disputes and align with commercial realities.

Rules

A. Foreseeability

Foreseeability is one of the foundational doctrines limiting money damages in contract law. It ensures that damages are tied to the risks the breaching party knew or should have known about at the time the contract was formed. By aligning damages with the expectation interest of the nonbreaching party, foreseeability ensures that remedies reflect the reasonable expectations of both parties, particularly the breaching party, who should not be held liable for risks it could not have reasonably anticipated. R2d § 351(1) provides:

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.

Similarly, NH UCC § 2-715(2)(a) states:

Consequential damages resulting from the seller's breach include any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise.

To evaluate whether damages are foreseeable, courts ask whether the breaching party knew or should have known about the other party's circumstances at the time of contracting. R2d § 351(2) explains:

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.

Foreseeability hinges on what the breaching party knew or should have known at the time of contracting. This includes not only actual knowledge but also constructive knowledge, i.e., information that a reasonable person in the breaching party's position would have known given the circumstances. For instance, in a contract for delivery services, a breaching party knew or should have known of a buyer's reliance on a

timely delivery if the buyer explicitly communicated their needs during negotiations or paid for rush delivery. In a sale of goods, the seller knew or should have known that the buyer's operations depend on timely fulfillment because the contract communicates that "time is of the essence" or it contains a representation that the seller understands the parts are "mission critical."

However, one cannot collect damages for all losses resulting from delays simply by writing "time is of the essence" in a contract. Damages must be foreseeably related to the breach. The famous case of *Hadley v. Baxendale*, 56 Eng. Rep. 145, 9 Exch. 341 (1854), which appears later in this chapter, illustrates this limitation.

In *Hadley*, Mr. Hadley and Mr. Anor, as partners, owned a mill in the city of Gloucester, England. One day, the central crankshaft of a critical steam engine at the mill broke. Hadley arranged for W. Joyce & Co. to make a new crankshaft, and he hired Baxendale to transport the new crankshaft to the mill. But Baxendale failed to deliver the crankshaft on time. Hadley sued for the cost of his mill being out of service for longer than expected.

Baron Sir Edward Hall Alderson, sitting as judge in the Court of Exchequer, considered whether Hadley should be allowed to recover these lost profits from Baxendale. First, Judge Alderson set forth the rule regarding such consequential damages:

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.

Judge Alderson then found, as a matter of fact, that delays from shipment are foreseeable. One question, however, remained: whether Baxendale reasonably supposed that his delay would cost the mill lost profits. The court heard convincing testimony that most mills had at least one spare crankshaft, such that the delay of a replacement crankshaft should not cause the mill to remain shut down. Baxendale, for his part, had no special reason to know that Hadley lacked this spare part. Since a shipper in ordinary circumstances would not expect his delay to cause such lost profits, and since there was nothing in this case which took its facts out of the ordinary, Baxendale was not liable for Hadley's lost profits. The case still stands as the paradigmatic example of the foreseeability limit on damages.

B. Certainty

The certainty doctrine ensures that damages awarded in breach of contract cases are based on concrete, provable losses rather than speculation. Expectation damages, the typical remedy for breach of contract, requires foresight because it asks what the

value would have been had the contract been performed. The question begs a counterfactual answer, which has inherent challenges: how does a litigant factually prove something that did not happen?

To address the problem, courts require a reasonable degree of certainty. This ensures that the remedies align with the compensatory goal of contract law: to put the injured party in the position they would have been in had the breach not occurred. By requiring reasonable certainty, the doctrine also prevents awards that go beyond compensation, which ensures that damages do not unintentionally create windfalls for the injured party.

Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty. R2d § 352.

This general principle is reflected in specific provisions of the UCC that emphasize the need for reliable proof of damages in various contexts. For example, UCC § 2-715(2)(b) allows recovery of consequential damages only when they “could not reasonably be prevented” and “result from the seller’s breach,” ensuring that claims are tied to demonstrable harm.

Certainty of damages is especially relevant in cases involving lost profits, new businesses, or complex contractual relationships. Established businesses typically have the financial records, historical data, and market analyses needed to prove lost profits with reasonable certainty. By contrast, new ventures face greater challenges. Courts are generally skeptical of awarding lost profits to businesses without a track record unless they can provide robust evidence, such as comparable market data or expert testimony.

For example, a commercial storage facility has ten storage units on premises. All are leased out consistently for the past ten years, and each currently generates \$1,000 in monthly rental income. The facility hires a construction company to build an eleventh unit by a certain date. If the construction company completes construction two months late, the facility can likely prove that its expectation damages include \$2,000 in lost profits. However, if an entrepreneur wants to build an entirely new commercial storage facility in a rural location that does not have any other storage options nearby, and if the contractor is late in this project, proving lost profits with certainty is much harder. Without evidence of rent rates, those damages are too speculative to recover.

C. Mitigation

The doctrine of mitigation (sometimes called the “duty to mitigate” or the “doctrine of avoidability”) requires an injured party to take reasonable steps, not extraordinary efforts, to minimize one’s own losses that result from a breach. Put differently, if you can avoid or lessen your damages by taking sensible action, the law expects you

to do so. Because contract law discourages waste and inefficiency, it will not compensate a party for losses that could have been prevented without undue risk, burden, or humiliation.

Damages are not recoverable for loss that the injured party could have avoided without undue risk, burden, or humiliation. R2d § 350.

I Imagine an employment contract for a one-year term at \$60,000, to be paid monthly at \$5,000 per month. Three months in, after paying \$15,000, the employer fires the employee without cause. The employee immediately looks for comparable work, spends one month and \$500 on the job search, and secures a new position that pays \$32,000 for the remaining eight months of the year. Because the employee made good-faith efforts to find substitute work, her damages would typically be the difference between the original salary (\$60,000) and her new earnings (\$32,000), plus job search expenses (\$500), minus the amount already paid (\$15,000). Her net recovery would be \$13,500. After a successful lawsuit, the court would award damages sufficient to make her financially whole—that is, to put her in the same position she would have occupied had the employer fully performed.

If instead she had sat at home without looking for another job, or turned down comparable positions out of spite, a court could reduce or deny recovery for those avoidable losses. Even though her total lost income might appear to be \$45,000 (the remaining nine months of the contract after the \$15,000 she already received), a court might find she could have reasonably mitigated \$32,000 of that amount. In that case, her damages would be reduced to \$13,000, plus any job search expenses she might have incurred. A party is thus advised to mitigate damages and not simply let them “pile up.”

Again, mitigation requires reasonable—not extraordinary—efforts. An employer who breaches can't insist that the employee take any job at any wage; the replacement position must be reasonably comparable. If the employment was for computer programming, she does not have to take a job as a correction officer. If she was hired to be the CEO of a mid-size bank, courts would not expect her to accept a position as a custodian in the subway. Mitigation focuses on what an ordinary, prudent person would do in the same situation: step up to reduce harm, but not at the expense of one's dignity or financial well-being.

The UCC applies the mitigation principle to the sale of goods. Under UCC § 2-712, a buyer has the right to cover by procuring substitute goods in good faith. Under UCC § 2-706, a seller may resell goods in a commercially reasonable manner to minimize damages. Both provisions reflect contract law's broader goal of preventing avoidable losses.

Consider a scenario where Precision Lasers agrees to buy 1,000 specialized microchips from ThinkPC at \$10 per chip. ThinkPC delivers only 600. Precision, needing the full shipment to meet its own obligations, purchases 400 replacement chips

elsewhere, at \$11 per chip. Precision sues for the extra cost of \$1 per chip. If the court finds that Precision acted reasonably, it will award \$400 in cover damages, plus appropriate incidental costs.

If Precision had not tried to cover and instead canceled its downstream orders while seeking \$20 in lost profits per laser, the court would probably reject that approach. Precision would have failed to mitigate its damages by making no reasonable effort to obtain the missing chips.

Consider another example. Focus Technologies refuses to accept 500 custom chips from ThinkPC, at \$15 per chip. ThinkPC resells them at \$12 each and then sues Focus. If ThinkPC acted promptly and resold at a fair price, then the court will award damages for the \$3 difference per chip, plus incidental expenses for storage and resale. But if ThinkPC does nothing and leaves the chips in a warehouse, then trashes them years later, a court would likely deny lost-profit damages and refuse any incidental damages for the disposal. ThinkPC did not resell but rather piled up unnecessary losses in a way that undercuts the law's goal of avoiding waste.

D. Reflections on Limitations on Money Damages

The doctrines limiting money damages in contract law—foreseeability, certainty, and mitigation—ensure that fairness and predictability remain central to resolving disputes while adapting remedies to evolving commercial realities. These doctrines not only connect to the core purposes of contract law, such as protecting expectation and reliance interests, but also highlight the law's practical goals: fostering trust in agreements and encouraging parties to act responsibly.

The foreseeability doctrine ensures that damages are tied to the risks contemplated by the parties when they entered into the agreement. This doctrine allows parties to assess potential risks upfront, which creates a more stable foundation for agreements. By focusing on what the breaching party reasonably expected, foreseeability provides a fair boundary for liability and strengthens trust in the contracting process.

The certainty doctrine reinforces the expectation interest by requiring concrete proof of loss, thus ensuring that damages awarded align with actual harm rather than speculation. This requirement prevents courts from overcompensating injured parties or awarding damages based on hypothetical outcomes. Certainty, therefore, protects the integrity of contract remedies while emphasizing fairness and accountability.

The mitigation doctrine connects primarily to the reliance interest by encouraging injured parties to act reasonably to limit their losses. This doctrine ensures that damages do not unfairly accumulate and promotes efficiency by discouraging wasteful inaction. It aligns with the broader goals of contract law by balancing the responsibilities of both parties in addressing breaches.

Together, these doctrines form a cohesive framework that shapes how courts assess contract disputes. They ensure that remedies remain practical and proportionate by balancing fair compensation for injured parties with reasonable limits on liability for breaching parties. This balance fosters confidence in contract law's ability to provide fair and predictable outcomes, thereby encouraging the use of contracts as reliable tools for commerce.

At the same time, the boundaries these doctrines set encourage careful planning and negotiation. Contracts must adapt to the realities of modern commerce, where risks are increasingly complex and stakes are higher than ever. How might foreseeability evolve to address the challenges posed by global supply chain disruptions or rapid technological changes? Can the doctrine of mitigation fully capture the nuances of today's digital and remote work environments? These questions underscore that contract law is not just about resolving past disputes but also about shaping agreements that meet future challenges.

By understanding these doctrines, students and practitioners alike can approach contract disputes with a deeper appreciation for how courts navigate the tension between fairness and efficiency. These limitations on money damages are not constraints; they are vital tools for reinforcing trust and ensuring that contract law evolves alongside the dynamic needs of modern commerce.

Cases

Reading Hadley v. Baxendale. One of the most famous and most durable cases in the law of contracts is *Hadley v. Baxendale*, a British case decided by the Court of Exchequer in 1854. In *Hadley*, a mill had to shut down because a carrier was slow in delivering a crankshaft to replace a broken one, and the owners of the mill sought to recover their lost profits from the carrier. However, the court ruled in favor of the carrier because the mill owners had not informed the carrier that this would be the consequence of any delay (and the carrier might have assumed that the mill had a spare shaft). The rule that emerges from the case is that a breaching party is not liable for lost profits unless the “special circumstances” giving rise to the loss were “fairly and reasonably contemplated” by the parties at the time that the contract was entered into.

The contract in *Hadley* was for shipment of a crankshaft for a steam mill. The language of this case is a bit archaic, so summaries and guide points have been added in [brackets]. Paragraph breaks have also been added, since the court did not seem to possess a “return” key and often went on for dozens of lines at a time. Otherwise, the reprinted case is mostly faithful to the original, in order to retain the color and tone of the court's famous language.

The R2d contains the modern statement of the rule on the reasonable foreseeability limitations of awards of expectation damages:

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. R2d § 351(3).

Hadley v. Baxendale

56 Eng. Rep. 145, 9 Exch. 341 (1854)

[Summary: Hadley ran a steam mill that broke its crankshaft. Baxendale promised to deliver a crankshaft to a manufacturer within two days, but it took ten extra days. Because of Baxendale's delay, Hadley's mill was out of commission during that time. Hadley sued Baxendale for the delay as measured by lost profits. Baxendale defended on the ground that a reasonable courier in his position would believe that Hadley had a spare crankshaft so that the delay would not cause lost profits. The trial court awarded lost profit damages to Hadley, and Baxendale appealed.]

At the trial before Crompton, J., at the last Gloucester Assizes, it appeared that the plaintiffs carried on an extensive business as millers at Gloucester; and that, on the 11th of May, their mill was stopped by a breakage of the crank shaft by which the mill was worked.

The steam-engine was manufactured by Messrs. Joyce & Co., the engineers, at Greenwich, and it became necessary to send the shaft as a pattern for a new one to Greenwich.

The fracture was discovered on the 12th, and on the 13th the plaintiffs sent one of their servants to the office of the defendants, who are the well-known carriers trading under the name of Pickford & Co., for the purpose of having the shaft carried to Greenwich.

The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately; and in answer to the inquiry when the shaft would be taken, the answer was, that if it was sent up by twelve o'clock that day, it would be delivered at Greenwich on the following day.

On the following day the shaft was taken by the defendants, before noon, for the purpose of being conveyed to Greenwich, and the sum of 2l. 4s. was paid for its carriage for the whole distance; at the same time the defendants' clerk was told that a special entry, if required, should be made to hasten its delivery.

The delivery of the shaft at Greenwich was delayed by some neglect; and the consequence was, that the plaintiffs did not receive the new shaft for several days after they would otherwise have done, and the working of their mill was thereby delayed, and they thereby lost the profits they would otherwise have received.



Figure 26.1. Steam mill in Yaroslavl, Russia, by unknown artist.
Public domain work.

[Hadley won in the lower court. The trial court awarded him lost profits for Baxendale's negligent delay.]

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

[Baxendale appealed, arguing that he did not know that Hadley would suffer this loss; therefore, he should not be liable for paying for it.]

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

The judgment of the [Appellate] Court was now delivered by 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.

Now we think the proper rule is such 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.

If the special circumstances under which the contract was:

actually made where communicated by the plaintiffs to the defendants, and thus known to both parties,

Then 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.

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.

[Remanded to trial court to determine whether Hadley's damages were reasonably foreseeable to Baxendale under the new rule stated above.]

Reflection

Kenney Hegland wrote an amusing reflection on this storied case. In his words:

“Of course zombies could have shown up and kept the mill going.”

Whether *Hadley* is the best of cases or the worst of cases, it surely is the most popular of cases, and the most cited.

Hadley, a miller, contracted with Baxendale, a carrier, to have a broken shaft sent to the manufacturer for repairs. Due to some neglect, the shaft was not sent on time, and Hadley lost profits due to the delay; so, he sued, and he won.

On appeal, the court granted a new trial, and the jury was to be instructed not to consider lost profits because the circumstances did not show that the mill would lose profits if the shaft was not delivered on time. Who knows? Maybe Hadley had another shaft he could use; maybe another machine had broken and the mill couldn't run anyway; or maybe zombies arrived

to save the day. Not to quibble, but it would be a very bad day to have two essential machines break down; and as to the backup shaft, was Hadley compulsive?

Of course, had Hadley told Baxendale that his was a unique case and that he had a pressing need for the shafts things might have turn[e]d out differently. Alas, he *only* said that the “article to be carried was the broken shaft of a mill and that the plaintiffs were millers of the mill.” Hold on there! In the first paragraph we are told that Hadley told Baxendale, “the mill was stopped, that the shaft must be delivered immediately, and that a special entry, if necessary, must be made to hasten its delivery.” Now my short-term memory is not what it used to be, but come on, five short paragraphs? Maybe the clerk who transcribed the opinion was in his cups—gin was very popular. But let us just put this down as a fake statement of facts and move on.

Baxendale made a promise, he did not keep it, and that breach injured Hadley. Why should he, rather than Hadley, take the loss? The jury thought he should, but the court tells us that this would be the “greatest injustice.” In tort law, you take the plaintiff as you find her—none of this “before you throw that apple let me tell you I have a very rare heart condition” nonsense. Why give the promisor a break? Between the two, it is more likely that the promisor would envision consequences of breach, as he is focusing on whether he can keep his word; the promisee is focusing on the price. It seems, however, that the greatest injustice does not turn on fault or who can better envision the harm, but rather on the harm that would flow if the jury did not buy into the notion of a cheap contract. But that is another article, and justice is beyond my scope.

“[I]f the jury [is] left without any definite rule to guide [it], it will . . . manifestly lead to the greatest injustice.” Put aside the notion that jurors might have a better idea of justice than do judges and focus instead on the notion “we cannot trust jurors.” A core notion in the law is that [. . .] we cannot trust anyone to do the right thing. Jurors are roped in by the instructions (which they must follow), by parties via their carefully drafted contracts (which they often ignore), and by judges[, and], alas, by *Hadley*.

Of course, *Hadley* did not start the fire. But are we sure that without instructions jurors would inflict the greatest injustice? Without precedent would judges be all over the lot? Why not at least think the unthinkable: junk it all and simply instruct folks to do the right thing. Do you do the right thing without first reciting rules to follow? Without *Hadley*, would the wild rumpus begin?

Kennedy Hegland, *Hadley v. Baxendale*, in Daniel Barnhizer et al., *The Best and Worst of Contracts Decisions: An Anthology*, 45 FLA. ST. U. L. REV. 887, 992–93 (2018).

Discussion

1. *Hadley* distinguishes between incidental and consequential damages, as does the R2d. But is this distinction necessary? Not all courts distinguish between different kinds of indirect damages in this way.
 2. As an alternative to distinguishing between incidental damages, which directly arise from direct damages, and consequential damages, which indirectly arise and only count as damages where they are reasonably foreseeable, could a court simplify this analysis with a rule that says all indirect damages count to the extent they are reasonably foreseeable?
 3. Do the separate concepts of incidental and consequential damages do some additional work beyond making reasonably unforeseeable losses unrecoverable?
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Problems

Problem 26.1 Freezer Failure

GeneCorp is a startup company that provides customized genetic sequencing for medical diagnostic purposes. This business relies on using cryogenic freezers that stably maintain extremely cold temperatures. GeneCorp contracts with Below Zero, Inc., a refrigeration company, to deliver and install a custom freezer for \$275,000. During negotiations, GeneCorp provided specifications for the freezer's performance but did not disclose that it was expecting \$25 million in venture capital funding that is contingent on proving GeneCorp's concept with its first customers. Below Zero delays installation by two months due to a supply chain issue, and GeneCorp loses the venture finance contract. GeneCorp sues for the \$25 million in lost funding.

What facts support GeneCorp's claim that the damages were foreseeable?

What facts support Below Zero's defense that the damages were not foreseeable?

How would the analysis change if GeneCorp had explicitly informed Below Zero about the financing contract during negotiations?

Problem 26.2 Jack's Furniture

Jack operates a small custom furniture business with inconsistent sales. He contracts with Elite Lumber to deliver \$25,000 worth of rare wood for a high-profile commission. When placing the order, Jack explained his client's request and expressed how this was a big deal for his business. Elite Lumber breaches by delivering defective materials, which causes Jack to lose the commission. Jack claims \$75,000 in lost profits but presents only an unsigned email from the potential client and no prior earnings data to support his claim.

Can Jack recover the \$75,000 in lost profits? Why or why not?

Would the result differ if Jack had presented signed contracts and detailed profit margins from similar past commissions?

What steps could Jack have taken to strengthen his claim for damages?

Problem 26.3 Shipping Servers

StreamTech, a company that builds streaming servers, contracts to sell \$500,000 worth of servers to Alpha Streaming. Alpha repudiates the contract two weeks before delivery, citing market downturns. Despite the notice, StreamTech ships the servers to Alpha and incurs \$15,000 in transportation costs. StreamTech fails to find another buyer for the servers and sues Alpha for the full \$500,000 plus the \$15,000 in transportation costs.

Should StreamTech recover the transportation costs? Why or why not?

How might StreamTech's claim for the \$500,000 change if it had made reasonable efforts to find a substitute buyer?

What are Alpha's best arguments for reducing its liability?

Problem 26.4 Defenses Down

CrowdStrike enters a contract with Delta Airlines to defend against hacks and malware for \$1 million per year. The contract includes a liability cap limiting damages to the contract price for any breach. Liability caps are common in the cybersecurity industry due to the high stakes of potential breaches. CrowdStrike delivers a defective software update, which causes Delta's entire computer network to go down. As a result, Delta has to cancel hundreds of flights. It loses \$10 million in revenue and pays an additional \$2 million in penalties to the FAA for delayed and canceled flights. Delta sues CrowdStrike for \$12 million, arguing that the liability cap is unconscionable given the scale of the losses.

Is the liability cap enforceable? Does it apply to both the lost revenue and the FAA penalties?

Would the analysis change if the defective software created a public safety risk by causing an airplane to crash?

How might CrowdStrike defend the reasonableness of the liability cap, considering industry norms and the negotiated terms of the contract?

Problem 26.5 Seeds of Dispute

Zoe's Organic Farms contracts with Harvest Supply to deliver \$50,000 worth of organic seeds for the upcoming planting season. The contract includes a clause limiting consequential damages to \$25,000 and requires disputes to be resolved under

UCC provisions. Harvest Supply delivers non-organic seeds, which causes Zoe to lose her organic certification and miss out on a \$200,000 government subsidy. Zoe sues for \$200,000, arguing that the damage cap is unconscionable and that Harvest Supply failed to mitigate damages by not inspecting the seeds before shipment. Harvest Supply counters that Zoe's failure to mitigate by planting replacement seeds also contributed to the losses.

Analyze how foreseeability, certainty, mitigation, and the contractual limitations interact in this case.

Which arguments are strongest for Zoe, and which are strongest for Harvest Supply?

How should the court resolve the conflicting principles in this dispute?

Chapter 27

Alternative Remedies

When contracts are breached, courts typically award monetary damages to compensate the injured party. This approach aligns with the fundamental principle of restoring the injured party to the position they would have occupied had the contract been performed. Yet some situations demand more than money can provide. What if the subject matter of the contract is unique, irreplaceable, or essential to the injured party's purpose? What if the harm caused cannot be fully measured in monetary terms? In these cases, courts may turn to alternative remedies.

Alternative remedies—like specific performance, replevin, injunctions, and restitution—extend beyond monetary relief. They compel a party to act, refrain from acting, or return benefits conferred under a contract. These remedies reflect the exceptional power of equity in contract law, but they also raise unique challenges. Equitable remedies require court supervision and must balance fairness and practicality. Courts are particularly cautious about issuing orders that impose undue burdens on one party or restrain fundamental freedoms, such as the right to earn a living.

This chapter explores these extraordinary remedies and the principles guiding their application. It begins by examining specific performance, focusing on cases where monetary damages are inadequate. Replevin allows recovery of wrongfully withheld goods, while injunctions enforce promises to refrain from certain actions, often in the context of non-compete or non-disclosure agreements. Restitution seeks to prevent unjust enrichment by restoring benefits conferred, while liquidated damages clauses attempt to define the parties' remedies in advance.

As you work through these concepts, consider the balancing act courts perform in awarding alternative remedies. Why are these remedies so rarely granted? What safeguards prevent their misuse? And how might modern challenges—like disputes involving digital assets, intellectual property, or custom software—shape their future application? These questions highlight the evolving nature of contract law and its capacity to address complex disputes while preserving fairness and efficiency.

Rules

A. Specific Performance

Specific performance is a court order directing one party to a contract to perform its obligations under that contract. The result is the rendering, as nearly as practicable, of a promised performance through a judgment or decree. It is a court-ordered remedy that requires precise fulfillment of a legal or contractual obligation.

Subject to the rules stated in §§ 359–69, specific performance of a contract duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of the duty. R2d § 357(1).

The common law might order specific performance when one party wrongfully refuses to transfer land. Real estate is traditionally considered unique due to its intrinsic qualities, such as location and character, and factors like geographical location or historical significance can render some real estate irreplaceable. A court might order a seller to transfer title to land via specific performance.

Similarly, custom-made goods often hold distinct qualities that make them impossible to replace with monetary compensation. NH UCC § 2-716(1) allows courts to require a breaching party to complete the manufacture and delivery of goods:

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

For example, a buyer contracts to purchase a custom-designed sofa. The seller wrongfully fails to complete the work. The buyer demands the sofa. In determining whether to grant specific performance instead of the typical remedies for nonperformance as discussed in Chapter 24, the court must weigh several factors. These factors include whether the sofa is truly unique, whether the buyer acted in good faith, and whether ordering specific performance imposes undue burden on the seller. If the buyer did not act with entirely “clean hands,” any bad faith on the part of the buyer disqualifies him from obtaining specific performance.

Specific performance is only granted when monetary damages are inappropriate or inadequate, as when the sale of real estate or a rare article is involved. It is an equitable remedy that lies within the court’s discretion to award when the common law remedy is insufficient, either because damages would be inadequate or because the damages could not possibly be established. Specific performance is also termed “specific relief” or “performance in specie.”

Specific performance overlaps with replevin (discussed in the next section). But replevin is focused on recovering goods wrongfully withheld, while specific performance addresses broader obligations, like completing a custom project.

B. Replevin

Replevin is an equitable remedy that allows a party to recover specific goods wrongfully withheld by another. It is particularly relevant in cases involving unique, scarce, or essential goods where monetary damages would be inadequate to address the harm caused by the breach. NH UCC § 2-716 specifies this remedy:

The buyer has a right of replevin for goods identified to the contract if, after reasonable effort, the buyer is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing.

Since parties must make reasonable efforts to cover, the replevin provision ensures that buyers can recover identified goods when efforts to secure substitutes fail or when alternative remedies are impractical or insufficient.

“Identified” means the goods exist and can be located. This distinguishes replevin from specific performance, which could require a manufacturer to produce some goods that do not currently exist. Replevin only applies to goods already made and wrongfully withheld.

For example, in a contract for a custom-designed yacht, replevin might allow the buyer to recover the yacht if it is completed but wrongfully withheld. In exceptional cases, specific performance might be used if the seller refuses to finish constructing the yacht. Both remedies ensure that injured parties receive what they were promised rather than a financial substitute.

C. Injunction

An injunction, also known as a “negative injunction” or “prohibitory injunction,” is a court-ordered prohibition that prevents an action. In other words, an injunction is a court order not to do something one promised to do. It is the opposite of specific performance, which is where a court requires a party to complete performance under a contract.

Subject to the rules stated in §§ 359–69, an injunction against breach of a contract duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of the duty if (a) the duty is one of forbearance, or (b) the duty is one to act and specific performance would be denied only for reasons that are inapplicable to an injunction. R2d § 357(2).

In general, a court will not grant injunctive relief unless four conditions are satisfied:

1. Likelihood of serious and irreparable harm. (Without the injunction, the party seeking the injunction will likely suffer serious and irreparable harm.)
2. Availability of an adequate remedy at law. (The party seeking the injunction cannot be adequately compensated by means of an award of money damages.)

3. Balancing the equities between the parties. (The benefit of the injunction to the party seeking the injunction outweighs the harm to the party against whom the injunction is sought.)
4. Public interest. (Granting the injunction will not unduly harm the public interest.)

There are three common types of contractual provisions that a party might seek to enforce by means of a prohibitory injunction: (1) non-compete agreements, (2) non-solicitation agreements, and (3) non-disclosure agreements. These are specific types of the more general category (4) negative covenants.

1. Non-Compete Agreements

A non-compete agreement is an agreement not to accept employment with a competitor or to set up a competing business. In certain businesses and professions, it is common for employees to be required to sign a non-compete.

The law of most states disfavors non-competes and will enforce them only to protect a legitimate business purpose, not simply to eliminate competition. Furthermore, courts routinely strike down or limit non-compete agreements if they cover an overly long time period, have an overly broad geographic scope, or are in conflict with the public interest.

As with all contractual provisions, the employee must receive consideration for signing the non-compete. If an employer attempts to impose a non-compete on an existing employee as a condition of future employment, the employer would be wise to offer some material inducement.

Moreover, if an employer fires an employee without cause, the courts are less likely to enforce the non-compete agreement.

2. Non-Solicitation Agreements

Non-solicitation agreements are a more targeted form of non-compete agreement and are more likely to be enforced than a general non-compete. Solicitation of existing customers or fellow employees during the period of employment is a serious breach of the duty of loyalty that an employee owes to an employer. A non-solicitation agreement represents an attempt to extend that duty once employment has terminated. As with non-competes, however, a court may find that a non-solicitation agreement is unreasonably broad in its duration or geographic scope.

3. Non-Disclosure Agreements

The parties to a contract may enter into a non-disclosure agreement prohibiting the disclosure or use of trade secrets or customer lists. Notably, however, non-disclosure of trade secrets may be enforced even in the absence of an express non-disclosure

agreement. The Uniform Trade Secrets Act (UTSA) has been adopted in nearly all states. The UTSA prohibits the misappropriation of trade secrets, i.e., the disclosure or use of trade secrets which were obtained by “improper means.” Under this statute, the courts are authorized to enjoin a former employee from disclosing information that the former employee knows is to be kept confidential.

4. Enforceability of Negative Covenants

Specific (equitable) enforceability of these “negative covenants” varies from state to state. Pursuant to the UTSA, prohibitory injunctions enforcing non-disclosure of trade secrets may be issued even in the absence of an express non-disclosure agreement. Non-compete and non-solicitation agreements may be limited or invalidated if they are too broad in duration or geographic scope, or if they are in conflict with the public interest. Courts are more likely to enforce restrictive covenants against a party that has sold a business than they are against a former employee.

D. Restitution

The purpose of awarding restitution damages is to prevent unjust enrichment. This is the only type of monetary damages for breach of contract that is recoverable by both the breaching party and the injured party. When a breach occurs, the party who breached may be unjustly enriched unless the law grants a remedy to the injured party, but it is also possible that the party who did not breach may be unjustly enriched unless the law grants the breaching party a remedy.

A party is entitled to restitution under the rules stated in this Restatement only to the extent that he has conferred a benefit on the other party by way of part performance or reliance. R2d § 370.

The measure of restitution damages is the value of the benefit that one party conferred upon the other party. For example, if a contractor abandoned work on the construction of a garage when the structure was partially completed, the owner is entitled to the return of any partial payment that was made to the contractor, and the contractor is presumptively entitled to restitution for the value of the work that was performed. A breaching party who acted in bad faith may be denied any recovery for restitution.

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. R2d § 371.

The purpose of restitutionary remedies is to restore the state of affairs that existed before the contract was formed (also known as the *status quo ante*). The restorative

purpose of restitution contrasts with expectation damages, whose purpose is to place a party in the position it would have been in if the other party had fully performed. The purpose of restitution and reliance, however, are very similar. Both look back to the *status quo ante*. So how do they differ?

Restitution is a body of law that is based on unjust enrichment. Unjust enrichment occurs when one party unfairly benefits at the expense of another, such as when one retains a benefit conferred by another without giving proper compensation reasonably expected under the circumstances in exchange for that benefit. Restitutionary remedies in contract law, therefore, are based not on the plaintiff's loss but rather on the defendant's gain. The benefit that one party received from the other party in the performance of a contract may include goods, land, securities, services, or money. Restitution thus consists of returning the value of those items, services, or money to the other party.

Reliance damages, on the other hand, focus on costs incurred by the plaintiff. This is distinguishable from restitution damages, which focus on benefits received by the defendant.

Recovery for restitution is measured by the value of the benefit that was conferred upon the other party, not the contract price, which distinguishes restitution from expectation damages. However, restitution under contract law may be limited by the contract price. If the parties entered into a valid contract, many courts would be reluctant to grant a party more in restitution than what it would have earned under the contract that it bargained for. Many courts would find that the contract price should represent a ceiling on the amount of restitution that a party is entitled to recover.

Restitution is a unique remedy in that, in many cases, both parties are entitled to it. Both parties may be required to disgorge the benefits received under the bargain, which may, in turn, effectively return the parties to the *status quo ante*.

E. Liquidated Damages and Penalties

Liquidated damages are contractually agreed-to, predetermined amounts of money that a party will owe for breach of contract. If the parties to a contract have properly agreed on liquidated damages, the sum they fixed will be the measure of damages for a breach, regardless of whether the amount exceeds or falls short of the actual damages. Liquidated damages are also known as "stipulated damages" or "estimated damages."

For example, a manufacturer agrees to supply a specialty component for \$50,000. The contract includes a liquidated damages clause requiring \$5,000 in damages if either party cancels within thirty days of the delivery date. This amount is reasonable if it reflects the costs incurred for materials and scheduling adjustments. However, if the clause instead required \$100,000 in damages for a \$50,000 contract, it would probably be deemed unreasonable because the damages would far exceed the anticipated harm. Unreasonable liquidated damages are called "penalties" and are not honored.

Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty. R2d § 356.

NH UCC § 2-718(1) mirrors this concept:

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.

Professor Atiyah explains how courts distinguish between reasonable liquidated damages and unreasonable penalties:

*The distinction between a penalty and genuine liquidated damages, as they are called, is not always easy to apply, but the Courts have made the task simpler by laying down certain guiding principles. In the first place, if the sum payable is so large as to be far in excess of the probable damage on breach, it is almost certainly a penalty. Secondly, if the same sum is expressed to be payable on any one of a number of different breaches of varying importance, it is again probably a penalty, because it is extremely unlikely that the same damage would be caused by these varying breaches. Thirdly, where a sum is expressed to be payable on a certain date, and a further sum in the event of default being made, this latter sum is prima facie a penalty, because mere delay in payment is unlikely to cause damage. Finally, it is to be noted that the mere use of the words “liquidated damages” is not decisive, for it is the task of the Court and not of the parties to decide the true nature of the sum payable. P.S. Atiyah, *An Introduction to the Law of Contract* 389–90 (5th ed. 1995).*

Liquidated damages must therefore be reasonable. Liquidated damages that are unreasonably large constitute a penalty rather than compensation and are unenforceable, and liquidated damages that are unreasonably small may be unconscionable and unenforceable. The reasonableness of the amount of liquidated damages depends upon the interaction of two factors: (1) whether the amount of liquidated damages reflects the anticipated or actual harm caused by the breach, and (2) the difficulties that the aggrieved party would have in proving loss.

F. Liability Caps and Exculpatory Clauses

The inverse of liquidated damages provisions—which may be unenforceable where they are unreasonably high—are liability caps and exculpatory clauses, which are enforceable unless they are unreasonably low.

Liability caps limit the maximum amount a party can recover in the event of a breach. These caps provide clarity and risk management regarding worst-case scenarios. While neither the R2d nor the UCC explicitly focuses on liability caps as a distinct topic, both offer frameworks for understanding and enforcing such provisions within the broader context of limiting remedies. A liability cap that is unreasonably low or grossly disproportionate may be deemed unconscionable or against public policy, paralleling the treatment of liquidated damages. If such limitations fail their essential purpose, such as by leaving one party without any meaningful remedy, they may be set aside. For example, if a liability cap prevents recovery for defective goods that cause significant losses, the court may allow broader remedies to ensure fairness.

Consider a sales contract where the parties agree to cap liability at 1% of the total contract price per day for delays. On a \$1 million deal, this equates to \$10,000 per day, which does not appear unreasonably low given the proportionality to the contract's overall value. However, if the liability cap were set at \$1 per day, such an amount would likely be deemed nominal and unenforceable, as it fails to provide a meaningful remedy and could be considered unconscionable.

Courts examine whether a liability cap reflects a genuine effort to allocate risks fairly or simply seeks to deprive one party of an adequate remedy. Courts generally uphold such provisions unless they are unconscionable or violate public policy.

Exculpatory clauses exclude liability for certain types of breaches. Unlike liability caps, which usually specify a dollar or percentage maximum, exculpation categorically sets contract liability to zero for a certain kind of breach. These provisions are explicitly addressed in the UCC and evaluated under broader principles of fairness and public policy in the R2d.

While UCC §2-719 allows parties to limit or alter remedies—such as restricting recovery to the return of goods or repair/replacement of defective parts—exculpatory clauses are suspect in some circumstances. For consumer goods, limitations on personal injury damages are presumed unconscionable, although limitations on commercial losses are typically upheld.

Common law likewise scrutinizes exculpatory clauses for fairness and reasonableness and will not enforce terms that violate public policy or grossly disadvantage one party. For instance, clauses waiving liability for intentional misconduct or gross negligence are typically unenforceable.

If a daycare center includes a clause in its enrollment agreement stating that it is not liable for minor injuries caused by ordinary negligence, such as a child tripping while playing, this clause is enforceable because it aligns with public policy. However, if the clause attempted to disclaim liability for gross negligence, such as death resulting from failing to supervise children altogether, it would violate public policy and be unenforceable.

G. Rescission and Reformation

Contracts occasionally fail to reflect the true agreement of the parties or are marred by fundamental flaws. In such cases, courts may grant rescission or reformation to address these issues and achieve fairness. Rescission cancels the contract entirely, restoring the parties to their pre-contractual positions. Rescission is appropriate when an agreement cannot be salvaged.

A party may have a claim for rescission of a contract if the contract was made under circumstances of fraud, mistake, duress, or undue influence that prevented a meeting of the minds. R2d § 164.

For instance, a buyer and seller agree to a real estate transaction based on the mutual belief that the property includes buildable land. Subsequent discovery reveals that the land is subject to a conservation easement prohibiting development. The court grants rescission, returning the purchase price to the buyer and restoring the land to the seller, as the mutual mistake undermined the foundation of the agreement.

Rescission may also be conditioned on the return of any benefits conferred under the contract—meaning that rescission may be combined with restitution. Courts try to ensure that rescission fully restores the status quo, thus preventing either party from retaining advantages gained through the voided agreement.

Reformation retains the contract but adjusts its terms to align with the parties' original intent. It addresses specific errors without undoing the entire deal.

Where a written agreement fails to accurately reflect the terms agreed upon by the parties due to mistake or misrepresentation, a court may order reformation to align the contract with their actual intent. R2d § 155.

For example, two businesses negotiate a supply agreement for 1,000 units of a product, but the final written contract mistakenly states "100 units." Both parties intended the higher quantity. Upon discovering the error, the court reforms the contract to reflect the agreed-upon terms of 1,000 units.

Reformation is particularly valuable when parties rely on a written agreement that inaccurately reflects their deal due to inadvertent drafting errors. Unlike rescission, it preserves the essence of the contract while correcting the mistake.

H. Nominal Damages

The purpose of awarding nominal damages (usually in the amount of \$1 or \$10) is to acknowledge that the breaching party committed a breach and that the aggrieved party, though uninjured, is the victor of the lawsuit.

If the breach caused no loss or if the amount of the loss is not proved under the rules stated in this Chapter, a small sum fixed without regard to the amount of loss will be awarded as nominal damages. R2d § 346.

Nominal damages may be legally significant for a number of reasons, including assigning court costs and awarding attorney's fees. In complex litigation involving multiple parties, a nominal victory against one party may insulate a party from liability to other parties. In any event, they are symbolic of one party's victory.

I. Reflections on Alternative Remedies

Alternative remedies address situations where typical nonperformance or defective performance remedies are inadequate to ensure fairness or justice. The alternative remedies discussed in this chapter have both forward-looking and corrective aims. Forward-looking remedies, like injunctions, prevent future harm or enforce obligations. Corrective remedies, like restitution, address past injustices by restoring balance.

Restitution is unique among contract remedies because it focuses on the wrongdoer's gain rather than the injured party's loss. For instance, a court might require a breaching party to return profits gained from an opportunistic breach, thus ensuring that the breaching party does not unfairly benefit. Restitution departs from contract law's usual focus on economic efficiency, reliance, or autonomy, because it originates in its own body of law—distinct from contract—and may apply even in cases that do not involve a contract at all.

As a student of contract law, consider how these remedies operate, not only as tools for enforcement but as expressions of the law's capacity to address human complexity. When analyzing a case, ask yourself, does a monetary remedy suffice, or does the situation demand a more nuanced approach? The answer may reveal the enduring significance of restitution and non-money damages in achieving justice in the intricate world of contracts.

Cases

Reading Bauer v. Sawyer. Courts generally prefer to award money damages to resolve contract disputes. But money is not always a sufficient remedy for an aggrieved contract party. For one thing, it can be hard to value certain broken promises, even when the courts recognize that such promises have significant value. Also, parties sometimes make promises that contemplate specific performance and not money damages for breach.

In *Bauer*, a party agreed to join a medical partnership and promised not to compete with it even if he departed. Such promises, known as non-compete agreements, are rather contentious. On the one hand, they obviously restrain trade—the doctor who promises not to compete cannot practice his trade

during the time and in the place contemplated by the non-compete—and restraints of trade are disfavored in law. On the other hand, if you look at the situation *ex ante*, i.e., before the parties agreed to work together in the first place, you may find that the parties would never have agreed to work together if one party did not have assurances that the other party would not take advantage of that work by opening a competing shop just down the block.

As you read this case, think about balancing these two concerns: the concern that restraints of trade are either unconscionable or bad for public policy and social welfare, and the concern that parties will not cooperate in the first place if they cannot prevent competition that arises from their prior collaboration. A business does not want to generate its own competition, after all.

Bauer v. Sawyer

8 Ill. 2d 351 (1956)

Opinion by SCHAEFER, J.

All of the parties to this action are doctors. Prior to March 31, 1954, they were associated together in a medical partnership known as the Kankakee Clinic. On that date Dr. P.W. Sawyer, the principal defendant, withdrew from the partnership and in May of 1954 he opened offices for the practice of medicine and surgery in the city of Kankakee. Five of the eleven remaining partners instituted this action, alleging that the partnership agreement prohibited a retiring partner from practicing medicine in the city of Kankakee and seeking an injunction to restrain Dr. Sawyer from violating the agreement. The other six remaining partners were joined as defendants. They admitted the allegations of the complaint, but sought no relief against Dr. Sawyer. Dr. Sawyer also admitted the allegations of the complaint, but defended on the ground that the partnership agreement contemplated that a withdrawing partner had the alternative right to perform the agreement or to pay liquidated damages. The case was submitted upon the pleadings and a stipulation of facts. The circuit court entered a decree dismissing the complaint. The Appellate Court reversed, and we granted leave to appeal.

The partnership agreement provides that the interest of an individual partner may be terminated by retirement based on physical incapacity, by voluntary withdrawal, or by expulsion for unprofessional conduct or for failure to carry out the provisions of the agreement. In each instance the remaining partners are to purchase the interest of the outgoing partner at a stated percentage of its value as shown on the partnership books: 100 per cent in case of retirement for incapacity, 80 per cent in case of voluntary withdrawal, and 75 per cent in case of expulsion. By the agreement each partner covenants that after the termination of his interest he will not engage in the practice of medicine, surgery or radiology within a radius of 25 miles of Kankakee for a period of five years. The agreement also provides that if the former partner violates

this covenant, he shall forfeit any unpaid portion of the purchase price of his interest. In the case of a partner withdrawing voluntarily, one half the purchase price is payable 30 days after withdrawal and the other half is to be evidenced by notes payable in one year which are to be delivered to an escrow agent, who is directed to cancel the notes upon certification by the remaining partners that the former partner has resumed practice. At the time of his withdrawal from the firm Dr. Sawyer was paid 40 per cent of the value of his partnership interest, and a note for the remaining 40 per cent was turned over to an escrow agent in accordance with the agreement.

Although Dr. Sawyer admits that he resumed practice in Kankakee in violation of the contract, he contends that the contract ought not to be specifically enforced against him, (1) because it is an unreasonable restraint of trade and contrary to public policy, and (2) because it contains a provision for liquidated damages which bars specific enforcement.

The principles governing cases of this kind were stated in *Ryan v. Hamilton*, in which a contract by a physician not to engage in practice in a specified community was enforced by injunction: "That contracts in general restraint of trade are generally held to be illegal is beyond controversy. But the rule admits of well defined exceptions, and among the exceptions are contracts of the kind and character presented in this case. Contracts of this class, where the limitation as to territory is reasonable and there exists a legal consideration for the restraint, are valid and enforceable in equity, and in such cases relief by injunction is customary and proper."

In determining whether a restraint is reasonable it is necessary to consider whether enforcement will be injurious to the public or cause undue hardship to the promisor, and whether the restraint imposed is greater than is necessary to protect the promisee.

In this case the interest of the public is in having adequate medical protection, and it is of course true, as suggested by Dr. Sawyer, that if the injunction is granted the number of doctors available in the Kankakee community will be reduced. A stipulation entered into by the parties, however, shows that there are now 70 doctors serving the area. We are unable to say that the reduction of this number by one will cause such injury to the public as to justify us in refusing to enforce this contract. In any case, there is no reason why Dr. Sawyer cannot serve the public interest equally well by practicing in another community. No special hardship to Dr. Sawyer appears which would justify the denial of relief in this case. He may resume practice in Kankakee after five years and in the meantime he may practice elsewhere. The territorial limitation to the city of Kankakee and the surrounding area is not, we think, unreasonable in the light of modern methods of transportation and communication.

Agreements unlimited in time have heretofore been enforced, although other authorities hold that the restraint must be limited in time as well as space. We need not here consider whether a time limitation is essential, because in any event the present five-year period does not appear unreasonable.

It thus appears that the agreement is not contrary to public policy by the tests that have heretofore been employed. Dr. Sawyer contends, however, that the prior cases

decided by this and other courts are distinguishable because they involved either the sale of an established practice or the taking of a newcomer into an established practice, as employee or partner. Pointing out that in this case there was no express sale of the practice of any of the partners, and each of the partners was a practicing physician when the agreement was entered into, he argues that "If there is no established practice sold and no newcomer as a potential usurper, there is no need for the restraint being enforced by injunction."

With this contention we do not agree. No case is cited which holds that the members of a partnership may not by their agreement reasonably protect themselves against the competition of an outgoing partner. Indeed such agreements are classic illustrations of reasonable restraints of trade. "A legitimate method of enhancing the good will of continuing partners in professional, as well as commercial, partnerships is to secure forbearance from competition by a retired partner. He may agree not to compete, within reasonable limits as to time and space, and such an undertaking will be enforced by injunction. . . . The contract of a partner not to compete with the partnership either directly or indirectly is not opposed to public policy; but such an agreement must be ancillary to the relation or contract of partnership or to a contract by which a partner disposes of his interest."

Our own decision in *Storer v. Brock* enforced an agreement, entered into between two doctors upon the dissolution of their partnership, which restricted the future practice of the retiring partner. The distinction attempted to be drawn is without merit.

The most significant of the two remaining contentions of the defendant relates to the effect of the forfeiture clause. Under the partnership agreement the purchase price to be paid to an outgoing partner is payable in equal annual installments. In the event of a retirement for incapacity, there is one installment; if there is voluntary withdrawal, as in this case, there are two installments, and in the case of an ouster there are three installments. The first installment is payable thirty days after the withdrawal and notes are issued for the other installments. Interest is payable on the outstanding balance, and the partners have the privilege of prepayment. The notes are to be deposited with an escrow agent, who is directed to deliver them to the outgoing partner on the due date, unless the remaining partners have certified that the outgoing partner has breached the conditions of the agreement limiting his subsequent practice of medicine. If the remaining partners make such a certification, the agreement provides that the "escrow agent shall turn over and deliver the remaining unpaid notes to the makers thereof for cancellation, it being the intention of the parties hereto that the retiring or withdrawing Partner who has breached the [said] provisions . . . shall thereby forfeit a portion of the value of his Partnership interest."

Dr. Sawyer claims that the contract gave him the option to resume practice by giving up the unpaid portion of the value of his partnership interest, in this case \$7451, which he characterizes as liquidated damages. Of course an agreement may be so formulated as to give an option to perform the contract or pay the stipulated damages.

That was the case in *Davis v. Eisenstein*, where the agreement provided that “Upon payment thereof [of the stipulated liquidated damages] this contract is to become null and void.” That agreement was held to give an option to each party to perform the contract or to pay the stipulated damages. There is no similar language in the present contract. On the contrary, the entire agreement indicates the intention of the parties that the covenant restricting the future activities of a former partner was intended to be enforced.

Upon the assumption that the provision contemplates liquidated damages, it is also argued that the existence of the liquidated damage clause bars the issuance of an injunction, and in support of the argument, *Bartholomae & Roesing Brewing and Malting Co. v. Modzelewski* is relied upon. That case was decided upon many grounds. Its statements to the effect that a provision for liquidated damages operates as a bar to an injunction have been sharply criticized. In accordance with our earlier and later decisions and with the weight of authority elsewhere, we hold that even if the provision in question is construed as one for liquidated damages the right to an injunction is not barred. To the extent that the *Modzelewski* case may be thought to hold otherwise, it is overruled.

While this case was under advisement in the Appellate Court, the continuing partners, including the plaintiffs, certified to the escrow agent that the condition as to subsequent practice had been breached by Dr. Sawyer. Under the agreement the escrow agent was required to return the notes to the makers for cancellation. Dr. Sawyer contends that liquidated damages have been collected, and that it would therefore be inequitable to enforce performance of the agreement by injunction. Plaintiffs argue that their certification was made with the thought that the clause was a penalty, and that the certification so stated. They say that the penalty cannot be enforced in its face amount and that they are still liable to Dr. Sawyer for \$7451, the amount of the notes, less such actual damages as may have been sustained by the partnership.

An agreement, made in advance of breach, fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.

In the present case it is not disputed that damages are difficult to ascertain. Indeed, plaintiffs’ complaint so alleges. The more difficult question is whether the parties intended to forecast and fix the probable damages which would result from a breach. We think that they did not, and that they intended the clause as an additional sanction, by way of penalty, to enforce performance of the covenant not to re-engage in practice. In determining intent the language used by the parties is significant. Here, the parties speak not in the language of damages, but in terms of forfeiture. Although it is not controlling, the use of the word “forfeit” tends to exclude the idea of liquidated damages.

So, too, the method of payment suggests that the purpose of the parties was to secure performance rather than to settle damages. The money is withheld, in this instance for a year, in the case of an excluded partner for two years. If settlement of damages alone had been intended, it would have been sufficient to have provided for initial payment of the value of the partnership interest, and for subsequent recovery of the stipulated amount of damages in the event of breach.

There are other indications that the purpose of the clause was not to fix the amount of damages. Although the covenant not to re-engage in practice runs for five years, the clause in question covers only one year in the case of a withdrawing partner and only two years in the case of an expelled partner. No satisfactory reason explains why the provision, if it is for liquidated damages, does not cover the entire period of the restraint. Nor, assuming that the clause is a liquidated damage provision, is there any satisfactory explanation of what is to happen if a breach occurs after the escrow agent has delivered the notes to the outgoing partner. It can hardly be assumed that no damages at all were intended. The suggestion of defendant that the plaintiffs would then be entitled to an injunction, or to actual damages, as assessed by a court or jury, has no support in the language of the clause.

Nor does the clause fulfill the requirement that the amount of damages fixed be a reasonable forecast of just compensation for the harm caused by the breach. The defendant suggests that a percentage of the value of the partnership interest is probably as good a measure of damages as any test which could be devised by a court or jury. Assuming that, no reason appears for the discrimination between withdrawing and expelled partners. If a breach occurs during the first year, an expelled partner loses 50 per cent of the value of his interest in the partnership, while a withdrawing partner loses only 40 per cent. If a breach occurs during the second year an expelled partner would lose 25 per cent, while a withdrawing partner would presumably be liable for actual damages, whether they were greater or less than 25 per cent of the value of his interest. These differences seem to us impossible to explain on the assumption that the clause was intended as a forecast of just compensation for the harm caused by a breach. The reason for this discrimination does not appear to be that there would be greater damage in the case of a breach by an expelled partner, but rather than there was thought to be greater likelihood of a breach. Accordingly, more stringent sanctions to secure performance were inserted.

Defendant Sawyer argues that the failure to provide damages for a breach occurring in the second and following years, in the case of a withdrawing partner, may be explained on the ground that a physician's goodwill would be largely lost if he remained out of practice for a year, and damages in that situation would be negligible. But even if we assume that a withdrawing physician's goodwill is as perishable as defendant suggests, we are unable to understand why an expelled physician's goodwill would last longer.

We conclude that the provision is a penalty and that the partners therefore remain liable to Dr. Sawyer in the amount of the outstanding unpaid balance. Plaintiffs'

conduct was not, we think, inequitable or inconsistent with their theory of recovery and does not bar injunctive relief. The issuance of an injunction need not await the assessment of interim damages and the determination of a net balance.

Dr. Sawyer's final contention is that the Appellate Court lacked jurisdiction to reverse the trial court, because the trial court was composed of three judges and therefore lacked jurisdiction to enter a valid final judgment. The record shows that because of the importance of the questions presented by this case the three judges of the Twelfth Judicial Circuit decided to hear the case *en banc*. We are of the opinion that if there was error in the organization of the court, it was waived by the defendant's failure to raise the objection in the trial court.

The judgment of the Appellate Court, reversing the decree of the trial court and remanding the cause with directions to issue the injunction, is affirmed, with further directions to proceed in accordance with the views expressed herein.

Judgment affirmed.

Reflection

Equitable remedies are exceptional, particularly where one party seeks to restrain the free trade of another. The freedom to work and engage in trade is a fundamental principle recognized in contract law, but like all rights, it is not absolute. Contract law acknowledges that parties can voluntarily agree to limit their rights under certain conditions, and courts are often called upon to enforce such agreements when fairness and justice demand it.

For example, employers may require employees to enter into non-compete agreements in which they promise not to work for competitors after leaving their positions. Whether courts enforce such agreements depends on whether they are reasonable in scope, duration, and necessity to protect legitimate business interests. Courts are particularly cautious when asked to enforce these agreements through equitable remedies like injunctions. Unlike monetary damages, which merely compensate for a breach, an injunction compels a party to act or refrain from acting—a significant intrusion into personal liberties.

This caution reflects the broader principles of fairness and proportionality that underpin contract law. Courts strive to balance the autonomy of contracting parties with the potential harm that enforcement might cause. For instance, while monetary damages are often deemed sufficient, equitable remedies are reserved for situations where they are truly necessary to achieve justice, such as when the subject matter of the agreement is unique or irreplaceable.

As you consider these doctrines, reflect on how courts navigate these tensions in modern contexts. How should principles of fairness and proportionality apply to disputes involving non-compete clauses, particularly in industries where innovation and talent mobility are critical? How might courts address agreements involving emerging technologies, where the balance between protecting business interests and ensuring

individual freedoms is increasingly complex? By grappling with these questions, students and practitioners alike can better understand how equitable remedies shape the law's response to complex disputes and ensure that outcomes remain fair, efficient, and just.

Discussion

1. If the *Bauer* case did not involve doctors in a medical practice but instead involved a similar agreement between two eighteen-year-olds who agreed to operate a lemonade stand together, would the court have reached a different result? Is the nature of the work significant in determining whether an agreement not to practice that trade within a certain time and space is valid?
 2. Why did the doctors agree to the non-compete in the first place? What business purpose did this provision solve?
 3. Was there any evidence of bad faith in the *Bauer* case? In general, equitable remedies are special. What about this case was special such that it rose to the level of meriting an equitable remedy?
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Reading *Van Wagner Advertising Corp. v. S & M Enterprises*. Before diving into the *Van Wagner* case, it's helpful to consider how courts evaluate specific performance as an equitable remedy. While monetary damages are the default remedy for breach of contract, specific performance becomes relevant when monetary damages cannot adequately compensate the injured party. This remedy requires courts to carefully weigh whether the subject matter of the contract is unique and whether its value can be quantified with reasonable certainty. The decision to grant specific performance often hinges on whether there is a lack of suitable substitutes, making monetary damages insufficient.

In *Van Wagner*, the court was tasked with determining whether specific performance should be awarded for the lease of a billboard space in a unique Manhattan location. The case is notable for its reasoning that uniqueness alone does not automatically justify specific performance. Instead, the court emphasized that monetary damages were an adequate remedy because the value of the advertising space could be calculated with reasonable certainty.

This case raises key questions about the boundaries of specific performance. What makes a contractual subject matter sufficiently unique? When does the burden of specific performance on the breaching party outweigh the injured

party's interest in performance? As you read, consider how the court balances the interests of both parties and how its reasoning aligns with broader principles of fairness and efficiency in contract law.

Pay close attention to the court's discussion of "disproportionate burden" and how it uses this concept to deny specific performance. Think about how the decision fits into the economic framework discussed by Anthony Kronman, who suggests that specific performance is justified when damages are too speculative to measure accurately. Does the court's reliance on the availability of market substitutes support or challenge Kronman's view?

As you engage with the case, reflect on the practical implications of the court's reasoning for modern contract disputes. How might this decision apply to cases involving digital assets, intellectual property, or other emerging markets where uniqueness and valuation pose new challenges? *Van Wagner* provides a foundation for understanding how courts balance equitable remedies with the practical realities of commerce, and it offers insights that remain relevant to evolving legal contexts.

Van Wagner Advertising Corp. v. S & M Enterprises

67 N.Y.2d 186 (1986)

Opinion by Judge KAYE.

Specific performance of a contract to lease "unique" billboard space is properly denied when damages are an adequate remedy to compensate the tenant and equitable relief would impose a disproportionate burden on the defaulting landlord. However, owing to an error in the assessment of damages, the order of the Appellate Division should be modified so as to remit the matter to Supreme Court, New York County, for further proceedings with respect to damages.

By agreement dated December 16, 1981, Barbara Michaels leased to plaintiff, Van Wagner Advertising, for an initial period of three years plus option periods totaling seven additional years space on the eastern exterior wall of a building on East 36th Street in Manhattan. Van Wagner was in the business of erecting and leasing billboards, and the parties anticipated that Van Wagner would erect a sign on the leased space, which faced an exit ramp of the Midtown Tunnel and was therefore visible to vehicles entering Manhattan from that tunnel.

In early 1982 Van Wagner erected an illuminated sign and leased it to Asch Advertising, Inc. for a three-year period commencing March 1, 1982. However, by agreement dated January 22, 1982, Michaels sold the building to defendant S & M Enterprises. Michaels informed Van Wagner of the sale in early August 1982, and on August 19, 1982 S & M sent Van Wagner a letter purporting to cancel the lease as of October 18 pursuant to section 1.05, which provided:

Notwithstanding anything contained in the foregoing provisions to the contrary, Lessor (or its successor) may terminate and cancel this lease on not less than 60 days prior written notice in the event and only in the event of a bona fide sale of the building to a third party unrelated to Lessor

Van Wagner abandoned the space under protest and in November 1982 commenced this action for declarations that the purported cancellation was ineffective and the lease still in existence, and for specific performance and damages.

In the litigation the parties differed sharply on the meaning of section 1.05 of the lease. Van Wagner contended that the lease granted a right to cancel only to the owner as it was about to sell the building—not to the new purchaser—so that the building could be conveyed without the encumbrance of the lease. S & M, in contrast, contended that the provision clearly gave it, as Michaels' successor by virtue of a bona fide sale, the right to cancel the lease on 60 days' notice. Special Term denied Van Wagner's motion for a preliminary injunction, concluding that the lease by its terms gave S & M the authority to cancel and that Van Wagner was therefore not likely to succeed on the merits.

At a nonjury trial, both parties introduced parol evidence, in the form of testimony about negotiations, to explain the meaning of section 1.05. Additionally, one of S & M's two partners testified without contradiction that, having already acquired other real estate on the block, S & M purchased the subject building in 1982 for the ultimate purpose of demolishing existing buildings and constructing a mixed residential-commercial development. The project is to begin upon expiration of a lease of the subject building in 1987, if not sooner.

Trial Term concluded that Van Wagner's position on the issue of contract interpretation was correct, either because the lease provision unambiguously so provided or, if the provision were ambiguous, because the parol evidence showed that the parties to the lease intended that only an owner making a bona fide sale could terminate the lease. They did not intend that once a sale had been made that any future purchaser could terminate the lease at will. Trial Term declared the lease valid and subsisting and found that the demised space is unique as to location for the particular advertising purpose intended by Van Wagner and Michaels, the original parties to the Lease.

However, the court declined to order specific performance in light of its finding that Van Wagner has an adequate remedy at law for damages. Moreover, the court noted that specific performance would be inequitable in that its effect would be disproportionate in its harm to the defendant and its assistance to plaintiff. Concluding that the value of the unique qualities of the demised space has been fixed by the contract Van Wagner has with its advertising client, Asch for the period of the contract, the court awarded Van Wagner the lost revenues on the Asch sublease for the period through trial, without prejudice to a new action by Van Wagner for subsequent damages if S & M did not permit Van Wagner to reoccupy the space. On Van Wagner's motion to resettle the judgment to provide for specific performance, the court adhered to its judgment.

On cross appeals the Appellate Division affirmed, without opinion. We granted both parties leave to appeal.

Whether or not a contract provision is ambiguous is a question of law to be resolved by a court. In our view, section 1.05 is ambiguous. Reasonable minds could differ as to whether the lease granted a purchaser of the property a right to cancel the lease, or limited that right to successive sellers of the property. However, Trial Term's alternate finding—that the parol evidence supported Van Wagner's interpretation of the provision—was one of fact. That finding, having been affirmed by the Appellate Division and having support in the record, is beyond the scope of our review. Thus, S & M's cancellation of Van Wagner's lease constituted a breach of contract.

Given defendant's unexcused failure to perform its contract, we next turn to a consideration of remedy for the breach: Van Wagner seeks specific performance of the contract, S & M urges that money damages are adequate but that the amount of the award was improper.

Whether or not to award specific performance is a decision that rests in the sound discretion of the trial court, and here that discretion was not abused. Considering first the nature of the transaction, specific performance has been imposed as the remedy for breach of contracts for the sale of real property, but the contract here is to lease rather than sell an interest in real property. While specific performance is available, in appropriate circumstances, for breach of a commercial or residential lease, specific performance of real property leases is not in this State awarded as a matter of course.

Van Wagner argues that specific performance must be granted in light of the trial court's finding that the demised space is unique as to location for the particular advertising purpose intended. The word "uniqueness" is not, however, a magic door to specific performance. A distinction must be drawn between physical difference and economic interchangeability. The trial court found that the leased property is physically unique, but so is every parcel of real property and so are many consumer goods. Putting aside contracts for the sale of real property, where specific performance has traditionally been the remedy for breach, uniqueness in the sense of physical difference does not itself dictate the propriety of equitable relief.

By the same token, at some level all property may be interchangeable with money. Economic theory is concerned with the degree to which consumers are willing to substitute the use of one good for another, the underlying assumption being that every good has substitutes, even if only very poor ones, and that all goods are ultimately commensurable. Such a view, however, could strip all meaning from uniqueness, for if all goods are ultimately exchangeable for a price, then all goods may be valued. Even a rare manuscript has an economic substitute in that there is a price for which any purchaser would likely agree to give up a right to buy it, but a court would in all probability order specific performance of such a contract on the ground that the subject matter of the contract is unique.

The point at which breach of a contract will be redressable by specific performance thus must lie not in any inherent physical uniqueness of the property but instead in the uncertainty of valuing it:

What matters, in measuring money damages, is the volume, refinement, and reliability of the available information about substitutes for the subject matter of the breached contract. When the relevant information is thin and unreliable, there is a substantial risk that an award of money damages will either exceed or fall short of the promisee's actual loss. Of course this risk can always be reduced—but only at great cost when reliable information is difficult to obtain. Conversely, when there is a great deal of consumer behavior generating abundant and highly dependable information about substitutes, the risk of error in measuring the promisee's loss may be reduced at much smaller cost. In asserting that the subject matter of a particular contract is unique and has no established market value, a court is really saying that it cannot obtain, at reasonable cost, enough information about substitutes to permit it to calculate an award of money damages without imposing an unacceptably high risk of undercompensation on the injured promisee. Conceived in this way, the uniqueness test seems economically sound.

Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1978).

This principle is reflected in the case law, and is essentially the position of the Restatement (Second) of Contracts § 360(a), which lists “the difficulty of proving damages with reasonable certainty” as the first factor affecting adequacy of damages.

Thus, the fact that the subject of the contract may be unique as to location for the particular advertising purpose intended by the parties does not entitle a plaintiff to the remedy of specific performance.

Here, the trial court correctly concluded that the value of the “unique qualities” of the demised space could be fixed with reasonable certainty and without imposing an unacceptably high risk of undercompensating the injured tenant. Both parties complain: Van Wagner asserts that while lost revenues on the Asch contract may be adequate compensation, that contract expired February 28, 1985, its lease with S & M continues until 1992, and the value of the demised space cannot reasonably be fixed for the balance of the term. S & M urges that future rents and continuing damages are necessarily conjectural, both during and after the Asch contract, and that Van Wagner's damages must be limited to 60 days—the period during which Van Wagner could cancel Asch's contract without consequence in the event Van Wagner lost the demised space. S & M points out that Van Wagner's lease could remain in effect for the full 10-year term, or it could legitimately be extinguished immediately, either in conjunction with a bona fide sale of the property by S & M, or by a reletting of the building if the new tenant required use of the billboard space for its own purposes. Both parties' contentions were properly rejected.

First, it is hardly novel in the law for damages to be projected into the future. Particularly where the value of commercial billboard space can be readily determined by comparisons with similar uses—Van Wagner itself has more than 400 leases—the value of this property between 1985 and 1992 cannot be regarded as speculative. Second, S & M having successfully resisted specific performance on the ground that there is an adequate remedy at law, cannot at the same time be heard to contend that damages beyond 60 days must be denied because they are conjectural. If damages for breach of this lease are indeed conjectural, and cannot be calculated with reasonable certainty, then S & M should be compelled to perform its contractual obligation by restoring Van Wagner to the premises. Moreover, the contingencies to which S & M points do not, as a practical matter, render the calculation of damages speculative. While S & M could terminate the Van Wagner lease in the event of a sale of the building, this building has been sold only once in 40 years; S & M paid several million dollars, and purchased the building in connection with its plan for major development of the block. The theoretical termination right of a future tenant of the existing building also must be viewed in light of these circumstances. If any uncertainty is generated by the two contingencies, then the benefit of that doubt must go to Van Wagner and not the contract violator. Neither contingency allegedly affecting Van Wagner's continued contractual right to the space for the balance of the lease term is within its own control; on the contrary, both are in the interest of S & M. Thus, neither the need to project into the future nor the contingencies allegedly affecting the length of Van Wagner's term render inadequate the remedy of damages for S & M's breach of its lease with Van Wagner.

The trial court, additionally, correctly concluded that specific performance should be denied on the ground that such relief would be inequitable in that its effect would be disproportionate in its harm to defendant and its assistance to plaintiff. It is well settled that the imposition of an equitable remedy must not itself work an inequity, and that specific performance should not be an undue hardship. This conclusion is not within the absolute discretion of the Supreme Court. Here, however, there was no abuse of discretion; the finding that specific performance would disproportionately harm S & M and benefit Van Wagner has been affirmed by the Appellate Division and has support in the proof regarding S & M's projected development of the property.

While specific performance was properly denied, the court erred in its assessment of damages. Our attention is drawn to two alleged errors.

First, both parties are dissatisfied with the award of lost profits on the Asch contract: Van Wagner contends that the award was too low because it failed to take into account incidental damages such as sign construction, and S & M asserts that it was too high because it failed to take into account offsets against alleged lost profits such as painting costs. Both arguments are precluded. Although the trial was not bifurcated or limited to the issue of liability, the Asch contract was placed in evidence and neither party chose to submit additional proof of incidental damages or other expenses for that period. Nor—as is evident from the judgment—did the trial court understand

that any separate presentations would be made as to damages for that period. Based on the Asch contract indicating revenues, and the lease indicating expenses, the trial court properly calculated Van Wagner's lost profits. Having found that the value of the space was fixed by the Asch contract for the entire period of that contract, however, the court erred in awarding the lost revenues only through November 23, 1983. Damages should have been awarded for the duration of the Asch contract.

Second, the court fashioned relief for S & M's breach of contract only to the time of trial, and expressly contemplated that if defendant continues to exclude plaintiff from the leased space action for continuing damages may be brought. In requiring Van Wagner to bring a multiplicity of suits to recover its damages the court erred. Damages should have been awarded through the expiration of Van Wagner's lease.

Accordingly, the order of the Appellate Division should be modified, with costs to plaintiff, and the case remitted to Supreme Court, New York County, for further proceedings in accordance with this opinion and, as so modified, affirmed.

Reflection

The *Van Wagner* case illustrates a key principle in contract law: equitable remedies like specific performance are extraordinary because they require court oversight and impose obligations that monetary damages cannot easily replace. The challenges in operationalizing specific performance necessitate a clear justification for ordering it. The court's observation that the term "uniqueness" does not serve as a "magic door to specific performance" underscores the need for courts to carefully balance fairness, practicality, and efficiency when awarding remedies.

In *Van Wagner*, the court refused to grant specific performance for the lease of a unique advertising billboard. The court emphasized that monetary damages could adequately compensate the injured party. This decision highlights the principle that specific performance is reserved for cases where monetary remedies are insufficient to make the injured party whole. Courts assess whether a contract's subject matter lacks substitutes or whether substitutes are difficult to value. If substitutes exist and can be easily quantified, monetary damages become the preferred remedy because they avoid unnecessary judicial oversight and disproportionate burdens on the breaching party.

This reasoning aligns with economic perspectives on specific performance, such as those articulated by Anthony Kronman. Kronman argues that specific performance is particularly valuable in cases where assessing monetary damages is uncertain due to the absence of reliable market data or comparable substitutes. In *Van Wagner*, this reasoning supports the court's decision that sufficient market information about the billboard lease made monetary damages an adequate remedy. When market information is robust, monetary damages are sufficient to align with the principles of efficiency and fairness. By contrast, when market substitutes are unavailable, specific performance prevents undercompensation, thus ensuring that the injured party receives the full benefit of their bargain.

The court in *Van Wagner* also considered the “disproportionate burden” that specific performance would have imposed on the breaching party. This reflects a broader concern in contract law that equitable remedies must not create new inequities. By tethering specific performance to cases of demonstrable necessity, and monetary damages to situations where they suffice, courts preserve predictability in contract enforcement while minimizing unnecessary costs.

Looking ahead, the principles established in *Van Wagner* raise important questions about how specific performance might adapt to modern contexts. Digital assets, intellectual property, and unique technologies often lack established market substitutes, challenging traditional notions of uniqueness and valuation. Courts will need to consider how emerging markets and novel goods affect the availability and appropriateness of equitable remedies. As in *Van Wagner*, they must evaluate whether these assets truly lack substitutes or whether adequate compensation can be calculated using modern valuation techniques. Kronman’s analysis suggests that balancing fairness and efficiency will remain central to these determinations and will require courts to innovate while staying true to foundational principles of contract law.

The interplay between economic theory and judicial discretion in *Van Wagner* underscores the critical role of courts in maintaining fairness and efficiency. By grounding specific performance in necessity and reserving it for exceptional cases, the decision highlights how contract law balances the interests of injured parties with the realities of equitable relief. Students can use the reasoning in *Van Wagner* to analyze whether a remedy is appropriate in cases involving evolving markets; doing so will help them to assess the suitability of specific performance in practice while considering its implications for justice and predictability in contract law.

Discussion

1. The *Van Wagner* court stated, “The word ‘uniqueness’ is not, however, a magic door to specific performance.” What factors do courts consider when evaluating whether a property is truly unique? How does the availability of reliable market data influence this determination?
2. Drawing on Kronman’s argument in the portion of his law review article that the court quoted, why might courts view specific performance as economically justifiable only in cases where money damages are uncertain or unreliable? How does this align with the court’s reasoning in *Van Wagner*?
3. In *Van Wagner*, the court denied specific performance, partly because it would impose an inequitable burden on the breaching party. How should courts balance the hardships imposed on breaching parties with the rights of injured parties seeking specific performance? Does the “disproportionate burden” test risk undermining fairness?

4. If *Van Wagner* were decided today in the context of digital advertising or NFT markets, would the reasoning about uniqueness still hold? How might new types of technology or even new types of contracts challenge traditional views of substitutability and damages?
 5. Kronman argues that specific performance operates as a property rule requiring the breaching party to negotiate for release rather than simply pay damages. Do you agree with this characterization? How might this approach encourage or discourage efficient outcomes in contract law?
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Problems

Problem 27.1. Luxe Deposit

Jasper contracts with Luxe Homes to build a custom vacation house. The contract includes a non-refundable deposit of \$100,000. Luxe begins work and completes the foundation and framing but then breaches by abandoning the project without explanation. Jasper discovers that Luxe spent only \$50,000 on materials and labor and retained the remaining \$50,000. Jasper hires another contractor to complete the project for \$200,000.

Luxe claims that Jasper received the full benefit of its partial performance because the foundation and framing are integral to the house. Luxe also argues that its breach was caused by unforeseen economic hardship, making retention of the deposit equitable under the circumstances. Jasper seeks restitution for the \$100,000 deposit.

Should Jasper recover the full deposit, or should Luxe retain any portion of it based on the value of its work?

Should restitution be measured by the value of the benefit conferred to Jasper or by Luxe's unjust gain?

Problem 27.2. The Ink Factory

Pigment Producers, Inc., produces ink for printers. However, sources of raw materials for several pigments are drying up. For example, the chemicals MX and diketene, used in the production of yellow pigment, are in very short supply because of a crackdown on air pollution in China and a factory explosion there. Pigment Producers has a contract with Okinawa Chemical, a Japanese company, for both MX and diketene. Assume the contract is governed by a jurisdiction that has adopted the UCC.

If Okinawa Chemical backs out of the contract because it can obtain a higher price by selling Pigment Producers' quota to other ink producers, can Pigment Producers obtain specific performance under UCC § 2-716?

Does the unique and irreplaceable nature of MX and diketene support specific performance, or are money damages sufficient? Does the global supply shortage qualify as “other proper circumstances” under UCC § 2-716?

Are there alternative suppliers, or is specific performance the only way to adequately protect Pigment Producers’ interests?

Problem 27.3. Pest Control

Orkin Exterminating Co., a national pest control company, hired Tony A. Martin to work as a pest exterminator at their office in Miami, Florida, which provided pest control services throughout Miami-Dade County. At the time of employment, the parties entered into a written contract containing a covenant not to compete. The covenant restricted Martin from engaging in the pest control business anywhere in Miami-Dade County for two years following his termination of employment.

Martin voluntarily terminated his employment and began working in Miami-Dade County with one of Orkin’s competitors. Orkin sued, asking for an injunction prohibiting Martin from working as an exterminator in Miami-Dade County. Orkin also claims Martin has access to proprietary pest control methods, making an injunction necessary to prevent disclosure.

Miami-Dade County has a total land area of 2,431 square miles and a total population of 2,700,000 people.

Should the court enforce Martin’s non-compete agreement by issuing an injunction?

Is the covenant’s scope—covering all of Miami-Dade County for two years—reasonable?

Do Orkin’s business interests outweigh Martin’s right to earn a living, or does public policy favor competition? Would enforcing the non-compete in a large, diverse economy like Miami-Dade County disproportionately harm competition or job mobility?

Would monetary damages adequately protect Orkin’s interests instead of an injunction?

Problem 27.4. The Victor’s Vintage Car

Mia contracts to purchase a vintage sports car from Victor for \$120,000, believing it to be a rare factory-original model. After delivery, she discovers the car was extensively modified with non-original parts. Victor claims he was unaware of the modifications and insists the sale is valid. Mia seeks rescission, arguing that the mutual mistake about the car’s originality undermines the agreement. Victor counters that the car’s current value, even with modifications, exceeds \$120,000, and he offers reformation to adjust the sale terms to reflect the true value of the car. Victor also argues

that the modifications enhance the car's performance and rarity, increasing its value beyond the original terms.

Should the court grant rescission or reformation?

Does the mutual mistake justify rescission, or does reformation better address the parties' intentions?

Should the court consider whether the modifications enhance the car's value?

Problem 27.5. Omega Medical

Omega Medical Systems orders a specialized imaging device from Precision Tech for \$500,000. Precision agrees to deliver the device within three months, but a week before delivery, Omega learns that Precision plans to sell the same device to another buyer for \$600,000. Omega has no alternative supplier and risks losing a lucrative contract with a hospital if it does not secure the device on time. Omega sues for replevin to recover the device. Precision Tech argues that canceling the sale to the other buyer would harm its long-term business relationships.

Should the court grant replevin?

Does the imaging device qualify as unique, and does Omega's inability to secure a substitute support replevin? Should the court prioritize the hospital's immediate needs over Precision Tech's commercial interests?

Would monetary damages adequately address Omega's harm, or is replevin necessary to prevent immediate and irreparable harm?

Problem 27.6. Greenfield Tech

Greenfield Tech contracts with Silverlight Solutions to develop a custom software application for \$500,000. Silverlight completes 70% of the project but then breaches by terminating the contract without cause. Greenfield sues, seeking specific performance to compel Silverlight to finish the project, restitution for the \$350,000 already paid, and replevin for the partially completed software code Silverlight retains. Silverlight argues that specific performance is impractical due to the remaining development timeline and the need to hire additional developers, which would impose a substantial burden. Silverlight also claims that restitution is unwarranted because Greenfield benefited from the completed work and monetized part of the incomplete software. Additionally, Silverlight contends that the partially completed code cannot be replevied because it is intangible.

Should the court grant specific performance, restitution, or replevin?

Does the partially completed software qualify for replevin despite its intangible nature? How should the court address the intangible nature of the software in considering Greenfield's replevin claim?

Should restitution account for the value of Silverlight's partial performance, or should Greenfield recover the full \$350,000? Should the court deduct Greenfield's revenue from its use of the incomplete software when calculating restitution?

Would specific performance impose an undue burden on Silverlight?

Chapter 28

Third-Party Beneficiaries

What happens when someone who never signed a contract seeks to enforce it? This question lies at the heart of the doctrine of third-party beneficiaries, which challenges the traditional requirement of privity in contract law. Ordinarily, only the parties to a contract may enforce its terms or be held liable under them. This rule ensures clarity and predictability in contractual relationships. Yet, in specific circumstances, courts allow non-parties to claim enforceable rights under a contract. These exceptions highlight a critical tension in contract law: balancing the contracting parties' autonomy—their right to control their agreements—with the legitimate interests of outsiders who may be significantly impacted by those agreements, especially when reliance or substantial harm is involved.

Consider the case of the *Athos I* oil spill. In 2004, the oil tanker *Athos I* struck an abandoned anchor while navigating the Delaware River to a CITGO terminal, spilling hundreds of thousands of gallons of crude oil. The cleanup costs soared, prompting Frescati Shipping, the tanker's owner, to seek damages under a "safe berth" clause in a charter agreement between CITGO's affiliates and a chartering intermediary. Frescati, not a signatory to the contract, argued it was an intended third-party beneficiary of the promise. The case hinged on whether the contracting parties intended to confer enforceable rights on Frescati.

This chapter explores when and why courts recognize third-party beneficiary claims. By focusing on the intent of the original contracting parties, courts distinguish intended beneficiaries—who have enforceable rights—from incidental beneficiaries, who do not. Through cases like *Frescati Shipping Co. v. Citgo Asphalt*, 718 F.3d 184 (2013), and other examples, this chapter provides a framework for analyzing such disputes. By the end, you will understand how the third-party-beneficiary doctrine balances flexibility and predictability in contract law while honoring the intent behind contractual promises.

Rules

A. The Intent Test

When a non-party to a contract seeks to enforce contractual rights, the threshold question is whether this non-party qualifies as an intended beneficiary. Contract law generally limits enforceable rights to the parties who sign the agreement, but an exception exists where the contracting parties clearly intended to confer a benefit on an outsider. Courts apply this principle cautiously to maintain the balance between party autonomy and fairness.

(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

(2) An incidental beneficiary is a beneficiary who is not an intended beneficiary. R2d § 302.

Courts answer the critical question of whether both the promisor and the promisee intended to confer a direct benefit on the third party by examining the language of the contract and its surrounding circumstances. Evidence supporting this intent may include explicit provisions naming the third party as a beneficiary, a requirement that the promisor perform directly for the third party's benefit, or contextual factors that show the third party's reliance on the promised performance.

To enforce rights as a third-party beneficiary, the claimant must demonstrate they have not benefitted incidentally but rather that the contracting parties bargained for their benefit. In *Frescati Shipping Co. v. Citgo Asphalt*, Frescati attempted to enforce a "safe berth" clause in a contract between CITGO affiliates and Star Tankers. The safe berth promise was breached when the *Athos I* tanker collided with a submerged anchor, resulting in significant oil-spill damages. Although Frescati was not a signatory to the contract, it argued that the clause directly benefited shipowners.

The Third Circuit ruled in favor of Frescati, holding that it was an intended beneficiary. The court reasoned that the safe berth clause was naturally aimed at protecting vessels and their owners, and it asked, "Who else could this promise reasonably protect if not the ships docking at the port?"

Courts distinguish intended beneficiaries from incidental ones to avoid imposing unforeseen obligations on promisors. For example, a local fisherman who relies on the safe conditions created by CITGO's berth agreement may benefit indirectly, but the contracting parties did not intend for him to enforce the promise. His reliance, though real, does not stem from the intent behind a contractual promise. Similarly, a

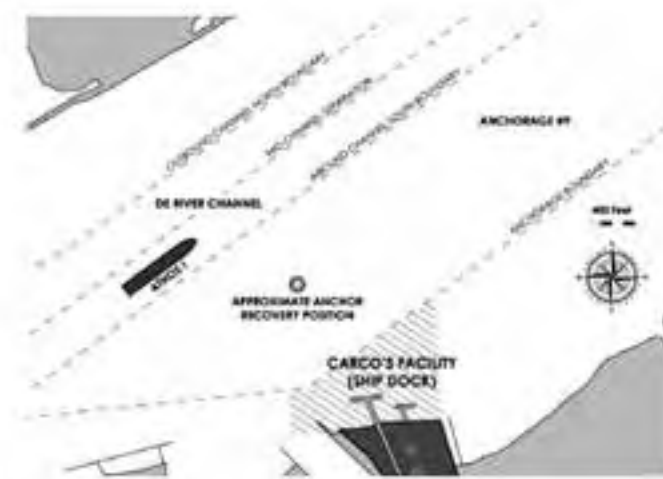


Figure 28.1. The presence of an abandoned anchor violated the safe berth provision in a contract between CITGO and Star Tankers. Frescati Shipping, owner and operator of the *Athos I* tanker, was found to be an intended third-party beneficiary of this contract.

tugboat operator might see increased business from more vessels entering the port; however, unless CITGO and Star Tankers explicitly intended to benefit tugboat operators, they remain incidental beneficiaries without enforceable rights.

Courts generally avoid allowing random bystanders to enforce third-party rights. The doctrine of third-party beneficiaries hinges on the principle that contractual obligations should not be expanded to cover parties the promisor never agreed to serve. By requiring clear evidence of intent, courts protect the autonomy of the original contracting parties while ensuring fairness in enforcement. This intent-driven approach reinforces the balance between predictability in contract law and the equitable recognition of legitimate third-party claims.

B. Creditor and Donee Beneficiaries

When courts determine whether a third party qualifies as an intended beneficiary, they often distinguish between two specific types: creditor beneficiaries and donee beneficiaries. These categories have roots in older common law but continue to serve as useful tools for analyzing intent in modern contract disputes. While not exhaustive, they provide a structured way to understand why certain third parties may enforce a contract. And courts still refer to these categories today.

A creditor beneficiary may arise when a contract is designed to fulfill a financial obligation that the promisee already owes to a third party (provided that the parties intend to benefit the third party). For example, if a landlord owes a repair company for renovations and contracts with a tenant to reduce the tenant's rent in exchange for the tenant's paying the repair company directly, the repair company may become a creditor

beneficiary. This is because the tenant's payment could fulfill the landlord's obligation to the repair company. Again, this scenario reflects a creditor beneficiary only if the landlord *and* tenant intended the repair company to benefit from their agreement.

By contrast, a donee beneficiary may arise when the promisee intends to confer a gift or gratuitous benefit on the third party. Unlike a creditor beneficiary, there is no preexisting obligation owed to the third party. However, the promisee's intent to benefit the third party must still be clear. A common example is a life insurance policy, where the insured person (the promisee) designates a beneficiary to receive payment upon their death. In such cases, courts routinely recognize the beneficiary's right to enforce the contract because the promisee's intent to benefit the third party is explicit and integral to the agreement.

Sometimes, a third party might qualify as both a creditor and a donee beneficiary, depending on the nature of the promise. For instance, a single promise might simultaneously satisfy a debt and provide an additional benefit as a gift. If a promisor agrees to pay \$5,000 to a promisee's friend in satisfaction of a \$3,000 debt and as a \$2,000 gift, the friend is a creditor beneficiary for \$3,000 and a donee beneficiary for the remaining \$2,000. Courts will carefully parse the contract's language and context to identify such dual roles.

And, even if a third party is not necessarily a creditor or donee beneficiary, it might still be an intended beneficiary in a broader sense. While these classifications are helpful in understanding intended beneficiaries, courts often adopt a broader approach. Rather than focusing strictly on whether a third party is a creditor or donee beneficiary, modern analysis asks whether recognizing the third party's rights aligns with the intent of the contracting parties. This ensures that the law remains flexible and capable of addressing the nuances of complex commercial and personal arrangements.

Finally, it is essential to note that *incidental* beneficiaries *never* fall into either category. While they may receive some benefit from the contract, their ability to enforce it is barred unless the contracting parties expressly intended to grant them enforceable rights. The terms "creditor beneficiary" and "donee beneficiary" implicitly refer only to *intended* beneficiaries. Courts use this distinction to prevent the expansion of liability beyond what the parties originally agreed upon, which preserves predictability and fairness in contract law. Remember that *unintended* (incidental) beneficiaries do not have contractual rights under the third-party beneficiaries doctrine.

C. Defenses

While an intended beneficiary may enforce a contract, their rights are not absolute. Just as the promisee must face certain defenses if they sue the promisor, the same defenses are generally available against the third-party beneficiary. Courts aim to preserve fairness by ensuring that the beneficiary's rights do not exceed those of the promisee.

One foundational defense is the non-formation of the contract itself. If the underlying agreement is void or voidable—for example, due to fraud, duress, mistake, lack of consideration, or incapacity—then no rights can vest in the third party. A contract lacking mutual assent leaves both the promisee and any potential beneficiary without enforceable claims. Or if a promisor argues that the contract was induced by fraudulent misrepresentation, a court may invalidate the agreement, leaving the third-party beneficiary unable to enforce it.

Similarly, failure of a condition precedent can serve as a defense against a third-party claim. Many contracts are conditional, meaning performance is contingent upon certain events or actions. If those conditions are not met, neither the promisee nor the beneficiary may compel performance. For example, a promisor might agree to pay a third party only if the promisee delivers specified goods or services. If the promisee fails to fulfill this condition, the third party's rights are extinguished along with the promisee's.

Another common defense is contract modification or rescission prior to the third party's rights vesting. Under R2d § 311, the promisor and promisee generally retain the ability to alter or terminate their agreement without the third party's consent until the beneficiary's rights vest. Rights typically vest when the beneficiary materially changes their position in reliance on the promise, brings suit to enforce it, or manifests assent to the contract. For example, if the promisee and promisor mutually agree to cancel a contract before the third party takes action to rely on it, the beneficiary loses the ability to enforce the promise.

Defenses rooted in the conduct of the third party also arise. For instance, if the beneficiary acts in a way that breaches a related duty or releases the promisor from obligations, their rights may be diminished or barred. A beneficiary who waives their rights explicitly or implicitly cannot later demand performance. Additionally, equitable defenses like unclean hands or estoppel may apply if the beneficiary's behavior undermines their claim to equitable relief.

The promisor may also assert any defenses they could have raised against the promisee. This includes arguments such as failure of consideration, impossibility or impracticability of performance, or frustration of purpose. For example, if a natural disaster renders performance impossible, the promisor may avoid liability to both the promisee and the beneficiary.

Finally, some contracts explicitly limit or disclaim third-party rights, creating a contractual defense. Courts generally enforce such disclaimers as long as they are clear and unambiguous. If a contract contains language explicitly barring third-party enforcement, the beneficiary's claim will fail even if they might otherwise qualify as an intended beneficiary.

In sum, while third-party beneficiaries enjoy significant rights under contract law, these rights are subject to the same limitations and defenses as those affecting the primary parties. This framework ensures that the extension of enforceable rights to

non-parties does not unfairly expand liability or disrupt the expectations of the original contracting parties.

D. Reflections on Third-Party Beneficiaries

The doctrine of third-party beneficiaries sharpens the focus on some of the most fundamental principles in contract law: honoring intent, enforcing promises, and maintaining the boundaries of privity. This doctrine provides flexibility in a system that often prioritizes rigid rules. Courts must adapt to complex multi-party arrangements while preserving the autonomy of the contracting parties.

The principle of intent serves as the cornerstone of this doctrine. Manifestation of mutual intent ensures that enforceable rights align with the purposes the contracting parties objectively contemplated when forming their agreement. Courts must determine whether the contracting parties clearly intended to confer enforceable rights on a non-party. This inquiry, grounded in both the language of the contract and the surrounding circumstances, ensures that third-party claims do not unfairly disrupt the expectations of the original parties. Cases like *Frescati Shipping* illustrate how courts weigh these considerations: courts distinguish between beneficiaries whose rights were deliberately conferred and those whose benefits are incidental.

At the same time, the doctrine exemplifies contract law's adaptability. Multi-layered commercial arrangements often involve intricate relationships, where the promises made by contracting parties naturally overlap with the interests of third parties. Such situations require courts to carefully evaluate which claims merit enforcement. The doctrine allows courts to recognize legitimate third-party claims without undermining contractual predictability. By carefully parsing intent, courts can strike a balance between enforcing promises and limiting undue burdens on promisors.

This balancing act highlights two of contract law's main objectives: By protecting reasonable third-party reliance, it ensures fairness. By avoiding undue burdens on contracting parties, it maintains efficiency. This careful calibration ensures that contract law remains practical in resolving disputes while upholding its core principles of autonomy and predictability.

As you reflect on this doctrine, consider its implications for modern disputes. How might courts assess intent in emerging contexts, such as decentralized networks, where traditional markers of intent—like clear promises and mutual understanding—are less evident? In what ways might multi-party agreements, such as those in blockchain ecosystems, challenge traditional notions of privity? By grappling with these questions, students and practitioners can better appreciate how third-party beneficiary law fits into the larger framework of contract law and ensures fairness without compromising the autonomy of contracting parties.

Cases

Reading Sovereign Bank v. BJ's Wholesale Club, Inc. *Sovereign Bank* explores whether a non-party to a contract can enforce its terms as a third-party beneficiary. At the heart of the case is the question of whether Sovereign Bank, as a Visa card issuer, was an intended beneficiary of a Member Agreement between Fifth Third Bank and Visa. The agreement obligated Fifth Third to ensure that merchants, including BJ's, complied with Visa's operating regulations, particularly those governing security protocols for cardholder information.

As you read, focus on how the court determines intent. Look at the evidence Sovereign Bank presented to support its argument that it was an intended beneficiary, and assess whether this evidence demonstrates a clear intent by Fifth Third and Visa to confer enforceable rights on Sovereign Bank. The court's application of R2d § 302 is central to this analysis. Consider why the court concludes that Sovereign Bank was, at most, an incidental beneficiary rather than an intended one.

Additionally, pay attention to the role of contractual language and context. The specific terms of the agreement, coupled with the broader regulatory framework of the Visa network, shaped the court's interpretation. This case underscores how precise drafting and an understanding of the operational environment can clarify or obscure third-party rights.

Through studying this case, students will gain a clearer understanding of the boundaries of third-party beneficiary doctrine, particularly in the context of complex commercial relationships. The decision demonstrates how courts balance the contracting parties' intent with broader considerations of fairness and enforceability.

Sovereign Bank v. BJ's Wholesale Club, Inc.

533 F.3d 162 (2008)

Opinion by MCKEE, Circuit Judge.

In these consolidated appeals, Sovereign Bank and the Pennsylvania State Employees Credit Union appeal orders dismissing claims that arose from the theft of certain credit card information from a retailer's computer files. For the reasons that follow, we will reverse in part, and affirm those orders in part.

I. Background

These consolidated appeals involve two law suits that arose from the theft of credit card information from the computer files of a prominent retailer. Visa U.S.A., Inc., is a corporation, comprised of an association of financial institutions, which operates a

credit card payment system known as “Visa.” Sovereign Bank and the Pennsylvania State Employees Credit Union (“PSECU”) are both members of the Visa network. Sovereign and PSECU have a Membership Agreement with Visa that allows them to issue Visa cards to their respective customers and members. Within the Visa network, Sovereign and PSECU are referred to as “Issuers,” which means that they issue Visa cards to cardholders pursuant to the contracts they enter into with them.

Fifth Third Bank is also a member of the Visa network, and it also has a Membership Agreement with Visa. Within the network, Fifth Third is referred to as an “Acquirer,” which means that Fifth Third enters into contractual relationships with businesses that agree to accept Visa cards as payment for their goods and services (“Merchants”). Acquirers process those transactions on behalf of the Merchants. BJ’s Wholesale Club, Inc., is a Merchant. Accordingly, Fifth Third and BJ’s have entered into a Merchant Agreement. Although Merchants participate in the Visa network, they are not members. Only financial institutions are eligible for membership. Therefore, Merchants have no contractual relationship directly with Visa.

Every time a cardholder uses a Visa card to pay a Merchant for goods or services, the Issuer, Acquirer and Merchant must interact to process and complete the transaction. The Merchant’s computer scanners first “read” the “Cardholder Information” contained in the magnetic stripe on the back of Visa cards as they are swiped through the familiar terminal at the checkout. The Merchant then sends the pertinent account information through the Visa network to the Issuer. The Issuer reviews the Cardholder Information and, assuming the card is valid with sufficient available credit, the Issuer authorizes the transaction, and so notifies the Merchant.

Upon receiving that notification, the Merchant completes the transaction with the cardholder, and then forwards the receipt to the Acquirer who pays the Merchant pursuant to their agreement. The Acquirer then notifies the Issuer that payment has been received, and the Issuer pays the Acquirer and charges the cardholder.

Visa has created an extensive set of “Operating Regulations” to both govern and facilitate transactions involving Visa cards. Those Regulations address virtually every aspect of the Visa payment system, and impose both general and specific requirements on participants in the network.

The disputes in these appeals center on certain security regulations including the Cardholder Information Security Program (“CISP”). The CISP provisions apply to Issuers and Acquirers and include broad security requirements intended to protect Cardholder Information. Those requirements include a prohibition against retaining or storing the data encoded in the familiar magnetic stripe on the back of credit cards, i.e., Cardholder Information, after a consumer transaction is completed.

One provision of the Operating Regulations, entitled “Enforcement,” defines procedures by which Visa can enforce compliance with the Operating Regulations. That provision expressly allows Visa to take specified remedial actions against Members who do not comply with the Operating Regulations, including levying fines and penalties. Enforcement actions can be appealed to Visa’s Board of Directors, but the

Board's decision is final. The Operating Regulations give Visa, and only Visa, the right to interpret and enforce the Operating Regulations, and only Visa can determine whether a violation of the Operating Regulations has occurred.

The Operating Regulations also impose extensive security requirements on Issuers and Acquirers. Section 2.3 of the Operating Regulations requires Issuers and Acquirers to ensure that their agents, service providers and Merchants comply with the Operating Regulations.

The Visa Operating Regulations also include comprehensive provisions for resolving disputes between Visa members. These provisions allow members to challenge disputed charges through "chargeback" and representment procedures, in accordance with risk allocation judgments made by Visa. Disputes about the use of these procedures are resolved by arbitration.

Finally, the Operating Regulations also include "Compliance" provisions that apply when a Member's violation of a Regulation causes a financial loss to another Member who cannot be made whole by resorting to chargeback or representment. For example, a loss resulting from fraudulent charges using stolen data is allocated to the Issuer. However, the Issuer may use the Compliance proceedings to shift that loss to the Acquirer if it resulted from the Acquirer's violation of an Operating Regulation. The Compliance provisions do not eliminate any rights a Member may have to pursue any legal remedies that may otherwise be available.

Pursuant to their Membership Agreements with Visa, all Members of the Visa network including Insurers and Acquirers, agree to be bound by the Operating Regulations. In addition, before an Acquirer can enter into a Merchant Agreement with a Merchant, the Acquirer must first determine that the Merchant will abide by the Operating Regulations. Given the importance attached to uniform compliance, an Acquirer's initial determination is deemed insufficient. Rather, an Acquirer must agree to ensure continued compliance with the Operating Regulations. Finally, the Acquirer must have a Merchant Agreement with each of its Merchants. The Merchant Agreements may generally contain whatever extraneous provisions the Acquirer and Merchant agree upon, but, the Agreement must, at a minimum, contain the provisions of Section 5.2 of the Operating Regulations.

These disputes involve §5.2.h.3.b. That subdivision prohibits a Merchant from retaining or storing Cardholder Information after an Issuer authorizes a transaction. Like all Visa Members, Fifth Third's predecessor agreed to be bound by the Visa Operating Regulations and By-Laws, which are incorporated by reference into the Membership Agreement.

The seeds that sprouted this litigation were sewn in February 2004, when Visa identified a potential compromise of electronically stored Cardholder Information pertaining to certain Visa cards issued by Sovereign, PSECU and other financial institutions. Electronic data on some credit cards had been copied and used to fraudulently obtain goods and services after cardholders had used the cards at various BJ's stores. Visa responded by issuing a "CAMS alert" to potentially affected Issuers. Such

CAMS alerts notify Visa members that Cardholder Information may have been compromised. The CAMS alert here notified the Issuers that Visa cards which had been properly presented for payment at BJ's stores from July 2003 through February 2004 had been compromised and could be used to make fraudulent purchases.

Sovereign responded to the February 2004 alert by cancelling some Visa cards and issuing new Visa cards to the affected cardholders. Sovereign claims that the fraud was only possible because BJ's improperly retained and stored the Cardholder Information from its customers' cards instead of deleting the data immediately after a sales transaction was completed, as required by Visa Operating Regulation § 5.2.h.3.b. In Sovereign's view, BJ's failure to comply with the requirements of § 5.2.h.3.b. breached a duty owed to Sovereign. Sovereign further contends that Fifth Third failed to comply with the Operating Regulations by failing to ensure that BJ's complied with § 5.2.h.3.b.

According to Sovereign, BJ's failure to delete the Cardholder Information magnetically stored in Visa cards, and Fifth Third's failure to ensure that BJ's complied with § 5.3.h.3.b, allowed the unauthorized and fraudulent use of Cardholder Information. Sovereign maintains that it was legally obligated to reimburse its cardholders for the resulting fraudulent charges, and that it incurred expenses, and lost income and fees from doing so. This purportedly included the costs of issuing replacement cards to Cardholders (in an effort to mitigate further losses), and loss of goodwill of its customer base.

After it discovered the breach of security of Cardholder Information that had been retained in BJ's system, PSECU also canceled approximately 20,000 Visa cards that it had issued to its members who had used the cards at BJ's. It then reissued Visa cards with new account numbers and new Cardholder Information at a cost of approximately \$ 98,000.

II. Sovereign Bank v. BJ's Wholesale Club and Fifth Third Bank (No. 06-3392)

On January 10, 2005, Sovereign sued Fifth Third and BJ's in state court asserting a claim for negligence, breach of contract, and equitable indemnification against each defendant. The suit was brought to recover the losses that resulted from the fraudulent use of Cardholders' Information, lost fees and commissions, the value of the unauthorized purchases and sales, and the cost of replacing Visa cards.

[Procedural details omitted.]

We discuss each of Sovereign's arguments in turn.

A. Sovereign's Breach of Contract Claim Against Fifth Third.

As noted, Sovereign's contract claim is based on the theory that it is a third-party beneficiary of Fifth Third's Member Agreement with Visa. As also noted, that agreement required Fifth Third to ensure that BJ's complied with the Visa Operating Regulations, and § 5.2.h.3.b. of that agreement prohibits Merchants from retaining

Cardholder Information. Sovereign contends that Fifth Third breached that contract by not ensuring BJ's compliance.

Historically, under Pennsylvania law, "in order for a third party beneficiary to have standing to recover on a contract, both contracting parties must have expressed an intention that the third-party be a beneficiary, and that intention must have affirmatively appeared in the contract itself."

Sovereign appropriately concedes that it is not an express third-party beneficiary of the Visa-Fifth Third Member Agreement. However, the Pennsylvania Supreme Court adopted § 302 of the Restatement (Second) of Contracts. That provision allows an "intended beneficiary" to recover for breach of contract even though the actual parties to the contract did not express an intent to benefit the third party. Section 302 provides as follows:

[See above for R2d text.]

Under § 302, Sovereign's contract claim depends on whether the "recognition of a right to performance" in Sovereign "is appropriate to effectuate the intentions of" both Visa and Fifth Third in entering into their member agreement and whether "the circumstances indicate that" Visa (the promisee) "intend[ed]" to give Sovereign "the benefit of the promised performance."

Fifth Third relies in part on Miller's testimony that he was not aware that Visa intended to create a direct right of enforcement under the Operating Regulations among Members and he has never seen a document that would allow a Member "to step into Visa's shoes under its contract with other members" and enforce the Operating Regulations. Miller testified in part as follows:

[T]he core purpose of the Operating Regulations is to set up the conditions for participation in the system, to set up the rules and standards that apply to that ultimately for the benefit of the Visa payment system, the members that participate in it and other stakeholders such as cardholders, merchants, and others who may participate in the system as well.

Fifth Third further contends that Miller also made it clear that the Operating Regulations' prohibition against retaining Cardholder Information, which Fifth Third claims was enacted long after it entered into its agreement with Visa, was not to benefit any individual member or class of members. Rather, according to Miller:

[t]he purpose of the CISP program . . . is to maximize the value to the Visa system as a whole. That can include the protection of any entity that may be involved in the use or—or handling of cardholder data, so it's to protect a cardholder, the privacy of their information, to protect their confidence in using the Visa system, to protect issuers, to protect acquirers, to protect merchants; and by creating a system that protects cardholder data, generally it's to maximize the usage and value of the Visa payment system for all of those participants.

Miller was asked whether, even though there may have been multiple purposes for requiring the Acquirer to ensure Merchant compliance with the regulations, at least one such reason was to protect Issuers. Miller responded as follows:

The part of your question I'm struggling with is to say whether that was the purpose or not. I think I summarized what the purpose was. One of the entities that is impacted by the Cardholder Information Program is issuers, as well as acquirers, merchants and cardholders. So my understanding was the purpose was not directed at any one of those entities but to maximize the value of the system in protecting cardholder information for all of the participants.

Finally, Fifth Third notes that in responding to a question about whether Visa intended to give Issuers the benefit of the Acquirer's compliance with the CISP, Miller testified:

Visa designed the CISP program to benefit the Visa system as a whole, to drive confidence in the integrity of the Visa system, to drive greater, greater efficiency, to drive cardholder security, and to do that from requirements that apply to all Visa members that designed ultimately to yield a more efficient system on behalf of all those participants.

In sum, Fifth Third contends that Miller's deposition testimony clearly shows that the intent of the Operating Regulations, and more particularly the prohibition on Merchant retention of Cardholder Information, is to benefit the Visa system as a whole and not Sovereign or any particular Issuer in particular.

Sovereign notes that in August 1993, Visa wrote a memorandum entitled "Retention of Magnetic-Stripe Data Prohibited." The memorandum described a new section of the Operating Regulations prohibiting the storage of magnetic-stripe data, i.e., Cardholder Information. It read in part as follows:

To protect the Visa system and Issuers from potential fraud exposure created by databases of magnetic-stripe information, Section 6.21 has been revised. Effective September 1, 1993, the retention or storage of magnetic stripe data subsequent to the authorization of a transaction is prohibited. Acquirers are obligated to ensure that their merchants do not store the magnetic-stripe information from Visa Cards for any subsequent use.

Sovereign contends that this August 1993 memorandum shows that Visa understood and clearly intended that Issuers such as Sovereign (and PSECU) would obtain direct benefits from the requiring members to ensure that magnetic-stripe data was not retained.

Sovereign further contends that other evidence obtained from Visa shows that Visa expressly understood and intended that the prohibition would provide direct benefits to Issuers and that the type of harm suffered by Sovereign was specifically intended to be avoided by compliance with the prohibition. Visa published an on-line

article entitled “Issuers and Acquirers Are At Risk When Magnetic-Stripe Data Is Stored,” in May 2003. The article stated that the CISP “was established to preclude a compromise that could lead to the duplication of valid magnetic-stripe data on counterfeit or altered cards,” because such a data compromise “impacts Issuers, Acquirers, cardholder goodwill and the integrity of the payment system.” Sovereign submits that this article is additional evidence that the prohibition against retaining Cardholder Information contained in the magnetic strip was intended to directly benefit Issuers.

Finally, Sovereign relies on the following exchange during Miller’s deposition:

Q: [by Fifth Third’s counsel] Is it fair to say that the operating regulations are not intended to benefit a single group of participants, but the Visa payment system as a whole?

Objection. Leading.

A: [by Miller] It’s fair to say that the core purpose of the operating regulations is to set up the conditions for participation in the system, to set up rules and standards that apply to that ultimately for the benefit of the Visa payment system, the members that participate in it and other stakeholders such as cardholders, merchants and others who may participate in the system as well. (emphasis added).

Q: They may have some incidental benefit; is that correct?

Objection. Leading, and calls for a legal conclusion.

A: The bylaws and operating regulations, by their terms, apply only to members. So to the extent you mean they might have benefits beyond the rules that apply to other stakeholders, that’s correct. They’re not directly parties to these rules. (emphasis added)

Sovereign argues that, despite the best efforts of Fifth Third’s counsel, the italicized portions of Miller’s testimony demonstrate that Visa understood that Issuers are more than incidental beneficiaries of the Member Agreements. Rather, it shows that Visa expressly understood that other classes of participants, such as Issuers, were intended and foreseeable beneficiaries of a Member Agreement, even though they are not parties to a particular agreement.

Sovereign also argues that in granting summary judgment to Fifth Third, the district court did not apply well-settled summary judgment standards. Rather, according to Sovereign, the district court acted like a fact-finder by weighing conflicting or ambiguous evidence and making credibility determinations. The district court explained:

In the face of this evidence of Visa’s intent [i.e., Miller’s deposition testimony], we do not believe that the single August 1993 reference to benefitting issuers nor the ambiguous “core purpose” statement is sufficient evidence to lead a reasonable jury to find for [Sovereign] on the contract claim.

It further commented:

It cannot be disputed that Sovereign benefits from the prohibition on the retention of magnetic-stripe data. It is probably also true that as an issuer it has the greatest need for such a prohibition, and benefits the most from it, since its cardholders' information is at risk if a merchant or other entity retains such data so that it is subject to theft. But one essential part of the test for third-party-beneficiary status is that the promisee, here Visa, must have intended to benefit the third party. There is sufficient evidence on summary judgment to state that Visa had no such intent. In sum, as Fifth Third argues, Sovereign is at most an incidental beneficiary of the member agreement between Visa and Fifth Third, and an incidental beneficiary has no right to enforce a contract, no matter how great a stake it might have in doing so.

[Procedural review omitted.]

In order to be an intended beneficiary of the Visa-Fifth Third Member Agreement, Sovereign has the burden of producing, *inter alia*, sufficient evidence that Visa intended to give it the benefit of the Fifth Third's promise to Visa to ensure that BJ's complied with the provision of the Member Agreement prohibiting Merchants from retaining Cardholder Information. We believe that Sovereign met that burden.

We do not, however, regard the May 2003 on-line article entitled "Issuers and Acquirers Are At Risk When Magnetic-Stripe Is Stored" as indicative of an intent to benefit a particular Issuer such as Sovereign or PSECU. That article simply states the reason for the prohibition against retention of Cardholder Information, *viz.*, a data compromise that could result from storage of magnetic-stripe data "impacts Issuers, Acquirers, cardholder goodwill, and the integrity of the system." However, we do believe that Visa's August 1993 memorandum, entitled "Retention of Magnetic-Stripe Date Prohibited," and Miller's "core purpose" deposition testimony raise a genuine issue of material fact regarding the intent of the Visa and Fifth Third Member Agreement. That was sufficient to preclude the grant of summary judgment on Sovereign's breach of contract claim.

In his deposition, Miller testified that the core purpose of the Operating Regulations was to benefit the Visa system and "the members that participate in it." Admittedly, any indication of an intent by Visa to specifically benefit Issuers is arguably undermined by Miller's references to "other shareholders such as cardholders, merchants and others who may participate in the system as well."

Nonetheless, his testimony clearly suggests an intent by Visa to benefit Issuers. An argument to the contrary is tantamount to claiming that since Visa intended to benefit everyone who was part of the Visa system, it did not specifically intend to benefit anyone. However, the fact that it intended to benefit several Members or classes of Members does not negate the possibility that it intended to benefit individual Issuers such as Sovereign.

Moreover, as recited earlier, the August 1993 memorandum provides, in relevant part: “To protect the Visa system and Issuers from potential fraud exposure created by databases of magnetic-stripe information. . . . Acquirers are obligated to ensure that their merchants do not store the magnetic-stripe information from Visa Cards for any subsequent use.” (emphasis added). Thus, the memorandum clearly states that Acquirers must act to protect Issuers by ensuring that their Merchants do not retain Cardholder Information. Accordingly, the August 1993 memorandum is sufficient evidence by itself to create a genuine issue about whether Visa intended to give Sovereign the benefit of Fifth Third’s promise to Visa to ensure BJ’s compliance with the provisions of the Visa-Fifth Third Member Agreement. Therefore, we will reverse the district court’s grant of summary judgment to Fifth Third on the breach of contract claim and remand for further proceedings on that claim.

Reflection

Sovereign Bank v. BJ’s Wholesale Club, Inc., illustrates the complexity of third-party beneficiary doctrine when applied to a multilayered commercial network like Visa’s. The case demonstrates how courts balance the strict requirements of contractual intent with the practical realities of modern business systems. Sovereign’s argument hinged on whether it was an intended beneficiary of the Visa–Fifth Third Member Agreement. The court’s decision turned on nuanced questions of intent requiring careful scrutiny of both explicit contractual language and broader contextual evidence.

The court’s analysis underscores the critical importance of clear language in defining the rights and obligations of third parties. The Visa–Fifth Third Member Agreement contained no explicit reference to Sovereign or other issuing banks as beneficiaries. This absence of express intent highlights the difficulty of inferring third-party rights, even in a system where issuing banks undeniably benefit from compliance with the Operating Regulations. The court’s reliance on R2d § 302 reinforces the principle that enforceable third-party rights must be grounded in demonstrable intent, not merely in practical advantages.

The evidence presented by Sovereign—including Visa’s 1993 memorandum and the 2003 online article—illustrates the challenges of proving intent in complex contractual arrangements. The court distinguished between general benefits provided to participants in the Visa network and specific benefits conferred on particular members, like Sovereign. Although the memorandum’s language supported Sovereign’s claim, the court deemed the broader context and deposition testimony by Visa’s representative insufficient to establish a clear intent to benefit issuers as a distinct class. The case ultimately rested on whether a jury could reasonably interpret the agreement’s terms and the surrounding circumstances to suggest an intention to benefit Sovereign.

This decision highlights a recurring tension in contract law: the need to respect the autonomy of the contracting parties while addressing the realities of interdependent

relationships. Sovereign's reliance on Visa's compliance structure, and that structure's vulnerability to fraud, emphasizes the stakes involved in interpreting these agreements. However, the court's hesitance to impose liability without unequivocal evidence of intent reflects the broader judicial caution against expanding third-party rights beyond what the contract expressly or implicitly supports.

Sovereign Bank invites reflection on how courts navigate the intersection of formal contractual language and the functional dynamics of large-scale commercial systems. It serves as a reminder that even in networks designed to create shared benefits, the extension of enforceable rights remains tethered to the clear intent of the original contracting parties.

Discussion

1. Should courts consider industry customs and practices when determining third-party beneficiary status, or should they limit their analysis to the four corners of the contract? In this case, Visa's operating regulations and Miller's testimony about the system's purpose provided contextual evidence of intent. What are the advantages of allowing courts to consider such evidence, and what risks or disadvantages might arise if courts rely too heavily on it?
 2. In complex commercial contexts, like the credit card network, how can parties draft contracts to clearly indicate their intent regarding third-party beneficiaries? Reflect on the absence of express language in the Visa–Fifth Third Member Agreement, and discuss how specific language might have avoided this litigation. What tools or drafting strategies would you recommend to ensure clarity?
 3. Do you think the court reached the right result in allowing this issue to go to a jury? Why or why not? Evaluate whether the evidence, including the 1993 memorandum and Miller's testimony, was sufficient to create a triable issue of fact. Should courts be cautious in allowing juries to weigh in on ambiguous contractual terms, or was this the appropriate approach given the stakes for Sovereign?
 4. What does this case reveal about the balance between party autonomy and the realities of interdependent commercial relationships? Sovereign's reliance on Visa's compliance framework and that framework's role in mitigating fraud highlight the interconnectedness of the network. Should courts prioritize protecting the expectations of individual participants like Sovereign, or should they focus on enforcing the original parties' contractual intent? How does this balance reflect broader themes in contract law, such as predictability, equity, and efficiency?
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Problems

Problem 28.1 Subaru Showdown

Subaru Distributors Corp. had an exclusive distribution agreement with Subaru of America, Inc., granting it rights to distribute Subaru vehicles within a defined territory. When Fuji Heavy Industries, the manufacturer, began supplying nearly identical vehicles to Saab for sale in the same territory, Subaru Distributors sued as a third-party beneficiary of the Subaru–Fuji agreement, claiming the arrangement violated its exclusivity.

Does Subaru Distributors have standing to sue as a third-party beneficiary?

What factors should the court consider in determining intent to benefit?

See *Subaru Distributors Corp. v. Subaru of America, Inc.*, 425 F.3d 119 (2d Cir. 2005).

Problem 28.2 Irrigation Irritations

The United States entered into a contract with Copco, a power company, to construct and operate a dam as part of a federal reclamation project. The contract aimed to allocate water resources in compliance with federal statutes and to serve downstream needs, including irrigation for agricultural landowners. Local irrigators sued, arguing they were third-party beneficiaries entitled to enforce the contract to ensure sufficient water supply.

Are the irrigators likely to succeed?

How does the federal purpose of the contract impact their claim?

See *Klamath Water Users Protective Ass'n v. Patterson*, 204 F.3d 1206 (9th Cir. 1999).

Problem 28.3 Sewage Saga

Franz Foods contracted with the City of Green Forest to use the municipal sewer system for its waste. The agreement required Franz Foods to process waste to prevent environmental harm. When waste discharges polluted a local creek, downstream landowners sued Franz Foods as third-party beneficiaries of the contract, claiming its failure to follow the agreement caused the pollution.

Can the landowners enforce the contract?

What role does foreseeability of harm play in determining beneficiary status?

See *Ratzlaff v. Franz Foods*, 250 Ark. 1003 (1971).

Problem 28.4 Symphony Strike

The San Diego Symphony entered into a collective bargaining agreement with its musicians' union. The agreement provided specific audition procedures for filling orchestra vacancies. When the symphony bypassed the process to fill a percussionist role, a union member who was not part of the orchestra sued as a third-party beneficiary, claiming he was entitled to an audition.

Does the member have standing to enforce the agreement?

How do collective bargaining dynamics influence third-party beneficiary claims?

See Karo v. San Diego Symphony Orchestra Ass'n, 762 F.2d 819 (9th Cir. 1985).

Problem 28.5 Insurance Intent

Landlord leased a property to Tenant and required Tenant to procure a property insurance policy naming both as insureds. Tenant obtained insurance through Travelers but failed to include Landlord as a named insured. After a fire destroyed part of the building, Landlord filed a claim with Travelers, asserting rights as a third-party beneficiary of the insurance contract.

Can Landlord enforce the insurance policy?

How does the lack of explicit designation affect the analysis?

See Travelers Indemnity Co. v. Dammann & Co., 594 F.3d 238 (3d Cir. 2010).

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