CONTRACTS AND SALES

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I. WHAT IS A CONTRACT?

A. GENERAL DEFINITION

A contract is a promise or 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.

B. COMMON LAW VS. ARTICLE 2 SALE OF GOODS

Generally, the common law governs contracts. However, special rules have been developed for contracts involving the sale of ***goods***, and those rules are contained in Article 2 of the Uniform Commercial Code ("UCC"). Article 2 has adopted much of the common law of contracts, but where the common law and Article 2 differ, Article 2 prevails in a contract for the sale of goods.

1. "Sale" Defined

A sale is a contract in which title to ***goods*** passes from the seller to the buyer for a price. [UCC §2-106(1)]

2. "Goods" Defined

Article 2 defines "goods" as all ***things movable*** at the time they are identified as the goods to be sold under the contract. [UCC §2-105(1)] Thus, Article 2 applies to sales of most tangible things (e.g., cars, horses, hamburgers), but does not apply to the sale of real estate, services (e.g., a health club membership), or intangibles (e.g., a patent), or to construction contracts. Goods associated with real estate (e.g., minerals, growing crops and uncut timber, and fixtures removed from the land) ***may*** fall under Article 2 under certain circumstances.

3. Contracts Involving Goods and Nongoods

If a sale involves both goods and services (e.g., a contract to paint a portrait), a court will determine which aspect is dominant and apply the law governing that aspect to the whole contract. However, if the contract divides payment between goods and services, then Article 2 will apply to the sale portion and the common law will apply to the services portion.

4. Merchants vs. Nonmerchants

A number of the rules in Article 2 depend on whether the seller and/or buyer are merchants. Article 2 generally defines "merchant" as one who regularly deals in goods of the kind sold or who otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved. [UCC §2-104(1)] For many of the Article 2 provisions dealing with general business practices (e.g., Statute of Frauds, confirmatory memos, firm offers, modification), almost anyone in business can be deemed a merchant. However, a few Article 2 provisions (e.g., the implied warranty of merchantability) are narrower and require a person to be a merchant with respect to goods of the kind being sold.

5. Good Faith and Fair Dealing

Every contract within the UCC imposes an obligation of good faith in its performance and enforcement. [UCC §1-304] The UCC's definition of "good faith" is honesty in fact and the observance of reasonable commercial standards. [UCC §1-201(20)] The common law also imposes a duty of good faith and fair dealing on each party to a contract with respect to performance and enforcement. A breach of this duty is a question of fact, but it usually

involves exercising discretion in a way that deprives the other party of the fruits of the contract.

Example: Pursuant to a written contract giving both parties the power terminate the contract without cause, CarCo employs Sam to sell cars on commission, with the commission to be paid when the customers take delivery of their cars. One month, Sam earned $100,000 in potential commissions, with the bulk of his customers taking delivery at the end of the month. To avoid paying the commissions, CarCo terminated Sam's employment on the 28th of the month. Although CarCo was within its contractual rights in terminating Sam, it was acting in bad faith. CarCo terminated the employment to escape paying money that was rightfully due. Thus, Sam is entitled to recover the commission [*See* Fortune v. National Cash Register, 373 Mass. 96 (1977)]

C. TYPES OF CONTRACTS

1. As to Formation

Contracts are frequently described as express, implied, or quasi. Only the first two are actually contracts, and they differ only in the manner in which they are formed.

a. Express Contract

Express contracts are formed ***by language***, oral or written.

b. Implied in Fact Contract

Implied contracts are formed by manifestations of assent other than oral or written language, i.e., ***by conduct*** (e.g., if a person sits in a barber's chair and the barber cuts his hair, a contract has been formed by the parties' conduct).

c. Quasi-Contract or Implied in Law Contract

Quasi-contracts are ***not contracts*** at all. They are constructed by courts to ***avoid unjust enrichment*** by permitting the plaintiff to bring an action in restitution to recover the amount of the benefit conferred on the defendant. (*See* VIII.C., *infra*.) Their only relationship to genuine contracts is historical.

2. As to Acceptance

a. Bilateral Contracts—Exchange of Mutual Promises

The traditional bilateral contract is one consisting of the exchange of mutual promises, i.e., a promise for a promise, in which each party is both a promisor and a promisee.

Example: Sidney promises to sell Blackacre to Bertram for $6,000, and Bertram promises to purchase Blackacre at that price.

b. Unilateral Contracts—Acceptance by Performance

The traditional unilateral contract is one in which the offeror requests performance rather than a promise. Here, the offeror-promisor promises to pay upon the ***completion of the requested act*** by the promisee. Once the act is completed, a contract is formed. In such contracts, there is one promisor and one promisee.

Example: Susan promises to pay Charles $5 if he will deliver a textbook to Rick. Charles is not obligated to deliver the book, but if he does in fact deliver it, Susan is obligated to pay him the $5.

c. Modern View—Most Contracts Are Bilateral

1) Acceptance by Promise or Start of Performance
Under Article 2 and the Restatement (Second) of Contracts, unless clearly indicated otherwise by the language or circumstances, ***all*** offers are "indifferent" offers, which means that they may be accepted by promising or beginning performance.

Example: Acme Co. orders specifically manufactured goods from Barnes Manufacturing Co. Recognizing the speed with which the order must be filled, Barnes begins to manufacture the ordered item shortly after the order is received. This constitutes an acceptance of the offer if Barnes gives Acme notice of its beginning of performance within a reasonable time, and it creates an implied promise on the part of Barnes to complete manufacture.

2) Unilateral Contracts Limited to Two Circumstances
Under Article 2 and the Second Restatement, a traditional unilateral contract (i.e., a contract that can be formed only by full performance) occurs in only two situations: (i) where the offeror clearly (unambiguously) indicates that ***completion of performance is the only manner of acceptance***—the offeror is the master of the offer and may create the offer in this fashion; and (ii) where there is an ***offer to the public***, such as a reward offer, which so clearly contemplates acceptance by performance rather than a promise (not to mention the total ineffectiveness of a promise in such a situation) that only the performance requested in the offer will manifest acceptance.

3. As to Validity

a. Void Contract
A void contract is one that is totally ***without any legal effect*** from the beginning (e.g., an agreement to commit a crime). It ***cannot be enforced by either party***.

b. Voidable Contract
A voidable contract is one that one or both parties may ***elect to avoid*** (e.g., by raising a defense that makes it voidable, such as infancy or mental illness).

c. Unenforceable Contract
An unenforceable contract is an agreement that is otherwise valid but which may not be enforceable due to ***various defenses*** extraneous to contract formation, such as the statute of limitations or Statute of Frauds.

D. CREATION OF A CONTRACT

When a suit is brought in which one party seeks to enforce a contract or to obtain damages for breach of contract, a court must first decide whether there was in fact a contract. In making this determination, a court will ask the following three basic questions:

1. Was there ***mutual assent***?

2. Was there ***consideration*** or some substitute for consideration?

3. Are there any ***defenses*** to creation of the contract?

II. MUTUAL ASSENT—OFFER AND ACCEPTANCE

A. IN GENERAL

Mutual assent is often said to be an agreement on the "same bargain at the same time"—"a meeting of the minds." The process by which parties reach this meeting of the minds generally is some form of negotiation, during which, at some point, one party makes a proposal (an offer) and the other agrees to it (an acceptance). An actual subjective meeting of the minds is not necessary. Rather, courts use an ***objective measure***, by which each party is bound to the ***apparent intention*** that he manifested to the other(s).

B. THE OFFER

An offer creates a power of acceptance in the offeree and a corresponding liability on the part of the offeror. For a communication to be an offer, it must create a ***reasonable expectation*** in the offeree that the offeror is willing to enter into a contract on the basis of the offered terms. In deciding whether a communication creates this reasonable expectation, you should ask the following three questions:

(i) Was there an expression of a ***promise***, ***undertaking***, ***or commitment*** to enter into a contract?

(ii) Were there ***certainty and definiteness*** in the essential terms?

(iii) Was there ***communication*** of the above to the offeree?

1. Promise, Undertaking, or Commitment

For a communication to be an offer, it must contain a promise, undertaking, or commitment to enter into a contract, rather than a mere invitation to begin preliminary negotiations; i.e., there must be an ***intent*** to enter into a contract. The criteria used to determine whether a communication is an offer include the following:

a. Language

The language used may show that an offer was or was not intended. Technical language such as "I offer" or "I promise" is useful to show that an offer was made, but it is not necessary. Also, certain language is generally construed as merely contemplating an invitation to deal, preliminary negotiations, or "feelers," rather than being an offer. This includes phrases such as "I quote," "I am asking $30 for," and "I would consider selling for." No mechanical formula is available.

b. Surrounding Circumstances

The circumstances surrounding the language will be considered by courts in determining whether an offer exists. For example, where the statement is made in jest, anger, or by way of bragging, and the statement is reasonably understood in this context, it will have no legal effect. However, where the statement is subjectively intended to be in jest but reasonably understood by the hearer to have been made seriously, the statement is an offer because it is interpreted objectively (i.e., according to a reasonable person's expectations).

c. Prior Practice and Relationship of the Parties

In determining whether certain remarks constitute an offer rather than preliminary negotiations, a court will look to the prior relationship and practice of the parties involved.

d. Method of Communication

1) Use of Broad Communications Media
The broader the communicating media (e.g., publications), the more likely it is that the courts will view the communication as merely the ***solicitation of an offer***. (Note that there is an exception as to reward offers.)

2) Advertisements, Etc.
Advertisements, catalogs, circular letters, and the like containing price quotations are ***usually*** construed as mere ***invitations for offers***. They are announcements of prices at which the seller is willing to receive offers. Typically, these are not considered offers because they usually are indefinite as to quantity and other terms, and addressed to the general public. If an advertisement addressed to the general public were considered an offer, it might be overaccepted; i.e., the number of acceptances may exceed the number of items for sale. However, in certain situations, courts have treated advertisements as offers if the language of the advertisement can be construed as containing a promise, the terms are certain and definite, and the offeree(s) is clearly identified. Price quotations also may be considered offers if given in response to an inquiry.

Example: Defendant store advertised a particular coat worth $140 for $1 on a "first come, first served" basis. *Held:* Valid offer to first person accepting on this basis as nothing was left open for negotiation.

e. Industry Custom
The courts will also look to generally accepted custom in the industry in determining whether the proposal qualifies as an offer.

2. Definite and Certain Terms
An offer must be definite and certain in its terms. The basic inquiry is whether enough of the essential terms have been provided so that a contract including them would be ***capable of being enforced***. The principle is that the parties make their own contract; the courts do not make it for them. What is essential for the requisite certainty in an offer depends on the kind of contract contemplated. Typically, the following are important: (i) the ***identity of the offeree***; (ii) the ***subject matter***; and (iii) the ***price*** to be paid. However, a promise generally will be enforceable even if it does not spell out every material term, as long as it contains some ***objective standard*** for the court to use to supply the missing terms. (*See* b.2), *infra*.)

a. Identification of the Offeree
To be considered an offer, a statement must sufficiently identify the offeree or a class to which she belongs to justify the inference that the offeror intended to create a power of acceptance.

Examples: 1) In the example above with the $140 coat selling for $1, the "first come, first served" language eliminates any identification problem.

2) Harvey promises a reward to the person who captures a wanted fugitive. Although the offeree is unidentified and indeed unidentifiable at the time the offer is made, the performance of the requested act constitutes both an identification of the offeree and an acceptance.

b. Definiteness of Subject Matter
The subject matter of the deal must be certain, because a court can enforce a promise only if it can tell with reasonable accuracy what the promise is.

1) Requirements for Specific Types of Contracts

a) Real Estate Transactions—Land and Price Terms Required
An offer involving realty must identify the ***land*** and the ***price*** terms. The land must be identified with some particularity but a deed description is not required (e.g., "my house in Erewhon" is sufficient if the seller has only one house in Erewhon). Most courts will ***not*** supply a missing price term.

b) Sale of Goods—Quantity Term Required
In a contract for the sale of goods, the ***quantity*** being offered must be certain or capable of being made certain.

(1) "Requirements" and "Output" Contracts
In a requirements contract, a buyer promises to buy from a certain seller all of the goods the buyer requires, and the seller agrees to sell that amount to the buyer. In an output contract, a seller promises to sell to a certain buyer all of the goods the seller produces, and the buyer agrees to buy that amount from the seller. Although no specific quantity is mentioned in offers to make these contracts, the offers are sufficiently definite because the quantity is ***capable*** of being made certain by reference to objective, extrinsic facts (i.e., the buyer's actual requirements or the seller's actual output).

(a) Quantity Cannot Be Unreasonably Disproportionate
It is assumed that the parties will act in good faith; hence, there may not be a tender of or a demand for a quantity ***unreasonably disproportionate*** to (i) any stated estimate, or in the absence of a stated estimate (ii) any normal or otherwise comparable prior output or requirements.

(b) Established Business vs. New Business
A number of courts have sometimes refused to enforce such agreements if the promisor did not have an established business. The courts in these cases reason that, due to the lack of any basis for estimating quantity, the agreement is illusory or the damages too speculative. Article 2 avoids this problem by reading a "good faith" agreement into the contract; i.e., the promisor must operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure.

(2) Reasonable Range of Choices
An offer allowing a person to specify an item within a reasonable range of choices may be sufficiently definite to result in a contract if accepted.

Example: Seller states to Buyer: "I will sell you any of these motorcycles for $1,000. Pick one." These words will result in a contract when Buyer's choice is made and manifested.

c) Employment and Other Services
In contracts for employment, if the ***duration*** of the employment is not specified, the offer, if accepted, is construed as creating a contract terminable at the will of either party. For other services, the ***nature of the work*** to be performed must be included in the offer.

2) Missing Terms
The fact that one or more terms are left open does ***not prevent the formation*** of a contract if it appears the parties ***intended to make a contract*** and there is a ***reasonably certain basis*** for giving a remedy. In such a case, the majority of jurisdictions and Article 2 hold that the ***court can supply reasonable terms*** for those that are missing. [*See* UCC §§2-204, 2-305] These terms will be supplied, however, only where they are consistent with the parties' intent as otherwise expressed. Note that the more terms the parties leave open, the less likely it is that they intended to enter into a binding agreement.

a) Price
Except in contracts for real property, the failure to state the price does not prevent the formation of a contract if the parties intended to form a contract without the price being settled. For example, if parties enter into a contract for services and the price is not included in the offer, a court might imply the service provider's usual price for the services, the normal price for such services in the area, etc.

(1) Article 2 Gap Filler
Article 2 includes some very specific "gap fillers" for situations where certain terms are not included in a contract for the sale of goods. Under Article 2, the price will be a ***reasonable price at the time of delivery*** if:

(i) Nothing is said as to price;

(ii) The price is left to be agreed to by the parties and they fail to agree; or

(iii) The price is to be fixed by some external factor or third party and it is not so set.

[UCC §2-305(1)]

(2) Price Fixed by Party Under Article 2
Under Article 2, a contract will be formed even if the parties agree that one of the parties will fix the price in the future (e.g., "price to be set by seller at time of delivery"). However, the party to whom the contract gives the right to fix the price must act in ***good faith***. If that party does not fix the price in good faith, the other party may either cancel the contract or fix a reasonable price herself. [UCC §2-305(3)]

b) Time
If an agreement does not specify the time in which an act is to be performed, the law implies that it is to be performed ***within a reasonable time***- .

3) Distinguish—Vague Terms
The presumption that the parties' intent was to include a reasonable term goes to supplying ***missing*** terms. However, the presumption ***cannot*** be made if the parties have ***included*** a term that makes the contract too vague to be enforced. The problem then is that the parties have manifested an intent that cannot be determined.

Examples: 1) An agreement to divide profits "on a liberal basis" is too vague to be enforced.

2) An agreement to purchase a parcel of land for "$8,000 or less" is also too vague.

a) Vagueness Can Be Cured by Part Performance
Where part performance supplies the needed clarification of the terms, it can be used to cure vagueness.

b) Uncertainty Can Be Cured by Acceptance
If uncertainty results because the offeree is given a choice of alternative performances, the offer becomes definite when the offeree communicates her choice. (*See* previous example about choice of motorcycle for $1,000.)

c) Focus on Contract
In short, the ***contract*** (as distinguished from the offer) must be definite and certain in its terms—hence, even if the offer lacks certainty, the problem can be cured if there is some way in which the offer is capable of being made certain, e.g., by part performance or acceptance.

4) Terms to Be Agreed on Later
Often, an offer will state that some term is to be agreed on at a future date. If the term is a ***material*** term, the offer is ***too uncertain***. The courts will not supply a reasonable term, as the parties have provided otherwise. However, as discussed above, Article 2 permits a reasonable ***price*** term to be supplied by the court under these circumstances if the other evidence indicates that the parties intended to form a contract.

3. Communication to Offeree
To have the power to accept, the offeree must have ***knowledge*** of the offer. Therefore, the proposal must be communicated to her.

Example: Chauncey returned Bowater's lost briefcase unaware that Bowater had placed an advertisement offering a $20 reward for its return. Because the offer had not been communicated to Chauncey, there could not be mutual assent. Hence, there is no contract.

C. TERMINATION OF OFFER

The power of acceptance created by an offer ends when the offer is terminated. The mutual assent

requirement obviously cannot be met where the termination occurs before acceptance is effective. Thus, you must establish whether the offer has been terminated, and if so, in what fashion.

1. Termination by Acts of Parties

a. Termination by Offeror—Revocation
A revocation is the retraction of an offer by the offeror. A revocation terminates the offeree's power of acceptance if it is communicated to her ***before she accepts***.

1) Methods of Communication

a) Revocation by Direct Communication
Revocation directly communicated to the offeree by the offeror terminates the offer.

(1) Revocation by Publication
Offers made by publication may be terminated by publication of revocation ***through comparable means***.
Example: An offer published in *The New York Times* may be revoked by publication in *The New York Times.* It may not be revoked by publication in *Reader's Digest* or by a TV spot.

b) Revocation by Indirect Communication
The offer may be effectively terminated if the offeree ***indirectly*** receives: (i) correct information, (ii) from a reliable source, (iii) of acts of the offeror that would indicate to a reasonable person that the offeror no longer wishes to make the offer.
Example: Offeree, before attempting to accept Offeror's offer to sell Greenacre, was informed by a reliable third party that Offeror had sold Greenacre to another. *Held:* Offeror revoked the offer.

2) Effective When Received
A revocation is generally effective when ***received*** by the offeree. Where revocation is by publication, it is effective when ***published.***

a) When a Communication Is Received
At common law, a written communication is considered to have been "received" when it comes into the possession of the person addressed (or of someone authorized by him to receive it) or when it is deposited in some place authorized as the place for this or similar communications to be deposited. [Restatement (Second) of Contracts §68] The communication ***need not be read*** by the recipient to be effective. Similarly, under the UCC, a person receives notice when (i) it comes to his attention, or (ii) it is delivered at a place of business through which the contract was made or another location held out by that person as the place for receipt of such communications. An organization receives a communication at the time it is brought (or should

have been brought) to the attention of the individual conducting the transaction. [UCC §1-202] Note that these rules do not restrict the communication or notice to a writing; thus, courts will likely apply the same rules to phone messages.

3) Limitations on Offeror's Power to Revoke

Offers can be revoked at will by the offeror, even if he has promised not to revoke for a certain period, except under certain situations where the offeror's power to terminate the offer is limited.

a) Options

An option is a distinct contract in which the ***offeree gives consideration*** for a promise by the offeror not to revoke an outstanding offer.

Example: An offeror offers to sell her farm—Blackacre—to an offeree for $1 million and promises to keep the offer open for 90 days if the offeree pays the offeror $1,000 to keep the offer open. If the offeree pays the offeror the $1,000, an option contract is formed and the offeror must keep the offer open for 90 days.

Compare: An offeror offers to sell her farm—Blackacre—to an offeree for $1 million and promises to keep the offer open for 90 days. Because there is no consideration (*see infra*) to make enforceable the promise to keep the offer open, the offeror may terminate her offer at any time despite her promise.

(1) Timely Acceptance Under Option Contract

An offer must be accepted within the time specified or, if no time is specified, within a reasonable time. Often, an option contract specifies that the offer must be accepted within the option period; i.e., the offer terminates when the option expires. In the absence of specific language stating when the offer terminates, the power of acceptance arguably survives the option period, but courts often treat the option period as the offer period so that at the end of that time, the option expires and the offer lapses.

b) Merchant's Firm Offer Under Article 2

Under Article 2, there are circumstances in which a promise to keep an offer open is enforceable even if no consideration has been paid to keep the offer open. Under Article 2:

(i) If a ***merchant***;

(ii) Offers to buy or sell goods in a ***signed writing***; and

(iii) The writing ***gives assurances that it will be held open*** (e.g., "this offer will be held open for 10 days," "this offer is firm for 10 days," "I shall not revoke this offer for 10 days");

(iv) The offer ***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 exceed ***three months***).

[UCC §2-205] *Note:* As with the Statute of Frauds requirements (IV.F., *infra*), the signed writing requirement for a merchant's firm offer may be satisfied by an electronic record (e.g., e-mail, fax) and an electronic signature. [*See* Uniform Electronic Transactions Act §7 (1999)]

(1) Form Supplied by Offeree
If the term assuring that the offer will be held open is on a form supplied by the offeree, it must be separately signed by the offeror. [UCC §2-205]

c) Detrimental Reliance
Where the offeror could reasonably expect that the offeree would rely to her detriment on the offer, and the offeree does so rely, the offer will be held ***irrevocable as an option contract for a reasonable length of time***. [Restatement (Second) of Contracts §87] The case law indicates that this may be limited to those situations in which the offeror would ***reasonably contemplate reliance*** by the offeree in ***using the offer before it is accepted***.

Example: A general contractor solicited bids from various subcontractors before making its own irrevocable offer on a construction project. For the subcontractor to be held to its offer, the subcontractor must reasonably have foreseen the possible use of its subcontracting bid in the making of the general contractor's irrevocable offer.

d) Beginning Performance in Response to True Unilateral Contract Offer
An offer for a true unilateral contract becomes ***irrevocable once performance has begun.*** Note that the unilateral contract will not be formed until the total act is complete. However, once the offeree begins to perform, she is given a ***reasonable time to complete performance***, during which time the offer is irrevocable. Note also that the offeree is ***not bound*** to complete performance—she may withdraw at any time prior to completion of performance.

Example: Matt offers to pay Lisa $1,000 if she will paint his house, insisting that the acceptance occur only by the act of painting the house rather than through Lisa's promise. Lisa begins to paint the house. Matt attempts to revoke the offer. Matt's attempt at revocation is ineffective because Lisa must have a reasonable time in which to complete the act of painting. If Matt refuses to allow Lisa to continue to paint, Matt will be in breach of contract and will be liable for damages.

(1) Preparations to Perform
The rules limiting the offeror's power to revoke an offer for a unilateral contract apply only if the offeree has ***embarked*** on performance. They do not apply when the offeree is only ***preparing*** to perform. Note, however, that substantial preparations to perform ***may constitute***

detrimental reliance sufficient to make the offeror's promise binding to the extent of the detrimental reliance. [Restatement (Second) of Contracts §§45, 87, 90]

Example: Matt offers to pay Lisa $1,000 if she will paint his house, insisting that the acceptance occur only by the act of painting. Lisa immediately drives to the local hardware store; expends $100 purchasing paint brushes, drop cloths, and masking tape to enable her to paint the house; and returns. On her return, Matt tells Lisa that he has changed his mind and does not want his house painted after all. Matt's revocation of his offer is valid because Lisa's acts did not constitute the beginning of performance, but rather were merely done in preparation to perform. However, Lisa will have an action against Matt to recover the $100 she spent in detrimental reliance on his offer.

(2) Offeror Refuses to Accept Performance
What happens if performance is tendered by the offeree but refused by the offeror? If the offeror's cooperation is necessary for performance, his withholding of it upon the tender of performance is the equivalent of commencing performance. [Restatement (Second) of Contracts §45]

e) Beginning Performance—Offer Indifferent as to Manner of Acceptance
As noted above, most offers are indifferent as to the manner of acceptance, and, thus, a bilateral contract may be formed ***upon the start of performance*** by the offeree. (*See* I.C.2.c.1), *supra*.) Therefore, once the offeree ***begins performance,*** the contract is complete and ***revocation*** becomes ***impossible.*** *But note:* Notification of the start of performance may be necessary. (*See* D.3.b., *infra*.)

b. Termination by Offeree

1) Rejection

a) Express Rejection
An express rejection is a statement by the offeree that she does not intend to accept the offer. Such a rejection will terminate the offer. [Restatement (Second) of Contracts §36]

b) Counteroffer as Rejection
A counteroffer is an offer made by the ***offeree*** to the offeror that contains the same subject matter as the original offer but differs in its terms. A counteroffer serves as a rejection of the original offer ***as well as a new offer.*** [Restatement (Second) of Contracts §39] This usually happens in two situations:

(i) Counteroffer combined with express rejection, e.g., "Not at that price, but I'll take it at $200."

(ii) Acceptance conditional upon additional terms, e.g., "I'll take it at that price, but only if it is also equipped with air conditioning."

Note: Article 2 provides for exceptions to the above general treatment in the "battle of forms" provision. (*See* D.5.b., *infra*.)

(1) Distinguish—Mere Inquiry
Distinguish between a counteroffer (which constitutes a rejection) and a mere inquiry. An inquiry will not terminate the offer when it is consistent with the idea that the offeree is still keeping the original proposal under consideration. The test is whether a ***reasonable person*** would believe that the original offer had been rejected.

Examples: 1) The offeree says to the offeror, "Would you consider lowering your price by $5,000?" This, without more, is merely an inquiry, not a rejection.

2) The offeree says to the offeror, "I couldn't possibly pay your asking price but could pay $5,000 less." This is more than a mere inquiry because of the certitude involved and will be treated as a counteroffer.

c) Effective When Received
A rejection is effective when ***received*** by the offeror.

d) Revival of Offer
If an offer is rejected, the offeror may restate the same offer and create a new power of acceptance. Some courts refer to this as the revival of the original offer. It is more precise to suggest that a new offer, although the same as the original offer, has been made.

e) Rejection of Option
Because an option is a contract to keep an offer open, a rejection of or a counteroffer to an option does ***not*** constitute a termination of the offer. The offeree is still free to accept the original offer within the option period unless the offeror has ***detrimentally relied*** on the offeree's rejection. [Restatement (Second) of Contracts §37]

2) Lapse of Time

a) Must Accept Within Specified or Reasonable Time
The offeree must accept the offer within the time period specified or, if no time period is specified, within a reasonable time. If she does not do so, then she will have allowed the offer to terminate. (*Note:* Where the offer's terms are unclear as to time, e.g., "by return mail," the time limit is what a reasonable person in the offeree's position would have assumed.)

b) Look to When Offer Is Received by Offeree
If the offer provides that it will expire within a particular time period, that period commences when the offer is received by the offeree. If the offer is

delayed in transmission and this fact ***is or should have been apparent to the offeree***, the offer terminates at the time it would have expired had there been no delay. All relevant facts must be considered in determining whether this knowledge is present. These include, e.g., date of letter, postmark, and any subsequent statements made by the offeror.

2. Termination by Operation of Law

a. Termination by Death or Insanity of Parties
If either of the parties dies or is adjudicated insane prior to acceptance, the offer is terminated. It is ***not*** necessary that the death or insanity be ***communicated*** to the other party. [Restatement (Second) of Contracts §48] (*Compare:* Supervening mental incapacity of the offeror without an adjudication of incapacity will terminate an offer only if the offeree is aware of the incapacity.) Note, however, that the offer will ***not*** terminate in this fashion if the rules limiting an offeror's power to terminate are applicable (e.g., an option contract).

b. Termination by Destruction of Subject Matter
Destruction of the subject matter terminates the offeree's power of acceptance. [Restatement (Second) of Contracts §36]

c. Termination by Supervening Legal Prohibition of Proposed Contract
If the subject matter of the proposed contract becomes illegal, the offer will terminate. [Restatement (Second) of Contracts §36]
Example: Lucky Lou offers Vegas Vernon a share in his casino business. Prior to acceptance, a law is passed banning casinos. The offer is automatically terminated.

D. THE ACCEPTANCE
An acceptance is a manifestation of assent to the terms of an offer. Through this manifestation of assent, the offeree exercises the power given her by the offeror to create a contract.

1. Who May Accept

a. Party to Whom Offer Is Addressed or Directed
Generally, only the person to whom an offer is addressed has the power of acceptance. This is so even if the offer does not call for personal performance or special financial responsibility on the part of the offeree. One may also have the power of acceptance if she is a member of a class to which an offer has been directed. If the offer is made to the general public, anyone may qualify as an offeree. If the offer requests performance from an unlimited number of persons, performance by anyone knowing of the offer will cut off the power of every other person to accept, provided that the offeror desires only one performance and there is no indication that he is willing to pay more than once.

b. Offeree's Power of Acceptance Cannot Be Assigned
Unlike rights under an existing contract, the offeree's power of acceptance ***cannot be assigned***.

1) Exception—Option Contracts
An exception exists for the right to accept under an option contract, because the power to accept is itself a contract right in these contracts, and contract rights generally are assignable (*see* IX.C.1.b., *infra*).

2. Offeree Must Know of Offer
The offeree must know of the offer in order to accept, and this is true whether the offer is for a bilateral or unilateral contract.

Examples: 1) Alex sends Becky a letter offering to sell her Blackacre for $500,000. That same day, without knowledge of Alex's letter, Becky sends Alex a letter offering to buy Blackacre from him for $500,000. No contract is formed because neither party knew of the other's letter when sending his or her own letter.

2) Cindy offers to pay $1,000 to the person who finds her missing dog. Dee finds a dog in her yard, reads its tags, and returns the dog to Cindy without knowledge of Cindy's offer. Most courts hold that no contract is formed here.

3. Acceptance of Offer for Unilateral Contract
If an offer provides that it may be accepted only by performance (i.e., an offer for a unilateral contract), note the following particular rules.

a. Completion of Performance
Most courts hold that an offer to form a unilateral contract is not accepted until performance is completed. The beginning of performance may create an option so that the offer is irrevocable. (*See* C.1.a.3)d), *supra*.) However, the offeree is not obligated to complete performance merely because he has begun performance, as only complete performance constitutes an acceptance of the offer.

b. Notice
Generally, the offeree is ***not*** required to give the offeror notice that he has begun the requested performance, but is required to notify the offeror within a reasonable time after performance has been completed. If a required notice is not given, a contract is formed, but the offeror's duties are discharged for failure of an implied condition subsequent (*see* VI.D.2.c., *infra*). However, no notice is required if:

(i) The offeror ***waived notice***; or

(ii) The offeree's ***performance would normally come to the offeror's attention*** within a reasonable time.

Example: Joe tells Susan he will pay her $1,000 if she paints the house that he is living in. Susan need not formally notify Joe that she has painted his house, as her performance would be obvious to him.

Compare: In writing, Joe tells Susan that if she lends Tina $1,000 for one year, he will repay the loan if Tina fails to pay. Joe becomes contractually bound on his promise the instant Susan loans Tina the money, but Joe will be discharged from this contractual obligation unless Susan notifies him

of her acceptance (i.e., her making the loan to Tina) within a reasonable time.

1) Compare—Article 2
Article 2 has a slightly different rule regarding notice, although the end result is basically the same. It provides that when a contract is accepted by the beginning of performance, if the offeree fails to notify the offeror of the acceptance (i.e., the ***beginning*** of performance rather than the completion of performance) within a reasonable time, the offeror may treat the offer as having ***lapsed before acceptance*** (i.e., no contract was ever formed, as opposed to the Restatement view that a contract was formed but performance is excused by failure of a condition). [UCC §2-206(2)]

4. Acceptance of Offer for Bilateral Contract
Recall that unless an offer specifically provides that it may be accepted only through performance, it will be construed as an offer to enter into a bilateral contract and may be accepted either by a promise to perform or by the ***beginning of performance*** (compare offers for true unilateral contracts, which may be accepted only by full performance).

a. Generally, Acceptance Must Be Communicated
Generally, acceptance of an offer to enter into a bilateral contract must be communicated to the offeror.

1) Exception—Waiver in Offer
If an offer provides that acceptance need not be communicated, then no communication of the acceptance is required.
Example: Alex applies for life insurance on a form that provides that the policy will become effective immediately upon approval by the insurance company's home office. The insurance contract is formed when the home office approves Alex's application.

2) Silence as Acceptance
Although the offeree cannot be forced to speak under penalty of having her silence treated as an acceptance, if the offeree silently takes offered benefits, the courts will often find an acceptance. This is especially true if prior dealings between the parties, or trade practices known to both, create a commercially reasonable expectation by the offeror that silence represents an acceptance. In such a case, the offeree is under a duty to notify the offeror if she does not intend to accept. [Restatement (Second) of Contracts §69]

a) Offered Services
When the recipient of services knows or has reason to know that the services are being rendered with the expectation of compensation and ***by a word*** could prevent the mistake, he may be held to have accepted the offer if he fails to speak. [*See* Restatement (Second) of Contracts §69, comment b]
Example: At Homeowner's request, Landscaper prepared a proposal for planting trees in Homeowner's yard. Homeowner stated that of the trees proposed she preferred beech trees. As beech

trees were in short supply, Landscaper said he would check the availability and get back to her. Landscaper e-mailed Homeowner that he had secured the beech trees and would need to plant them within the week as a hard freeze was coming. Landscaper stated that if he did not hear back, he was going ahead with the planting. Homeowner read the e-mail but did not respond. Just in advance of the freeze, Landscaper planted the trees. Homeowner watched the work from her window. When it was done, Homeowner refused to pay, arguing there was no contract. Because Homeowner knew that Landscaper was rendering services with the expectation of payment and Homeowner, by a word, could have prevented the mistake, she will be held to have accepted the offer.

b. Method of Acceptance

Unless otherwise provided, an offer is construed as inviting acceptance in ***any reasonable manner*** and by any medium reasonable under the circumstances. Any objective manifestation of the offeree's counterpromise is usually sufficient.

Example: Nikki ***telephones*** an offer to Skip that is to remain open for five days. Two days later, Skip ***e-mails*** an acceptance, or two days later Skip ***mails*** an acceptance. Whether there has been a proper acceptance depends on whether the use of e-mail or mail was reasonable under the circumstances.

1) Act as an Acceptance

The offeror is the master of her offer and may require an act to signify acceptance.

Example: Jennifer offers to purchase Steve's car for $1,000, specifying that Steve accept the offer by wearing a yellow shirt to lunch next Tuesday. Steve can accept the offer only by acting as requested. If Steve simply tenders the automobile, most courts would construe the tender as a rejection and counteroffer. Also, recall that Steve must know of the offer to accept. If he simply wears a yellow shirt without knowing of Jennifer's offer, there is no acceptance and no bilateral contract.

2) Offers to Buy Goods for Current or Prompt Shipment

Under Article 2, an offer to buy goods for current or prompt shipment is construed as inviting acceptance either by a ***promise to ship*** or by ***current or prompt shipment*** of conforming or nonconforming goods. (*See* 5.a., *infra*.)

c. Acceptance Must Be Unequivocal

Traditional contract law insisted on an absolute and unequivocal acceptance of each and every term of the offer (the "mirror image rule"). At common law, any different or additional terms in the acceptance make the response a ***rejection and counteroffer***.

Example: Adam offers to lease a warehouse to Jamie by handing Jamie a signed copy of his standard lease agreement. Jamie reads over the lease, adds a clause providing that disputes will be settled by arbitration, signs the lease, and hands it back to Adam. Adam hands the keys over to Jamie.

By adding the arbitration clause to the lease, Jamie rejected Adam's offer and made a counteroffer. By handing Jamie the keys to the warehouse, Adam accepted Jamie's counteroffer.

1) Distinguish—Statements that Make Implicit Terms Explicit
Statements by the offeree that make implicit terms explicit do not prevent acceptance.
Example: The statement by an offeree, "I accept provided you convey marketable title," is a valid acceptance because the obligation to convey marketable title is implicit in the offer to sell.

2) Distinguish—"Grumbling Acceptance"
A "grumbling acceptance" (i.e., an acceptance accompanied by an expression of dissatisfaction) is an effective acceptance as long as it stops short of actual dissent.
Example: "I think it's highway robbery at that price, but I guess I'll have to accept" is a valid acceptance.

3) Distinguish—Request for Clarification
A request for clarification does not necessarily amount to a rejection and counteroffer.
Example: "The $1,000 price—that includes shipping, doesn't it?" is not a counteroffer.

5. Acceptance Under Article 2

a. Offers to Buy Goods for Current or Prompt Shipment

As noted above, an offer to buy goods for current or prompt shipment may be accepted by either a promise to ship or by a shipment of conforming or nonconforming goods.

1) Shipment of Nonconforming Goods
The shipment of nonconforming goods is an acceptance creating a bilateral contract as well as a ***breach*** of the contract unless the seller seasonably notifies the buyer that a shipment of nonconforming goods is offered only as an ***accommodation***. The buyer is not required to accept accommodation goods and may reject them. If he does, the shipper is not in breach and may reclaim the accommodation goods, because her tender does not constitute an acceptance of the buyer's original offer.
Examples: 1) Craig orders 1,500 blue widgets from Susy. Susy ships 1,500 black widgets but does not notify Craig that the goods are offered only as an accommodation. Susy's shipment is both an acceptance of Craig's offer and a breach of the resulting contract. Craig may sue for any appropriate damages.

2) In the example above, Susy, before the goods arrive, notifies Craig that black widgets have been sent as an accommodation. The shipment is a counteroffer and, if Craig accepts delivery, there will be a contract for the purchase of black widgets.

3) Craig orders 1,500 blue widgets from Susy. Susy sends Craig a fax promising to ship the widgets within two days. Upon checking her stock, Susy discovers that she has only 1,000 blue widgets. She ships the 1,000 blue widgets along with 500 black widgets and a letter explaining that the black widgets are offered only as an accommodation. Craig may sue for damages. Susy accepted Craig's order via the fax, promising to ship 1,500 blue widgets. This is not a case of acceptance by shipment.

b. Battle of the Forms

1) Mirror Image Not Required

Article 2 has abandoned the mirror image rule, providing instead that the proposal of additional or different terms by the offeree in a definite and timely acceptance does ***not*** constitute a rejection and counteroffer, but rather is ***effective as an acceptance***, unless the acceptance is ***expressly*** made conditional on assent to the additional or different terms. (*See* 3), *infra*.)

Example: Harry sends Sally an e-mail offering to sell her his car for $1,000. Sally e-mails back, "I accept; deliver it to my house by noon tomorrow." At common law, no contract would be formed here because Sally's acceptance added a delivery term. Under Article 2, a contract is formed and whether or not Harry is required to deliver the car to Sally's house by noon of the next day is determined by the rules discussed below.

Compare: Same facts as above, but Sally's e-mail says, "I accept, but only if you agree to deliver the car to my house by noon tomorrow." No contract is formed here because Sally's acceptance was expressly conditioned on assent to the new terms.

2) Terms Included

a) Contracts Involving a Nonmerchant—Terms of Offer Govern

If any party to the contract is not a merchant, the additional or different terms are considered to be mere proposals to modify the contract that do ***not*** become part of the contract unless the offeror expressly agrees.

Example: Paul sends a letter offering to sell his car to Stephanie for $1,200. Stephanie sends Paul a letter stating: "I accept and want you to put new tires on it." This is a contract, but Paul is not bound to put new tires on the car.

b) Contracts Between Merchants—Additional Terms Usually Included

If ***both*** parties to the contract are merchants, ***additional*** terms in the acceptance will be included in the contract unless:

(i) They ***materially alter*** the original terms of the offer (e.g., they change a party's risk or the remedies available);

(ii) The offer ***expressly limits acceptance*** to the terms of the offer; or

(iii) The ***offeror has already objected*** to the particular terms, or ***objects within a reasonable time*** after notice of them is received.

Example: Sellco offers to sell to Buyco 1,500 widgets at $10 each. Buyco replies, "We accept, 5% discount for paying within 30 days." The parties have formed a contract and it probably includes a 5% discount for payment within 30 days (assuming that the discount is not material).

Compare: Sellco offers to sell to Buyco 1,500 widgets at $10 each. Buyco replies, "We accept. Any disputes will be settled by arbitration." The parties have formed a contract. However, the arbitration provision will be construed by most courts as a material alteration that will not be included in the terms of the contract.

(1) Note—Different Terms May or May Not Be Included
There is a split of authority over whether terms in the acceptance that are ***different*** from (as opposed to in addition to) the terms in the offer will become part of the contract. Some courts treat different terms like additional terms and follow the test set out above in determining whether the terms should be part of the contract. Other courts follow the ***"knockout rule,"*** which states that conflicting terms in the offer and acceptance are knocked out of the contract because each party is assumed to object to the inclusion of such terms in the contract. Under the knockout rule, gaps left by knocked-out terms are filled by the UCC (e.g., when the date of delivery differs in the offer and the acceptance, the UCC provides that delivery must be made within a reasonable time).

Example: Sellco offers to sell to Buyco 1,500 widgets at $10 each ***plus freight***. Buyco replies, "I accept. The price is $10.10 each ***including freight***." There is a contract, assuming that the actual cost of freight is not materially different from $150, as the offer was to sell the widgets for $10 plus (actual) freight costs and the acceptance was to purchase the widgets at $10.10 each including freight costs (the extra 10¢ apparently being to cover freight costs). Under the approach treating different terms like additional terms, the buyer's acceptance will control (i.e., the buyer is obligated to pay $15,150 for the widgets and no additional freight charges) unless the seller objects. If the seller does object, there is a contract on the seller's original terms. However, under the knockout rule, the different freight terms will be knocked out. The price will be $10 plus the reasonable cost of freight at the time of delivery according to the UCC.

c) Merchant's Confirmatory Memo
A merchant's memo confirming an oral agreement (IV.F.3.f.2), *infra*) that contains different or additional terms is also subject to the battle of the forms provisions. [UCC §2-207(1)]

3) Effect of Conditional Acceptance
When an acceptance is made expressly conditional on the acceptance of new terms, it is a rejection of the offer. It can be considered a counteroffer only to the extent that the original offeror may ***expressly assent*** to the new terms and thus form a contract. It is not considered a counteroffer that may be accepted by performance. If the parties ship or accept goods after a conditional acceptance, a contract is formed by their conduct, and the new terms are not included. The contract consists of all terms on which their writings agree, plus supplementary terms supplied by the UCC. [UCC §2-207(1), (3)]

Example: Same facts as the example in b.1) *supra*, except that after Sally's e-mail making her acceptance conditional on Harry's consent to the delivery term, Harry does not reply but delivers the car to Sally's house two days later. Sally accepts the delivery. Harry is not in breach because Sally's conditional acceptance was not a counteroffer that could be accepted by performance. When Sally conditioned her acceptance on consent to the delivery term, there was no contract. The contract was not formed until Harry delivered the car and Sally accepted it. The contract was formed by performance and its terms are those to which the parties agreed (i.e.., $1,000 for the car) plus the terms supplied by their course of performance (delivery two days later at Sally's house) and the UCC.

c. Moment of Mutual Assent Uncertain
In situations in which it cannot be determined with certainty which specific communication was the offer and which the acceptance but the parties act as though there is a contract, the UCC considers this a binding contract even though the moment of its making is uncertain. [UCC §2-204(2)]

6. Bilateral Contracts Formed by Performance
Sometimes in business, a contract is not formed by the parties' communications, either because: (i) the mirror image rule has not been satisfied; or (ii) in a contract for the sale of goods, the original offeror's form contains a clause objecting in advance to any new or inconsistent term and the offeree sends a response with new or different terms that states it is not an acceptance unless the original offeror agrees to these terms. Clearly, no contract is formed at this point. But, as is sometimes the case, if the parties begin to perform as if they formed a contract, a contract is formed. *Rationale:* At common law, the last communication sent to the party who performed is considered a counteroffer and the performance is considered acceptance of the counteroffer. In contracts for the sale of goods, Article 2 specifically provides that conduct by both parties that recognizes the existence of a contract is sufficient to establish the contract. [UCC §2-207(3)]

7. When Acceptance Effective—The Mailbox Rule
Acceptance by mail or similar means creates a contract at the ***moment of dispatch***, provided that the mail is properly addressed and stamped, ***unless:***

(i) The ***offer stipulates*** that acceptance is not effective until received; or

(ii) An ***option contract*** is involved (an acceptance under an option contract is effective only upon ***receipt*** [Restatement (Second) of Contracts §63]).

Note: Because in most states a revocation is effective only upon receipt (*see* C.1.a.2), *supra*), under the mailbox rule if the offeree dispatches an acceptance ***before he receives a revocation*** sent by the offeror, a contract is formed. This is true even though the acceptance is dispatched after the revocation is dispatched and received after the revocation is received.

a. Effect of Offeree Sending Both Acceptance and Rejection
Because a rejection is effective only when received, an offeree sending both an acceptance and rejection could create problems for the offeror if the mailbox rule were applicable; e.g., a contract would be created when the acceptance was dispatched even if the offeror received the rejection and relied on it before receiving the acceptance.

1) Offeree Sends Rejection, Then Acceptance—Mailbox Rule Does Not Apply
If the offeree sends a rejection and then sends an acceptance, the mailbox rule does not apply. Whichever one is ***received first*** is effective.

2) Offeree Sends Acceptance, Then Rejection—Mailbox Rule Generally Applies
If the offeree sends the acceptance first, the mailbox rule applies; i.e., a contract is created upon dispatch of the acceptance. However, if the offeror received the rejection first and ***changed his position in reliance*** on it, the offeree will be ***estopped*** from enforcing the contract.

b. Acceptance by Unauthorized Means
An acceptance transmitted by unauthorized means or improperly transmitted by authorized means may still be ***effective if it is actually received*** by the offeror while the offer is still in existence.

Examples: 1) Bailey makes an offer to Janet specifying that acceptance should be by fax. Janet mails Bailey her acceptance. The acceptance will not be effective upon dispatch of the letter but only upon receipt by Bailey, if the offer is still open.

2) Janet, in a situation where the mailbox rule otherwise applies, incorrectly addressed the envelope in mailing back the acceptance. It will be effective upon receipt if the offer is still open.

E. AUCTION CONTRACTS

The UCC contains some special rules regulating auction sales. [*See* UCC §2-328] They are:

1. Goods Auctioned in Lots
In a sale by auction, if goods are put up in lots, each lot is the subject of a separate sale.

2. When Sale Is Complete
A sale by auction is complete when the auctioneer so announces by the ***fall of the hammer*** or in another customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid, the auctioneer may, in his discretion, reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

3. Auction With Reserve or Without Reserve

An auction sale is with reserve unless the goods are explicitly put up without reserve. "***With reserve***" means the ***auctioneer may withdraw the goods*** at any time until he announces completion of the sale. In an auction without reserve, once the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case, a bidder may retract his bid until the auctioneer announces completion of the sale, but a bidder's retraction does not revive any previous bid.

4. A Bid on Seller's Behalf

Except at a forced sale, if the auctioneer knowingly receives a bid on the seller's behalf, or the seller makes or procures such a bid (in order to drive up the price of the goods), and notice has not been given that liberty for such bidding is reserved, the winning bidder may at his option avoid the sale or take the goods at the price of the ***last good faith bid*** prior to the completion of the sale.

III. CONSIDERATION

A. INTRODUCTION

The majority of agreements that qualify as legally enforceable contracts contain a bargained-for change in legal position between the parties, i.e., valuable consideration. While substitute doctrines may permit enforcement of an agreement, only the presence of ***valuable consideration on both sides*** of the bargain will make an executory bilateral contract fully enforceable from the moment of formation. Simply stated, consideration is the price for enforceability in the courts.

B. ELEMENTS OF CONSIDERATION

Basically, two elements are necessary to constitute consideration: (i) there must be a ***bargained-for exchange*** between the parties; and (ii) that which is bargained for must be considered of ***legal value*** or, as it is traditionally stated, it must constitute a benefit to the promisor ***or*** a detriment to the promisee. At the present time, the ***detriment*** element is emphasized in determining whether an exchange contains legal value.

Example: Jeff promises to sell his used television to Kristen for $100 in exchange for Kristen's promise to pay $100. Both elements of consideration are found in this example. First, Jeff's promise was bargained for. Jeff's promise induced a detriment in the promisee, Kristen. Kristen's detriment induced Jeff to make the promise. Second, both parties suffered detriments. The detriment to Jeff was the transfer of ownership of the television, and the detriment to Kristen was the payment of $100 to Jeff.

1. Bargained-For Exchange

This element of consideration requires that the promise induce the detriment ***and*** the detriment induce the promise (*see* preceding example). Unless both of these elements are present, the "bargained-for exchange" element of consideration is not present.

a. Gift

If either of the parties intended to make a gift, he was not bargaining for consideration, and this requirement will not be met.

1) Act or Forbearance by Promisee Must Be of Benefit to Promisor
It is not enough that the promisee incurs detriment; the detriment must be the ***price*** of the exchange, and not merely fulfillment of certain conditions for making the gift. The test is whether the act or forbearance by the promisee would be of any benefit to the promisor. In other words, if the promisor's motive was to induce the detriment, it will be treated as consideration; if the motive was no more than to state a condition of a promise to make a gift, there is no consideration.

Example: "Come to my house and I will give you my old television." The promisee suffers a detriment by going to the promisor's house, as she did not have to go there at all. However, the promise of the television was probably not made to induce the promisee to come to the promisor's house. Hence, there is no consideration.

2) Economic Benefit Not Required
The benefit to the promisor need not have economic value. Peace of mind or the gratification of influencing the mind of another may be sufficient to establish bargained-for consideration, provided that the promisee is not already legally obligated to perform the requested act.

Example: Father tells Daughter, "I'll give you $1,000 if you stop smoking." Father's emotional gratification from influencing his daughter's health suffices as consideration.

b. "Past" or "Moral" Consideration

1) General Rule—Not Sufficient Consideration
If something was already given or performed before the promise was made, it will not satisfy the "bargain" requirement. The courts reason that it was not given in exchange for the promise when made.

Example: A loose piece of molding fell from a building and was about to hit Sam. Sherry, seeing this, pushed Sam out of the molding's path and was herself struck by it and seriously injured. Sam later promised Sherry that he would pay her $100 per month for life. There is no consideration because Sherry did not bargain for Sam's promise.

2) Exceptions
There is substantial disagreement with the general rule. Thus, the courts have sought to avoid its application by creating exceptions.

a) Debt Barred by a Technical Defense
If a past obligation would be enforceable except for the fact that a technical defense to enforcement stands in the way (e.g., statute of limitations), the courts will enforce a new promise if it is ***in writing*** or has been ***partially performed***. However, the court will enforce the contract only to the extent of the new promise.

Example: Debtor owed Creditor $2,000, but the statute of limitations had run on the debt. Debtor won some money in her state lottery and wrote to Creditor, explaining that she had just won some money and promising to pay Creditor $1,000. The promise

to pay is enforceable—at least to the extent of the $1,000—despite the lack of new consideration.

b) Promise to Pay Arising Out of Past Material Benefit—Material Benefit Rule

Under a modern trend, ***some*** courts will enforce a promise if it is based on a material benefit that was previously conferred by the promisee on the promisor and if the promisee did not intend to confer the benefit as a gift. This includes situations in which the promisee performed an act at the promisor's request or performed an unrequested act during an emergency (such as in the example in b.1), above). The Second Restatement follows this rule but adds that the promise is unenforceable to the extent it is disproportionate to the benefit conferred. [Restatement (Second) of Contracts §86]

2. Legal Value

a. Adequacy of Consideration

Courts of law normally will ***not*** inquire into the adequacy of consideration (i.e., the relative values exchanged). If a party wishes to contract to sell an item of high market value for a relatively low price, so be it. However, ***courts of equity*** may inquire into the relative values and deny an ***equitable remedy*** (such as an order for specific performance) if they find a contract to be unconscionable.

1) Token Consideration

If the consideration is only token (i.e., something entirely devoid of value), it will usually not be legally sufficient. The courts reason that this indicates a gift rather than bargained-for consideration.

2) Sham Consideration

Parties to a written agreement often recite that it was made in consideration of $1 or some other insignificant sum. Frequently, this recited sum was not in fact paid and, indeed, it was never intended to be paid. Most courts hold that evidence may be introduced to show that the consideration was not paid and no other consideration was given in its stead.

3) Possibility of Value

Where there is a possibility of value in the bargained-for act, adequacy of consideration will be found even though the value never comes into existence.

Example: Alex and Becky are siblings. They agree that whatever their grandmother leaves them in her will they will pool it together and divide it evenly. There is consideration even though the grandmother may leave everything to one of the siblings or nothing at all.

b. Legal Detriment and Benefit

1) Legal Detriment to Promisee

Legal detriment will result if the promisee does something he is under no legal obligation to do or refrains from doing something that he has a legal right to do. It

is important to remember that the detriment to the promisee need not involve any actual loss to the promisee or benefit to the promisor.

Example: Uncle promises Nephew $5,000 if he will refrain from drinking, smoking, swearing, and gambling until he reaches age 21. Nephew's refraining is a legal detriment, and because it was bargained for, Uncle must pay the $5,000 if Nephew so refrains. [*See* Hamer v. Sidway, 124 N.Y. 538 (1891)]

Note: Remember that the promisor must have sought to induce the detrimental act by his promise. (*See* television set example under B.1.a.1), *supra*.)

2) Legal Benefit to Promisor

A legal benefit to the promisor is simply the reverse side of legal detriment. In other words, it is a forbearance or performance of an act by the promisee which the promisor was not legally entitled to expect or demand, but which confers a benefit on the promisor.

c. Preexisting Legal Duty Not Consideration

Traditionally the promise to perform, or the performance of, an existing legal duty ***is not consideration***.

Examples: 1) Mike contracts to build a garage for Richard for $15,000. Mike discovers that he cannot make a profit at that price and tells Richard that he will not build the garage unless Richard promises to pay him $16,000. Because Richard does not have time to find a new contractor before winter and he does not want his new car exposed to snow, he agrees to pay Mike the $16,000. When Mike finishes the garage, Richard pays Mike $15,000. Mike cannot enforce the promise for the additional $1,000 because he was under a preexisting duty to build the garage.

2) Smith offers a $10,000 reward for recovery of his kidnapped daughter. Jones, a police officer assigned to this case, recovers the daughter. Jones's performance of her official duty is not sufficient consideration.

1) Exception—New or Different Consideration Promised

If the promisee has given something in addition to what she already owes in return for the promise she now seeks to enforce, or has in some way agreed to vary her preexisting duty, such as by accelerating performance, there is consideration. It is important to note that it is usually immaterial how slight the change is, because courts are anxious to avoid the preexisting duty rule.

2) Exception—Voidable Obligation

A promise to perform a voidable obligation (i.e., ratification) is enforceable despite the absence of new consideration. Thus, an infant's (i.e., minor's) ratification of a contract upon reaching the age of majority is enforceable without new consideration, as is a defrauded person's promise to go through with the tainted contract after learning of the fraud.

3) Exception—Preexisting Duty Owed to Third Party

Traditionally, when a preexisting duty was owed to a third party, courts held that the new promise did not constitute consideration. However, the modern view adopted by the Second Restatement and the majority of jurisdictions states that the new promise ***constitutes consideration***. [*See* Restatement (Second) of Contracts §73]

Example: Saul Pimon contracts with Pam Promotor to sing at a concert in New York for $25,000. Later, when Pimon threatens to cancel, Dud Dooright, a Pimon fan, offers to pay Pimon an additional $5,000 if he sings at the concert. Pimon appears and sings as agreed. Under the traditional view, Pimon cannot enforce Dooright's promise to pay the additional $5,000, but under the majority view Pimon can enforce the promise because Pimon did not owe a duty to Dooright under the original contract.

4) Exception—Honest Dispute as to Duty

If the scope of the legal duty owed is the subject of honest dispute, then a modifying agreement relating to it will ordinarily be given effect. The compromise by each party is a detriment.

5) Exception—Unforeseen Circumstances

Under the modern view, which appears to be the view adopted by the National Conference of Bar Examiners for MBE purposes, a promise modifying a contract that has not been fully performed on either side is binding without consideration if the modification is ***fair and equitable in view of circumstances not anticipated*** when the contract was made (e.g., contractor unexpectedly hits bedrock). [*See* Restatement (Second) of Contracts §89] Under the majority view, however, mere unforeseen difficulty in performing is ***not*** a substitute for consideration. But if the unforeseen difficulty ***rises to the level of impracticability***, such that the duty of performance would be discharged (*see* VI.E.5., *infra*), most states will hold that the unforeseen difficulty is an exception to the preexisting legal duty rule.

6) Exception—Modification of Contract for the Sale of Goods

At common law, a contract modification generally is ***unenforceable*** unless it is supported by new consideration. Article 2 does not follow this rule. Under Article 2, contract modifications sought in ***good faith*** are binding without consideration. Modifications extorted from the other party are in bad faith and are unenforceable. [*See* UCC §2-209, comment 2]

Example: Paintco has agreed to sell to Retailco 15,000 gallons of paint at a price of $5 per gallon, to be delivered in 500-gallon installments each month for 30 months. After 15 months, the price of materials rises so that Paintco is losing 50¢ per gallon. Paintco had at the inception of the contract made a profit of 25¢ per gallon. Paintco tells Retailco the circumstances and asks if Retailco will agree to pay $5.75 per gallon for the remaining deliveries. Retailco agrees and the proper writing is executed. The modification was no doubt sought in good faith and is binding even though Paintco gave Retailco no new consideration. If Paintco had asked for an

increased price because she believed that it was too late for Retailco to purchase elsewhere and Retailco would pay the higher price to get the paint, the modification would be in bad faith and would be unenforceable.

7) Existing Debts

One of the recurring problems in the preexisting duty area concerns promises regarding existing debts. When the amount due is undisputed, ***payment of a smaller sum*** than due will ***not*** be sufficient consideration for a promise by the creditor to discharge the debt. Neither a legal detriment nor a benefit would be present.

But again, bear in mind that courts will attempt to avoid this result by application of the above exceptions. Thus, for example, if the consideration is in any way ***new or different*** (e.g., payment before maturity or to one other than the creditor; payment in a different medium, e.g., stock instead of cash; or payment of a debt that is subject to an honest dispute), then sufficient consideration may be found.

d. Forbearance to Sue

The promise to refrain from suing on a claim may constitute consideration. If the claim is ***valid***, the forbearance to sue is, of course, sufficient consideration. If the claim is ***invalid*** and the claimant is aware of this fact, he has no such right; his suit is no more than the wrongful exercise of a power. But even if the claim is invalid, in law or in fact, if the claimant reasonably and in good faith believes his claim to be valid, forbearance of the legal right to have his claim adjudicated constitutes detriment and consideration.

C. MUTUAL AND ILLUSORY PROMISES—THE REQUIREMENT OF MUTUALITY

Consideration must exist on both sides of the contract; that is, promises must be mutually obligatory. There are many agreements in which one party has become bound but the other has not. Such agreements lack mutuality, i.e., at least one of the promises is "illusory." If so, consideration fails.

Example: Acme Co. promises to buy from Batcher, Inc. "such ice cream as I may wish to order from Batcher, Inc." Acme's promise is illusory, because it is still free to buy from anyone else it chooses, or not to buy at all.

However, the requisite mutuality will be found to exist in certain situations even though the promisor has some choice or discretion. Notable among these are the following:

1. Requirements and Output Contracts

"Requirements" contracts (promises to buy "all that I will require") and "output" contracts (promises to sell "all that I manufacture") are enforceable. (*See* II.B.2.b.1)b)(1), *supra*.) Consideration exists, as the promisor is suffering a legal detriment; he has parted with the legal right to buy (or sell) the goods he may need (or manufacture) from (or to) another source. [UCC §2-306]

2. Conditional Promises

Conditional promises are ***enforceable***, no matter how remote the contingency, ***unless*** the "condition" is entirely within the promisor's control.

Example: Alice promises to deliver goods to Charles "only if her son comes into the business." Valid consideration exists. If the promise were "only if I decide to take my son into the business," a court might find no consideration.

a. Promise Conditioned on Satisfaction
A promise conditioned on the promisor's satisfaction is not illusory because the promisor is constrained by good faith (for contracts involving personal taste) and a reasonable person standard (for contracts involving mechanical fitness, utility, or marketability). (*See* VI.D.3.a., *infra*.)

3. Right to Cancel or Withdraw
Although reservation of an unqualified right to cancel or withdraw at any time may be an illusory promise, the consideration is valid if this right is in ***any way restricted***, e.g., the right to cancel upon 60 days' notice. Note that Article 2 implies a requirement of reasonable notice even if it is not specified in the contract. [UCC §2-309(3)]

4. Exclusivity Agreements—Best Efforts Implied
A court may find an implied promise furnishing mutuality in appropriate circumstances (such as exclusive marketing agreements). The courts generally will find an implied promise to use best efforts and sustain agreements that might otherwise appear illusory.

Example: Y Corp. was granted exclusive rights to sell Dominick's dresses in return for one-half the profit. The agreement was silent as to any obligation on the part of Y Corp. *Held:* Y Corp. impliedly promised to use its best efforts to sell Dominick's dresses. [*See* UCC §2-306(2)]

5. Voidable Promises
Voidable promises are not held objectionable on "mutuality" grounds. [Restatement (Second) of Contracts §78]

Example: Victor entered into a contract with Baby Jane, an infant. Baby Jane's power to disaffirm her contractual obligation will not prevent her promise from serving as consideration.

6. Unilateral/Option Contracts
Unilateral contracts, enforceable because one has begun performance, or option contracts, enforceable because one has purchased time to decide (e.g., whether to purchase land), are not held objectionable on "mutuality" grounds.

7. Suretyship Promises
A suretyship contract involves a promise to pay the debt of another. A suretyship contract is not enforceable unless it is supported by consideration. If a surety is compensated, the requirement of consideration is not much of an issue, because the compensation will serve as consideration for the surety's promise. If, however, the surety is gratuitous (i.e., the surety is not paid for his services), the consideration requirement may cause problems. The timing becomes important in determining whether adequate consideration is present in a gratuitous surety situation.

a. Surety Makes Promise Before (or at the Same Time as) Creditor Performs or Promises to Perform—Consideration Present
If the gratuitous surety makes his promise to pay ***before*** (or at the ***same time*** as) the

creditor performs or promises to perform, the ***creditor's*** performance or promise will serve as consideration for the surety's promise, because the creditor has incurred a detriment in exchange for the surety's promise.

Example: Beth sees a car on Sam's used car lot that she wants, but she does not have enough money to pay for the car. Sam tells Beth that he will sell her the car for $500 and a two-year promissory note for the remainder if Beth can get her father to co-sign the note with her. Beth's father agrees. The three parties meet, Beth and her father sign the note, and Sam signs over title of the car to Beth. Beth's father is bound as a surety because the consideration passed from Sam at the same time Beth's father made his promise.

b. Surety Makes Promise After Creditor Performs or Promises to Perform—Generally No Consideration to Support Surety's Promise

If a gratuitous surety does not make his promise until ***after*** the creditor has performed or made an absolute promise to perform, there is no consideration to support the surety's promise because of the preexisting legal duty rule—the creditor has not incurred any new detriment in exchange for the surety's promise. Thus, the surety's promise is unenforceable.

Example: Beth sees a car on Sam's used car lot that she wants, but she does not have enough money to pay for the car. Sam tells Beth that she can have the car for $500 and a two-year promissory note for the remainder. Beth agrees. Sam signs the title of the car over to Beth, and Beth gives Sam $500 and a promissory note for the remainder. A few days later, Sam discovers that Beth works only part-time and will likely have trouble making payments on her current income. He calls Beth and asks her to get a surety on the note. Beth's father sends Sam a letter promising to pay whatever Beth owes if she defaults. Beth's father is not bound as surety because there is no consideration to support his promise.

1) Exception—Obtaining Surety Is Condition Precedent

If the contract between the debtor and the creditor makes obtaining a surety a condition precedent to the creditor's performance, so that the creditor would be justified in refusing to perform the contract until a surety is obtained, the surety's promise is binding if the creditor performs in reliance on the surety's promise.

2) Exception—Additional Consideration

As with other contracts, if the creditor gives additional consideration in exchange for the surety's promise, the surety will be bound.

8. Right to Choose Among Alternative Courses

A promise to choose one of several alternative means of performance is illusory unless ***every alternative*** involves ***some legal detriment*** to the promisor. However, if the power to choose rests with the ***promisee*** or some ***third party*** not under the control of the promisor, the promise is enforceable as long as ***at least one alternative*** involves some legal detriment.

Example: Smith, an English professor, tells Jack that in return for Jack's promise to pay $250, Smith will either (i) give Jack swimming lessons, (ii) paint Jack's portrait, or (iii) teach his English class (of which Jack is a member) on a

regular basis during the next term, the choice to be entirely Smith's. Because alternative (iii) represents a ***preexisting duty*** owed by Smith to the university under his contract of employment, it involves no legal detriment, and Smith's promise does not constitute valuable consideration for Jack's promise to pay $250.

Compare: Had Smith allowed Jack's mother (or Jack) to select the performance, there would be a legal detriment and valuable consideration—even if alternative (iii) were selected.

a. Selection of Valuable Alternative Cures Illusory Promise
Even if a promisor retains the power to select an alternative without legal detriment, his ***actual*** selection of an alternative involving legal detriment would cure the illusory promise.

Example: In the above example (in which Smith was allowed to select a means of performance), if Smith had ***actually*** chosen alternative (i) or (ii), his illusory promise would have been cured.

D. PROMISSORY ESTOPPEL OR DETRIMENTAL RELIANCE

Consideration is not necessary if the facts indicate that the promisor should be estopped from not performing. A promise is enforceable if necessary to prevent injustice if:

(i) The promisor should reasonably ***expect to induce action or forbearance***; and

(ii) ***Such action or forbearance is in fact induced***.

If the elements for promissory estoppel are present, some jurisdictions will award expectation damages (i.e., what was promised under the contract), but the Second Restatement provides that the remedy "***may be limited as justice requires***." Thus, a jurisdiction following the Second Restatement might award only reliance damages (i.e., whatever the promisee spent in reliance on the promise), which usually is something less than expectation damages, but theoretically can exceed them.

Examples: 1) Alberto Alum promises to bequeath State University $5 million for a new School of Management building. State University puts up a plaque announcing the new building and hires an architect to design it. If Alberto Alum does not bequeath the money, expectation damages would be $5 million, but State University would likely recover only the cost of the plaque and the architect's fees under the Second Restatement approach.

2) Tom offers to give Betty $15,000 if she will buy herself a new car. Betty buys a car for $13,000. The expectation damages are $15,000, but Tom is liable to Betty for only $13,000 under the Second Restatement approach.

IV. REQUIREMENT THAT NO DEFENSES EXIST

A. INTRODUCTION

Even if an agreement is supported by valuable consideration or a recognized substitute, contract

rights may still be unenforceable because there is a defense to formation of the contract, because there is a defect in capacity (making the obligations voidable by one of the parties), or because a defense to enforcement of certain terms exists.

B. ABSENCE OF MUTUAL ASSENT

1. Mutual Mistake as to Existing Facts

A mutual mistake is generally a mistaken assumption ***shared*** by both parties. Thus, when both parties entering into a contract are mistaken ***about existing facts*** (not future happenings) relating to the agreement, the contract may be voidable by the adversely affected party if:

(i) The mistake concerns a ***basic assumption*** on which the contract is made (e.g., the parties think they are contracting for the sale of a diamond but in reality the stone is a cubic zirconia);

(ii) The mistake has a ***material effect*** on the agreed-upon exchange (e.g., the cubic zirconia is worth only a hundredth of what a diamond is worth); and

(iii) The party seeking avoidance ***did not assume the risk*** of the mistake.

a. Not a Defense If Party Bore the Risk

Mutual mistake is not a defense if the party asserting mistake as a defense bore the risk that the assumption was mistaken. This commonly occurs when one party is in a position to better know the risks than the other party (e.g., contractor vs. homeowner) or where the parties knew that their assumption was doubtful (i.e., when the parties were consciously aware of their ignorance). In other words, to be a defense it must be a mistake, not a mere uncertainty.

Examples: 1) Homeowner contacts builder regarding the cost of installing an inground pool. Builder bids $15,000 and Homeowner accepts. While digging the hole for the pool, Builder encounters an unexpected slab of granite. Blasting away the granite will add 20% to Builder's costs, making the contract unprofitable. Builder will be held to have assumed the risk.

2) Roger finds a stone that appears to be valuable and shows it to his friend Betsy. The two do not know what the stone is but think it is a topaz. Roger agrees to sell the stone to Betsy for $100. The parties subsequently discover that the stone is a diamond worth $1,000. Roger cannot void the contract on mutual mistake grounds because the parties knew that their assumption about the stone was doubtful.

Compare: Roger finds a stone that appears to be valuable. Because Roger is not an expert as to gems, he takes it to Jeweler. Jeweler, in good faith, tells Roger that the stone is a topaz worth very little and offers to buy it for $100. Roger accepts, but subsequently discovers that the stone actually is a diamond worth $1,000. Roger can rescind the contract on mutual mistake grounds. Roger's reliance on an expert's opinion shows that Roger did not intend to assume the risk of not knowing about the stone.

1) Mistake in Value Generally Not a Defense

If the parties to a contract make assumptions as to the value of the subject matter, mistakes in those assumptions will generally not be remedied—even though the value of the subject matter is generally a basic assumption and the mistake creates a material imbalance—because both parties usually assume the risk that their assumption as to value is wrong. However, it is possible for the facts to show that the adversely affected party did not assume the risk in determining value.

Example: Roger finds a stone that appears to be valuable and shows it to his friend Betsy. The two properly determine that the stone is a topaz. Roger believes the topaz is worth $500, and Betsy believes the topaz is worth $50, but Roger agrees to sell it to Betsy for $200. The parties subsequently discover that the topaz is worth $600. Roger cannot void the contract because he knew that the parties did not know the true value of the stone, and so assumed the risk that their valuation was incorrect.

Compare: Same facts as above, but because Roger and Betsy did not know the value of a topaz, they took it to Jeweler, who told them the stone was worth $200. Subsequently, Roger discovers that Jeweler knows nothing about topaz stones and determines that the stone was worth $600. Roger can void the contract for mutual mistake and force Betsy to return the stone because here the facts show that the parties did not intend to assume the risk of determining value (because they sought out an expert to determine the true value).

2. Unilateral Mistake

Unilateral mistakes arise most commonly when one party makes a mechanical error in computation. If only one of the parties is mistaken about facts relating to the agreement, the mistake will ***not*** prevent formation of a contract. However, if the nonmistaken party ***knew or had reason to know of the mistake*** made by the other party, the contract is voidable by the mistaken party. As is the case with mutual mistake, for the contract to be voidable, the mistake must have a ***material effect*** on the agreed upon exchange and the mistaken party must not have borne the risk of the mistake. Materiality is determined by the overall impact on both parties. Ordinarily this is proven by showing the exchange is much less desirable to the mistaken party and more advantageous to the nonmistaken party.

Example: Seller agrees to sell Buyer a number of different items of hardware. Seller computes the total price at $15,000, and Buyer agrees to pay this amount. Subsequently, Seller discovers that he made an error in computation and the price should be $17,000. In this situation, the preferred analysis is that there ***is*** a contract at $15,000, assuming that Buyer was ***reasonably unaware of the unilateral computation error***. Note also that the error was not an error in the offer; the mistake was ***antecedent*** to the offer by Seller. When Seller stated the offer at $15,000, he meant $15,000.

Compare: Homeowner asks four contractors to submit bids to build a two-car garage on Homeowner's property. When Homeowner receives the bids they are: $17,000, $19,000, $19,500, and $9,000. The last bid was due to a typographical error. Homeowner will not be able to snap up the $9,000 offer because

he should have known, based on the other bids, that the $9,000 bid probably contained an error.

a. Unilateral Mistake May Be Canceled in Equity

There is authority in a number of cases that contracts with errors, such as mistakes in ***computation***, may be canceled in equity, assuming that the nonmistaken party has ***not relied*** on the contract. There is also modern authority indicating that a unilateral mistake that is ***so extreme*** that it outweighs the other party's expectations under the agreement will be a ground for cancellation of the contract.

b. Error in Judgment

An error in judgment by one of the parties as to the value or quality of the work done or goods contracted for will ***not*** result in a voidable contract, even if the nonmistaken party knows or has reason to know of the mistake made by the other party.

Examples: 1) Seller offers to sell her car to Buyer for $500, and Buyer accepts. Buyer knows that Seller's car has a market value of $1,500 and that this fact is unknown to Seller. The contract is enforceable.

2) Seller advertises a particular dredge for sale. After an employee of Buyer inspects the dredge, Buyer offers $35,000 for it, which Seller accepts. Prior to the delivery of the dredge, Buyer discovers that the dredge will not perform certain operations in shallow water, which was the central purpose Buyer intended for the dredge. The contract is not voidable by Buyer because Buyer's unilateral mistake was a mistake in judgment about goods contracted for.

3. Mistake by the Intermediary (Transmission)

When there is a mistake in the transmission of an offer or acceptance by an intermediary, the prevailing view is that the message ***as transmitted*** is operative unless the other party knew or should have known of the mistake.

Example: Harry put his home up for sale at the price of $340,000. After viewing the home, Sally called her attorney and asked him to prepare an offer to purchase the home for $313,000. The attorney misunderstood Sally and prepared an offer for $330,000 and transmitted the offer to Harry. Harry accepted. Assuming that the attorney had the power to bind Sally, a contract was formed to buy the house for $330,000, despite the attorney's mistake in transmitting the price.

Compare: Same facts as above, but Sally asked her attorney to prepare an offer for $318,000 and the attorney misunderstood and submitted an offer for $380,000. Here, Sally probably would not be bound because Harry probably should have known of the error as the offer substantially exceeded his asking price.

4. Misunderstanding—Ambiguous Contract Language

Contract language with at least two possible meanings leads to different results depending on the awareness of the parties. Most often there is no contract because there is no meeting of the minds.

a. Neither Party Aware of Ambiguity—No Contract
If neither party was aware of the ambiguity at the time of contracting, there is ***no contract unless*** both parties happened to intend the same meaning.

Example: Buyer agrees to purchase cotton from Seller when the cotton is delivered by a ship named Peerless. This is the total expression of the agreement. It is subsequently determined that Buyer contemplated a ship named Peerless that was to dock in September while Seller contemplated a ship named Peerless that was to dock in December. Neither party was aware that there were two ships named Peerless. Their subsequent expression of the ship each intended indicates that they did not intend the same ship at the time of contracting. Therefore, there is no contract. [*See* Raffles v. Wichelhaus, 159 Eng. Rep. 375 (1864)]

b. Both Parties Aware of Ambiguity—No Contract
If both parties were aware of the ambiguity at the time of contracting, there is ***no contract unless*** both parties in fact intended the same meaning.

c. One Party Aware of Ambiguity—Contract
If one party was aware of the ambiguity and the other party was not at the time of contracting, a ***contract*** will be enforced according to the intention of the party who was unaware of the ambiguity.

Example: Collector agrees to purchase a Picasso sketch from Gallery. It is subsequently determined that Gallery has two sketches and that Gallery intended to sell one of these to Collector while Collector intended to buy the other one. Collector did not know that Gallery owned two sketches; Gallery, of course, knew that it did. Here, there is a contract for the sketch that Collector had in mind because this is a situation in which one party knew of the ambiguity (Gallery) while the other party did not (Collector).

d. Subjective Intention of Parties Controls
While the objective test is used in contract law generally, the latent ambiguity situation is unique in that the courts look to the subjective intention of the parties. This is because the objective test simply does not work in this situation. The objective manifestations of the parties appear to be perfectly clear but subsequent facts indicate the latent ambiguity. It is then necessary to receive evidence of what each party subjectively thought at the time of contracting.

5. Misrepresentation

a. Fraudulent Misrepresentation (Fraud in the Inducement)—Contract Voidable
A misrepresentation is a false assertion of fact. It is fraudulent if it is intended to induce a party to enter into a contract and the maker knows or believes the assertion is false or knows that he does not have a basis for what he states or implies with the assertion. A fraudulent assertion can be inferred from conduct; i.e., concealment or sometimes even nondisclosure may be considered a misrepresentation. If a party induces another to enter into a contract by using ***fraudulent misrepresentation*** (e.g., by asserting information she knows is untrue), the contract is ***voidable*** by the innocent party if she ***justifiably relied*** on the fraudulent misrepresentation. This is a type of ***fraud in the inducement***.

Example: Buyer agreed to buy a painting from Seller because Seller told her that the painting previously had been owned by Bubbles Springfield, a famous rock star. In fact, Seller knew that Springfield had never owned the painting. Buyer's promise is voidable if she justifiably relied on Seller's misrepresentation.

1) Concealment and Nondisclosure

An action intended to prevent another from learning a fact is the equivalent of asserting that a fact does not exist. Similarly, if a party frustrates an investigation by the other party or falsely denies knowledge of a fact, it can be considered a misrepresentation. Note, however, that nondisclosure without concealment usually is not a misrepresentation. A party is not required to tell everything he knows to the other party, but if the nondisclosure is either ***material or fraudulent***, the contract is voidable for misrepresentation. [*See* Restatement (Second) of Contracts §§159 - 164]

2) Distinguish—Fraud in the Factum

If one of the parties was tricked into giving assent to the agreement under circumstances that prevented her from appreciating the significance of her action, the agreement cannot be enforced; it is ***void***.

Example: Joe Rocket, a famous football player, signs autographs after each game. After one game, a fan handed him a paper to sign that was in reality the last page of a contract. The contract is void due to fraud in the factum because Rocket was tricked into signing it.

b. Nonfraudulent Misrepresentation—Contract Voidable If Material

Even if a misrepresentation is ***not*** fraudulent, the contract is ***voidable*** by the innocent party if the innocent party ***justifiably relied*** on the misrepresentation and the misrepresentation was ***material***. A misrepresentation is material if: (i) it would induce a reasonable person to agree, or (ii) the maker knows that for some special reason it is likely to induce the particular recipient to agree, even if a reasonable person would not.

Example: Same facts as in the painting example in a., above, except that Seller truly believed that the painting had once belonged to Springfield. Because a famous prior owner would likely make a reasonable person agree to buy a painting, the misrepresentation is material. Therefore, Buyer's promise is voidable if she justifiably relied on Seller's misrepresentation.

c. Justified Reliance

A party's reliance on a misrepresentation must be justified for the contract to be voidable; i.e., he is not entitled to relief if the reliance was unreasonable under the circumstances. However, the mere fact that the misrepresentation could have been revealed by the exercise of reasonable care does not mean reliance was unjustified. For example, a party's failure to read a contract or use care in reading it will not necessarily preclude him from avoiding the contract.

Example: Able and Baker agree that Able will mow Baker's lawn weekly for $50. Able draws up a contract, hands it to Baker, and states that it is the written version of their agreement. In fact, the writing states that Baker

will pay Able $60 per week for the mowing. Baker signs the contract without reading it, despite having an opportunity to do so. Baker can void the contract.

d. Innocent Party May Rescind Agreement
The innocent party need not wait until she is sued on the contract, but may take affirmative action in equity to ***rescind*** the agreement. The right to rescind the agreement exists even if the terms are fair or beneficial to the misled party. The right to void or rescind such a contract may be lost, however, if the party so induced affirms the contract in question.

e. Remedies for Fraud
In addition to rescission, remedies for material misrepresentation or fraud include all remedies available for breach (*see* VIII., *infra*). In a contract for the sale of goods, neither rescission nor the return of the goods is inconsistent with a claim for damages. [UCC §2-721] Note that the time period to bring an action for fraud does not run until the party knows or should have known of the fraud.

C. ABSENCE OF CONSIDERATION

If the promises exchanged at the formation stage lack the elements of bargain or legal detriment, ***no contract*** exists. In this situation, one of the promises is always illusory.

D. PUBLIC POLICY DEFENSES—ILLEGALITY

If either the ***consideration or the subject matter*** of a contract is illegal, this will serve as a defense to enforcement. Contracts may be illegal because they are inconsistent with the Constitution, violate a statute, or are against public policy as declared by the courts.

1. Some Typical Cases of Illegality

Some of the most common areas in which problems of illegality have arisen are:

a. Agreements in restraint of trade;

b. Gambling contracts;

c. Usurious contracts;

d. Agreements obstructing administration of justice;

e. Agreements inducing breach of public fiduciary duties; and

f. Agreements relating to torts or crimes.

2. Effect of Illegality

a. Generally Contract Is Void
Illegal consideration or subject matter renders a contract void and unenforceable. In a close case, a court may sever an illegal clause from the contract rather than striking down the entire contract.

b. Effect Depends on Timing of Illegality
If the subject matter or consideration was illegal at the time of the offer, there was ***no valid offer***. If it became illegal after the offer but before acceptance, the supervening illegality operates to ***revoke the offer***. If it became illegal after a valid contract was formed, the supervening illegality operates to ***discharge the contract*** because performance has become impossible (*see* VI.E.5.a., *infra*).

c. Compare—Illegal Purpose
If the contract was formed for an illegal ***purpose*** but neither the consideration nor the subject matter is illegal (e.g., a contract to rent a plane when the renter's purpose is to smuggle drugs out of Colombia), the contract is only ***voidable*** (rather than void) by the party who (i) did not know of the purpose; or (ii) knew but did not facilitate the purpose ***and*** the purpose does not involve "serious moral turpitude." If both parties knew of the illegal purpose and facilitated it, or knew and the purpose involves serious moral turpitude, the contract is ***void*** and unenforceable. [Restatement (Second) of Contracts §182]

3. Limitations on Illegality Defense

a. Plaintiff Unaware of Illegality
If the plaintiff contracted without knowledge that the agreement was illegal and the defendant acted with knowledge of the illegality, the innocent plaintiff may recover on the contract.

b. Parties Not in Pari Delicto
A person may successfully seek relief if he was not as culpable as the other.
Example: Punter, a casual bettor, may recover against Booker, a professional bookie. (Some courts reach this result on the theory that the criminal proscription was designed to protect a class to which Punter belongs.)

c. Licensing—Revenue Raising vs. Protection
If a contract is illegal solely because a party does not have a required license, whether the contract will be enforceable depends on the reason for the license:

1) Revenue Raising—Contract Enforceable
If the license is required merely to raise revenue (e.g., a city requires all vendors at a fair to pay a $25 license fee), the contract generally is enforceable.

2) Protection of Public—Contract Not Enforceable
If the license is required to ensure that the licensee meets minimum requirements to protect the public welfare (e.g., a license to practice law, medicine, accounting, etc.), the contract is void. This means that even if the unlicensed party performs perfectly under the contract, the party cannot collect any damages.

E. DEFENSES BASED ON LACK OF CAPACITY

1. Legal Incapacity to Contract
Individuals in certain protected classes are legally incapable of incurring binding contractual obligations. Timely assertion of this defense by a promisor makes the contract ***voidable*** at his election.

a. Contracts of Infants (Minors)

1) Who Is an Infant?
The age of majority in most jurisdictions is 18. However, in many states, married persons under age 18 are considered adults.

2) Effect of Infant's Contract
Infants generally lack capacity to enter into a contract binding on themselves. However, contractual promises of an adult made to an infant are binding on the adult. In other words, a contract entered into between an infant and an adult is ***voidable by the infant but binding on the adult***.

3) Disaffirmance
An infant may choose to disaffirm a contract any time before (or shortly after) reaching the age of majority. If a minor chooses to disaffirm, she must return anything that she received under the contract ***that still remains*** at the time of disaffirmance. However, there is no obligation to return any part of the consideration that has been squandered, wasted, or negligently destroyed.

a) Exceptions
Most states have created a small number of statutory exceptions to the rule that minors can disaffirm their contracts (e.g., student loan agreements, insurance contracts, agreements not to reveal an employer's proprietary information, etc.).

b) Contracts for Necessaries
"Necessaries" generally includes food, shelter, clothing, medical care, medicines, and other items necessary for the minor's subsistence, health, or education. A minor may disaffirm a contract for necessaries but in most states will be liable in restitution for the value of benefits received.

4) Affirmance upon Majority
An infant may affirm, i.e., choose to be bound by his contract, upon reaching majority. He affirms either expressly or by conduct, e.g., ***failing to disaffirm*** the contract ***within a reasonable time after reaching majority***.

b. Mental Incapacity
One whose mental capacity is so deficient that he is incapable of understanding the nature and significance of a contract may disaffirm when lucid or by his legal representative. He may likewise affirm during a lucid interval or upon complete recovery, even without formal restoration by judicial action. In other words, the contract is ***voidable***. As in the case of infants, mentally incompetent persons are liable in quasi-contract for necessaries furnished to them.

c. Intoxicated Persons
One who is so intoxicated that he does not understand the nature and significance of his promise may be held to have made only a ***voidable*** promise if the other party had reason to know of the intoxication. The intoxicated person may affirm the contract upon recovery. Once again, there may be quasi-contractual recovery for necessaries furnished during the period of incapacity.

2. Duress and Undue Influence

Contracts induced by duress (e.g., "sign the contract or I'll break your legs") or undue influence are ***voidable*** and may be rescinded as long as not affirmed.

a. Duress

There are two types of duress. In the first, a party is physically forced to sign against her will; e.g., a stronger person grabs her hand and signs the contract with the victim's hand or the victim signs the contract at gunpoint. With this type of physical-compulsion duress, the contract is void. The much more common type of duress arises when a party's assent to a contract is induced by an improper threat by the other party that leaves the victim no reasonable alternative. In these cases, the contract is voidable by the victim. [*See* Restatement (Second) of Contracts §175] Examples of this type of duress include threats of bodily harm to the victim or her family and threats to bring unfounded criminal or civil charges.

Example: Able tells Baker that Baker must sign a business contract with Able in which all provisions greatly favor Able. Able states that if Baker fails to sign, Able will hire someone to hurt Baker's teenage daughter. Baker signs the agreement. The contract is voidable at Baker's option.

1) Economic Duress Generally Not a Defense

Generally, taking advantage of another person's economic needs is not a defense. However, withholding something someone wants or needs will constitute economic duress if:

(i) The party threatens to commit a wrongful act that would seriously threaten the other contracting party's property or finances; and

(ii) There are no adequate means available to prevent the threatened loss.

Example: Barry buys his dream home for $700,000. A few years later, Barry loses his job, stops making mortgage payments, and is threatened with foreclosure. Because of the economy, houses are not selling in Barry's neighborhood, so his friend Freida offers to buy Barry's house for the $500,000 that he owes on it. Before the closing, Barry finds a job and does not want to sell the house. Barry is bound; his economic duress is not a defense.

Compare: Barry buys his dream home for $700,000. A few years later, Barry's boss, Freida, tells Barry that if he will not sell her his house for $500,000, she will fire him from his job. Barry agrees to the sale, but before closing finds a new job. The economic duress here would probably be a defense.

b. Undue Influence

Undue influence is unfair persuasion of a party who is under the domination of the person exercising the persuasion or who by virtue of the relationship between them is justified in assuming that that person will not act in a manner inconsistent with his welfare. [Restatement (Second) of Contracts §177] The elements of undue influence are

often described as undue susceptibility to pressure by one party and excessive pressure by the other. Other factors considered are the unfairness of the resulting bargain and the availability of independent advice.

F. STATUTE OF FRAUDS

In most instances, an oral contract is valid. However, certain agreements, by statute, must be evidenced by a ***writing signed by the party sought to be bound.***

1. Writing Requirement

The Statute of Frauds does not require a formal written contract. Among other things, the writing could be a receipt, a letter, a check with details in the memo line, or a written offer that was accepted orally. The Statute requires only one or more writings, signed by the party to be charged, that: (i) reasonably identify the subject matter of the contract, (ii) indicate that a contract has been made between the parties, and (iii) state with reasonable certainty the essential terms of the unperformed promises. [Restatement (Second) of Contracts §131]

Example: Becky Baker calls Sam Supplier and orders 2,000 pounds of flour for use in her bakery at Sam's price of 70¢ a pound. As will be discussed *infra,* this contract is within the Statute of Frauds and is unenforceable by either party without some writing evidencing the material terms. Later the same day, Becky receives a flyer from another supplier indicating that their price for flour is 65¢ per pound. Becky immediately faxes Sam Supplier the following note: "Please cancel my order for 2,000 pounds of flour. /s/ Becky Baker." Becky's attempted cancelation of the contract is a sufficient writing under the Statute of Frauds to make the contract enforceable, at least against her.

a. Electronic Record Satisfies Writing Requirement

Whenever a law, such as the Statute of Frauds, requires a record to be in writing, an electronic record satisfies that law. [Uniform Electronic Transactions Act ("UETA") §7(c)] Thus, the writing requirement may be satisfied by an e-mail.

b. Essential or Material Terms

If a writing does not contain the essential terms of the agreement, it does not satisfy the Statute and the contract cannot be enforced. There is no definitive list of essential terms. They vary depending on the situation. What is essential depends on the agreement, its context, and the subsequent conduct of the parties, including the dispute that has arisen. There must be enough in the writing to enable a court to enforce the contract. If an element is contained in the writing, evidence is admissible to explain the particulars. If, however, a term is missing and cannot be supplied by implication or rule of law, evidence will not be admitted to add it. The essential terms normally include the identity of the parties, description of the subject matter, and the terms necessary to make the contract definite (*see* II.B.2., *supra*). For example, writings evidencing land sale contracts must contain a description of the land and the price, and those for employment contracts must state the length of employment. For the sale of goods, the UCC requires only some signed writing indicating that a contract has been made and specifying the quantity term.

2. Signature Requirement

The signature requirement is liberally construed by most courts. A signature is any mark or

symbol made with the intention to authenticate the writing as that of the signer. It need not be handwritten; it can be printed or typed. Under the UCC, even a party's initials or letterhead may be sufficient.

a. Electronic Signature
The signature requirement may be satisfied by an electronic signature. [UETA §7(d)] As with paper signatures, whether a record is "signed" is a question of fact. No specific technology is necessary to create a valid signature. If the requisite intent is present, one's name as part of an e-mail may suffice as a signature, as may the firm name on a facsimile (fax).

3. Agreements Covered

a. Executor or Administrator Promises Personally to Pay Estate Debts
A promise by an executor or administrator to pay the estate's debts out of ***his own funds*** must be evidenced by a writing.

b. Promises to Pay Debt of Another (Suretyship Promises)

1) Must Be a Collateral Promise
A promise to answer for the debt or default of another must be evidenced by a writing. The promise may arise as a result of a tort or contract, but it must be collateral to another person's promise to pay, and not a primary promise to pay.
Example: "Give him the goods, and if he does not pay, I will." This promise is a collateral promise and must be evidenced by a writing. But if the promise is, "Give him the goods, and I will pay for them," the promise is a primary promise and need not be evidenced by a writing.

2) Main Purpose Must Not Be Pecuniary Interest of Promisor
If the main purpose or leading object of the promisor is to serve a pecuniary interest of his own, the contract is ***not within the Statute of Frauds*** even though the effect is still to pay the debt of another.
Example: Ernie contracted with ABC Co. to have some machines custom-made for his factory. He promised ABC Co.'s supplier that if it would continue to deliver materials to ABC, Ernie would guarantee ABC Co.'s payment to the supplier. This promise need not be in writing because Ernie's main purpose in guaranteeing payment was to assure that ABC Co. had adequate supplies to build his machines.

c. Promises in Consideration of Marriage
A promise the consideration for which is marriage must be evidenced by a writing. This applies to promises that induce marriage by offering something of value (other than a return promise to marry—e.g., "if you marry my son, I will give the two of you a house").

d. Interest in Land
A promise creating an interest in land must be evidenced by a writing. This includes not only agreements for the sale of real property, but also other agreements pertaining to land.

1) What Is an Interest in Land?
In addition to agreements for the ***sale of real property***, the following items are among the more important interests in land generally covered by the Statute:

a) ***Leases for more than one year;***

b) ***Easements of more than one year;***

c) ***Mortgages*** and most other security liens;

d) ***Fixtures;*** and

e) ***Minerals (or the like) or structures*** if they are to be severed by the ***buyer.*** If they are to be severed by the seller, they are not an interest in land but rather are goods. If the subject matter is growing crops, timber to be cut, or other things attached to realty capable of severance without material harm to the realty, it is a contract for the sale of goods (*see* f., *infra*). [UCC §2-107]

2) Items That Do Not Create an Interest in Land
Even though the end result of some contracts may involve land, they still do not come within this portion of the Statute. For example, a contract to build a building or a contract to buy and sell real estate and divide the profits does not create an interest in land.

3) Effect of Performance on Contracts
Full performance by the seller will take the contract out of the Statute of Frauds. Part performance by the buyer may also remove the contract from the Statute. (*See* 5.a.1), *infra*.)

e. Performance Not Within One Year
A promise that by its terms ***cannot*** be performed within one year is subject to the Statute of Frauds. Part performance does not satisfy the Statute of Frauds in this case.

1) Effective Date
The date runs from the ***date of the agreement*** and not from the date of performance.
Example: Maria entered into an employment agreement whereby she was to perform services from April 1, 2014, until March 31, 2015. The agreement was entered into on March 15, 2014. It must be evidenced by a writing.

2) Contracts Not Within the Statute
The following contracts do not fall within this provision of the Statute:

a) Possibility of Completion Within One Year
If the contract is ***possible*** to complete within one year, it is not within the one-year prong of the Statute of Frauds, even though actual performance may extend beyond the one-year period.

Example: Carlo makes the following oral statement to Nellie: "Be my nurse until I recover and I will pay you a small salary now, but leave you a large estate in my will." The contract need not be evidenced by a writing because Carlo could recover within one year.

b) Right to Terminate Within Year

If a contract that cannot be performed within one year allows both parties the right to terminate within a year, there is a ***split*** as to whether the right to terminate takes the contract out of the one-year prong of the Statute of Frauds. The majority view is that nonperformance is not performance within one year, and so the contract is still within the Statute of Frauds. The minority Second Restatement view suggests that because the contract is terminable by either party within a year, it is outside the Statute.

Example: Susan contracts to employ Linda for two years. Part of their agreement allows either party to terminate on 30 days' notice. Under one view, this contract would be within the Statute of Frauds (excusable nonperformance is still not performance within a year). The Second Restatement view makes this contract enforceable because giving the 30 days' notice is an alternative form of performance that can occur within one year.

c) Lifetime Contracts

A contract measured by a lifetime (e.g., a promise to "employ until I die" or "work until I die") is not within the Statute because it is capable of performance within a year, since a person can die at any time.

d) Performance by One Party

Even if a contract cannot be performed within one year, if it has been ***fully performed on one side***, most courts will find that it is enforceable even though it is oral. Even if a court were to find that it was not enforceable, the performing party can sue for restitution for the reasonable value of the benefit conferred.

f. Goods Priced at $500 or More

A contract for the sale of goods for a price of $500 or more is within the Statute of Frauds and generally must be evidenced by a signed writing to be enforceable. Note that a writing is sufficient even though it omits or incorrectly states a term, but the contract is ***not enforceable beyond the quantity of goods shown in the writing***.

Examples: 1) To meet the Statute of Frauds requirement, Constructo offers a notation made on Widgetco's office pad and signed by Widgetco's president reading: "Sold to Constructo, widgets." The writing is probably not sufficient because no quantity term is given.

2) Facts the same as above, but the memorandum reads: "Sold to Constructo, 1,500 widgets." The memorandum is sufficient to support a contract for up to 1,500 widgets. If the actual agreement was for 15,000

widgets, the agreement would be enforceable only to the extent of 1,500 widgets. However, if the actual agreement was for only 150 widgets, the actual agreement may be shown.

1) When Writing Not Required

There are three situations described in UCC section 2-201(3) in which contracts are enforceable without the writing described above:

a) Specially Manufactured Goods

If goods are to be specially manufactured for the buyer and are not suitable for sale to others by the seller in the ordinary course of his business, the contract is enforceable if the seller has, under circumstances that reasonably indicate that the goods are for the buyer, made a ***substantial beginning*** in their manufacture or ***commitments*** for their purchase before notice of repudiation is received. [UCC §2-201(3)(a)]

b) Admissions in Pleadings or Court

If the party against whom enforcement is sought admits in pleadings, testimony, or otherwise in court that the contract for sale was made, the contract is enforceable without a writing (but in such a case the contract is not enforced beyond the quantity of goods admitted). [UCC §2-201(3)(b)]

c) Payment or Delivery of Goods

If goods are either received and accepted or paid for, the contract is enforceable. However, the contract is not enforceable beyond the quantity of goods accepted or paid for. Thus, if only some of the goods called for in the oral contract are accepted or paid for, the contract is only partially enforceable. If an indivisible item is partially paid for, most courts hold that the Statute of Frauds is satisfied for the whole item.

Examples: 1) Ketty and Lydia orally agree that Lydia will purchase 150 widgets from Ketty at a price of $10 each. Lydia gives Ketty a check for $70. The contract is enforceable for seven widgets only.

2) Joe orally contracts to buy a car from Suzette for $15,000. Joe gives her a $1,000 down payment. Although Joe has only partially paid for the car, most courts would hold that the contract is enforceable.

2) Merchants—Confirmatory Memo Rule

In contracts between merchants, if one party, within a reasonable time after an oral agreement has been made, sends to the other party a ***written*** confirmation of the understanding that is sufficient under the Statute of Frauds to bind the sender, it will also bind the recipient if: (i) he has reason to know of the confirmation's contents; and (ii) he does not object to it in writing within 10 days of receipt. [UCC §2-201(2)]

4. Effect of Noncompliance with the Statute

Under the majority rule, noncompliance with the Statute of Frauds renders the contract unenforceable at the option of the party to be charged (i.e., the party being charged may raise the lack of a sufficient writing as an affirmative defense). If the Statute is not raised as a defense, it is waived.

5. Situations in Which the Contract Is Removed from the Statute of Frauds

a. Performance

1) Land Sale Contracts

If a seller conveys to the buyer (i.e., fully performs), he can enforce the buyer's oral promise to pay. Likewise, the buyer may seek to specifically enforce an oral land sale contract under the doctrine of ***part performance***. Part performance that ***unequivocally*** indicates that the parties have contracted for the sale of land takes the contract out of the Statute of Frauds. What constitutes sufficient part performance varies among jurisdictions. Most require ***at least two*** of the following: (i) payment (in whole or in part), (ii) possession, and/or (iii) valuable improvements.

a) Specific Performance Only

A purchaser of an interest in land may enforce an oral contract in this manner only in equity (i.e., he may sue only for specific performance, not damages).

2) Sale of Goods Contracts

Part performance is sufficient to take a sale of goods contract out of the Statute of Frauds when: (i) the goods have been specially manufactured, or (ii) the goods have been either paid for or accepted. If a sales contract is only partially paid for or accepted, the contract is enforceable ***only to the extent of the partial payment or acceptance***.

3) Services Contracts—Full Performance Required

As noted above, an oral contract that cannot be completed within one year but has been fully performed by one party is enforceable.

b. Equitable and Promissory Estoppel

Estoppel (*see* III.D., *supra*) is sometimes applied in cases where it would be inequitable to allow the Statute of Frauds to defeat a meritorious claim. When a defendant ***falsely and intentionally*** tells a plaintiff that the contract is not within the Statute or that he will reduce their agreement to a writing, or when his conduct foreseeably induces a plaintiff to change his position in reliance on an oral agreement, courts may use the doctrine to remove the contract completely from the Statute of Frauds.

c. Judicial Admission

If the party asserting the Statute of Frauds defense admits in pleadings or testimony that there was an agreement, it is treated as though the Statute is satisfied. The contract will be enforced without a writing.

6. Remedies If Contract Is Within Statute

If a contract is within the Statute of Frauds and there is noncompliance with the Statute with no applicable exception, in almost all cases a party can sue for the ***reasonable value*** of the services or part performance rendered, ***or*** the ***restitution*** of any other benefit that has been conferred. (*See* VIII.C., *infra,* for a detailed discussion.) This recovery would be in ***quantum meruit*** rather than a suit on the contract. The rationale is that it would be unjust to permit a party to retain benefits received under the failed contract without paying for them.

7. Contract Made by Agent

The problem: A given contract is required under state law to be evidenced by a writing. An agent now purports to enter into such a contract on behalf of her principal. Must the agent's authority also be in writing? Most states would answer no, except for contracts involving interests in real property. A few states would answer yes as to all such contracts pursuant to the states' ***equal dignities*** statutes. However, even where written authority would otherwise be required, written authority may be dispensed with if the agent contracted in the presence and under the direction of the principal or if the principal later ratified the contract in writing.

G. UNCONSCIONABILITY

The concept of unconscionability allows a court to ***refuse to enforce a provision or an entire contract*** (or to modify the contract) to avoid "unfair" terms. It is sometimes said that there are two types of unconscionability: substantive unconscionability (i.e., unconscionability based on price alone) and procedural unconscionability (i.e., unconscionability based on unfair surprise or unequal bargaining power). However, few cases recognize substantive unconscionability based on unfair price alone. Instead, the cases have dealt mostly with procedural unconscionability.

1. Common Instances of Procedural Unconscionability

a. Inconspicuous Risk-Shifting Provisions

Standardized printed form contracts often contain a material provision that seeks to shift a risk normally borne by one party to the other. Examples of such provisions are:

(i) ***Confession of judgment*** clauses, which are illegal in most states;

(ii) ***Disclaimer of warranty*** provisions; and

(iii) ***"Add-on" clauses*** that subject all of the property purchased from a seller to repossession if a newly purchased item is not paid for.

Typically, such clauses are found in the fine print ("boilerplate") in printed form contracts. Courts have invalidated these provisions because they are ***inconspicuous*** or ***incomprehensible*** to the average person, even if brought to his actual attention.

b. Contracts of Adhesion—"Take It or Leave It"

Courts will deem a clause unconscionable and unenforceable if the signer is unable to procure necessary goods, such as an automobile, from any seller without agreeing to a similar provision. The buyer has no choice.

c. Exculpatory Clauses
An exculpatory clause releasing a contracting party from liability for his own ***intentional*** wrongful acts is usually found to be unconscionable because such a clause is against public policy in most states. Exculpatory clauses for ***negligent*** acts may be found to be unconscionable if they are inconspicuous (as discussed above), but commonly are upheld if they are in contracts for activities that are known to be hazardous (e.g., a contract releasing a ski hill operator for liability for negligence often will be upheld).

d. Limitations on Remedies
A contractual clause limiting liability for damages to property generally will ***not*** be found to be unconscionable unless it is inconspicuous. However, if a contract limits a party to a certain remedy and that remedy ***fails of its essential purpose***, a court may find the limitation unconscionable and ignore it. Note that under the UCC any limitation on consequential damages for personal injury caused by consumer goods is prima facie unconscionable. [*See* UCC §2-719]

Example: An automobile dealership sells a car and the contract provides that the dealer's liability for defects in the car is limited to repair or replacement. Generally, such a clause is ***not*** unconscionable. However, if a particular customer brings his car back numerous times for the same problem and the dealer is unable to effectively fix the car, the remedy fails of its essential purpose, and a court may ignore the limiting clause and allow the normal remedies for breach.

2. Timing
Unconscionability is determined by the circumstances as they existed ***at the time the contract was formed***.

3. Effect If Court Finds Unconscionable Clause
If a court finds as a matter of law that a contract or any clause of the contract was unconscionable ***when made***, the court may: (i) refuse to enforce the contract; (ii) enforce the remainder of the contract ***without*** the unconscionable clause; or (iii) ***limit the application of any clause*** so as to avoid an unconscionable result. [*See*, *e.g.*, UCC §2-302]

V. DETERMINING THE TERMS OF THE CONTRACT

A. INTRODUCTION
Once you have determined that a contract exists, the next thing you must do is determine its terms.

B. GENERAL RULES OF CONTRACT CONSTRUCTION
There are a number of general rules of construction applied by the courts when interpreting contracts. The following are among the more frequently invoked:

1. Construed as a Whole
Contracts will be construed as a "whole"; specific clauses will be subordinated to the contract's general intent.

2. Ordinary Meaning of Words
The courts will construe words according to their "ordinary" meaning unless it is clearly shown that they were meant to be used in a technical sense.

3. Inconsistency Between Provisions
If provisions appear to be inconsistent, written or typed provisions will prevail over printed provisions (which indicate a form contract).

4. Preference to Construe Contract as Valid and Enforceable
It is important to note that the courts generally will try to reach a determination that a contract is valid and enforceable. Hence, they will be inclined to construe provisions in such a fashion as to make them operative. Obviously, this general policy will not be carried so far as to contravene the intention of the parties.

5. Ambiguities Construed Against Party Preparing Contract
Ambiguities in a contract are construed against the party preparing the contract, absent evidence of the intention of the parties. This is particularly true when there is no evidence of fraud, mutual mistake, duress, or knowledge by one party of unilateral mistake; and both parties are represented by counsel.

6. Course of Performance
Where a contract involves ***repeated occasions for performance*** by either party and the other party has the opportunity to object to such performance, any course of performance accepted or acquiesced to is relevant in determining the meaning of the contract. [UCC §1-303(a), (d)]

7. Course of Dealing
The parties' course of dealing may be used to explain a contract. A course of dealing is a sequence of conduct concerning ***previous transactions*** between the parties to a particular transaction that may be regarded as establishing a common basis of their understanding. [UCC §1-303(b), (d)]

8. Usage of Trade
A usage of trade may also be used to explain a contract. A usage of trade is a ***practice or method of dealing***, regularly observed in a particular business setting so as to justify an expectation that it will be followed in the transaction in question. [UCC §1-303(c), (d)]

9. Priorities of Conflicting Rules
Express terms are given greater weight than course of performance, course of dealing and usage of trade. Course of performance is given greater weight than course of dealing or usage of trade, and course of dealing is given greater weight than usage of trade.

C. PAROL EVIDENCE RULE—SUPPLEMENTING, EXPLAINING, OR CONTRADICTING TERMS

In interpreting and enforcing a contract, questions often arise as to whether the written instrument is the complete embodiment of the parties' intention. Where the parties to a contract express their agreement in a ***writing*** with the ***intent*** that it embody the final expression of their bargain, the writing is an "***integration***." Any other expressions—written or oral—made ***prior to*** the writing, as well as any oral expressions ***contemporaneous with*** the writing, are ***inadmissible to vary*** the terms of the writing.

Example: Buyer is interested in purchasing a new car from Dealer. He settles on a particular car, and Buyer and Dealer begin to negotiate the terms of the sale. During the negotiations, Dealer tells Buyer that if he agrees to buy the car "today," Dealer will provide free car washes for as long as Buyer owns the car. The two parties finally come to an agreement on price and sign a written contract. The written contract contains a clause providing that it is the full agreement between the parties. However, it does not provide for free car washes. Absent an applicable exception, the parol evidence rule would prevent Buyer from introducing evidence in court of the oral agreement concerning car washing services that was made prior to the execution of the written contract.

1. Purpose

Its name notwithstanding, the parol evidence rule is not generally regarded as a rule of evidence, but rather as a rule of ***substantive contract law***. It is designed to carry out the apparent intention of the parties and to facilitate judicial interpretation by having a single clean source of proof (the writing) on the terms of the bargain.

2. Is the Writing an "Integration"?

The question of whether a writing is an "integration" of all agreements between the parties can be broken down into two further subquestions:

(i) Is the writing intended as a ***final*** expression?

(ii) Is the writing a ***complete*** or ***partial*** integration?

a. Is the Writing Intended as a Final Expression?

Writings that evidence a purported contract are not necessarily the "final" expression of that contract. Thus, for example, the parties might only have intended such writings to be preliminary to a final draft. If so, the parol evidence rule will not bar introduction of further evidence. Any relevant evidence is admissible to show that the parties did not intend the writing to be final. Note that the ***more complete*** the agreement appears to be on its face, the more likely it is that it was intended as an ***integration***.

b. Is the Writing a Complete or Partial Integration?

After establishing that the writing was "final," one should determine if the integration was "complete" or only "partial." If complete, the writing may not be contradicted or supplemented; if partial, it cannot be contradicted, but it may be supplemented by proving up consistent additional terms. As with the finality component, whether an integration is complete or partial depends on the intent of the parties. All relevant evidence is admissible for the purpose of making the determination, even the evidence whose admissibility is challenged. The UCC presumes all writings are partial integrations unless there is evidence that the parties intended a writing to be the complete agreement. [UCC §2-202(b)]

1) Effect of Merger Clause

A merger clause is a statement in a writing reciting that the agreement is the complete agreement between the parties. The presence of a merger clause is often determinative in large commercial contracts in which both parties are represented

by lawyers. The modern trend, however, is to consider the clause as one factor in determining the integration issue.

c. Who Makes Decision?

The ***majority view*** is that the question as to whether an agreement is an integration is decided by the ***judge***, not the jury. If the judge decides that the writing was an integration of all agreements between the parties, he will exclude evidence of prior written or oral terms, or contemporaneous oral terms, that seek to vary the terms of the integrated writing. Otherwise, he may admit the offered extrinsic evidence. Then, if there is a jury, it will make its own determination as to whether this extrinsic evidence was part of the agreement.

3. Evidence Outside Scope of Rule

Because the rule prohibits admissibility only of extrinsic evidence that seeks to vary, contradict, or add to an "integration," other forms of extrinsic evidence may be admitted where they will not bring about this result, i.e., they will fall outside the scope of the parol evidence rule.

a. Validity Issues

A party to a written contract can attack the agreement's validity. The party acknowledges (concedes) that the writing reflects the agreement but asserts, most frequently, that the ***agreement never came into being*** because of any of the following:

1) Formation Defects

Formation defects (e.g., fraud, duress, mistake, and illegality) may be shown by extrinsic evidence.

2) Conditions Precedent to Effectiveness

Where a party asserts that there was an oral agreement that the written contract would not become ***effective*** until a condition occurred, all evidence of the understanding may be offered and received. This would be a condition precedent to effectiveness. The rationale is that you are not altering a written agreement by means of parol evidence if the written agreement never came into being. It should be borne in mind that parol evidence of such a condition precedent will not be admitted if it contradicts the express language of the written contract.

Example: Giorgio and Susan sign what appears to be a complete contract, but agree orally that the agreement is not to become binding unless Susan can secure financing, or until her home office approves, or the like. The nonhappening of the stipulated event may be shown because the parol evidence rule does not come into play until a binding contract exists.

a) Distinguish from Condition Precedent to Performance

Parol evidence is inadmissible as to conditions precedent to ***performance***, i.e., an oral agreement that the party would not be obliged to perform until the happening of an event. This latter type of condition limits or modifies a duty under an existing or formed contract.

b. Collateral Agreements and Naturally Omitted Terms

Parol evidence is often said to be admissible if the alleged parol agreement is collateral to the written obligation (i.e., related to the subject matter but not part of the primary promise) and does not conflict with it. This "collateral agreement" doctrine is hard to apply because it is conclusory. The Restatements of Contracts include a similar concept with a more definitive approach: the naturally omitted terms doctrine. The doctrine allows evidence of terms that would naturally be omitted from the written agreement. A term would naturally be omitted if:

(i) It ***does not conflict*** with the written integration; and

(ii) It concerns a subject that similarly situated parties ***would not ordinarily be expected to include*** in the written instrument.

[Restatement (First) of Contracts, §240; Restatement (Second) of Contracts, §216]

Example: Seller offered to sell his sister his ranch. The deed gave Seller an option to repurchase, but the parties orally agreed that the option could not be transferred to a third party. Oral evidence of the agreement was not barred by the parol evidence rule. The court held that when family members are contracting, they would not ordinarily be expected to put such a term into the written contract. [*See* Masterson v. Sine, 68 Cal. 2d 222 (1968)]

c. Interpretation

If there is uncertainty or ambiguity in the written agreement's terms or a dispute as to the ***meaning*** of those terms, parol evidence can be received to aid the fact-finder in reaching a correct interpretation of the agreement. If the meaning of the agreement is plain, parol evidence is inadmissible.

d. Showing of "True Consideration"

The parol evidence rule will not bar extrinsic evidence showing the "true consideration" paid.

Example: A contract states that $10 has been given as full and complete consideration. Extrinsic evidence will be admitted, by way of a defense, to show that this sum has never been paid.

e. Reformation

If a party to a written agreement alleges facts (e.g., mistake) entitling him to reformation of the agreement (*see* VIII.E., *infra*), the parol evidence rule is inapplicable. Why? Because the plaintiff is asserting as a cause of action that despite the apparently unambiguous terms of the written agreement, those terms do not in fact constitute the agreement between the parties.

f. Subsequent Modifications

Parol evidence can be offered to show subsequent modifications of a written contract, because the parol evidence rule applies only to prior or contemporaneous negotiations. In short, the parties may show that they have altered the integrated writing after its making.

g. Additional Terms Under Article 2
As noted above, under Article 2 a party cannot contradict a written contract but he may add ***consistent additional terms*** unless: (i) there is a merger clause, or (ii) the courts find from all of the circumstances that the writing was intended as a complete and exclusive statement of the terms of the agreement. [*See* UCC §2-202] Article 2 also provides that a written contract's terms may be ***explained*** or ***supplemented*** by evidence of course of performance, course of dealing, and usage of trade—regardless of whether or not the writing appears to be ambiguous.

D. ARTICLE 2 PROVISIONS ON INTERPRETING CONTRACTS

1. Supplemental ("Gap-Filler") Terms

Recall that the key to forming a contract for the sale of goods is the quantity term (*see* II.B.2.b.1)b), *supra*). If other terms are missing from the agreement, Article 2 has gap-filler provisions to fill in the missing term(s).

a. Price
If: (i) nothing has been said as to price; (ii) the price is left open to be agreed upon by the parties and they fail to agree; or (iii) the price is to be fixed in terms of some standard that is set by a third person or agency and it is not set, then the price is a ***reasonable price at the time for delivery***. [UCC §2-305]

b. Place of Delivery
If the place of delivery is not specified, the place is the ***seller's place of business***, if he has one; otherwise, it is the seller's home. However, if the goods have been identified as the ones to satisfy the contract and the parties know that they are in some other place, then that is the place of delivery. [UCC §2-308]

c. Time for Shipment or Delivery
If the time for shipment or delivery is not specified, shipment/delivery is due in a ***reasonable time***. [UCC §2-309]

d. Time for Payment
If the time for payment is not specified, payment is due at the ***time and place at which the buyer is to receive the goods***. [UCC §2-310]

e. Assortment
If a contract provides that an assortment of goods is to be delivered (e.g., blouses in various colors and sizes) and does not specify which party is to choose, the assortment is to be ***at the buyer's option***. If the party who has the right to specify the assortment does not do so seasonably, the other party is excused from any resulting delay and may either proceed in any reasonable manner (e.g., choose a reasonable assortment) or treat the failure as a breach. [UCC §2-311]

2. Delivery Terms and Risk of Loss

All contracts for the sale of goods require delivery of the goods. Often, delivery consists merely of allowing the buyer to take the goods with him (e.g., a purchase of groceries from the grocery store). However, circumstances often require some other type of delivery (e.g., delivery of 100 cases of cereal to the grocery store requires shipment). A contract's delivery

terms are important because they determine when risk of loss passes from the seller to the buyer if the goods are damaged or destroyed.

a. Noncarrier Case

A noncarrier case is a sale in which it appears that the parties did not intend that the goods would be moved by a common carrier (e.g., when you buy groceries). In such a case, if the ***seller is a merchant***, risk of loss passes to the buyer only when she ***takes physical possession*** of the goods. If the ***seller is not a merchant***, risk of loss passes to the buyer upon ***tender of delivery***. [*See* UCC §2-509(3)]

Examples: 1) Merchant Seller sells goods to Buyer who is to pick them up at noon on Monday. Seller has the goods ready for Buyer at that time, but Buyer does not arrive. The goods are destroyed at 1:30 p.m. that day. Risk of loss falls on the merchant seller because the buyer had not actually picked up the goods.

2) Nonmerchant Seller sells goods to Buyer and the parties agree that the goods will be picked up by Buyer at noon on Monday. Seller has the goods ready for Buyer at that time, but Buyer does not arrive. The goods are destroyed at 1:30 p.m. that day. Risk of loss falls on Buyer because Seller tendered delivery at noon when he had the goods ready for pickup by Buyer.

b. Carrier Cases

A carrier case is a sale in which it appears that the parties intended the goods to be moved by a carrier (e.g., when you order a book from an Internet website). There are two types of carrier cases: shipment contracts and destination contracts. Whether a contract is a shipment contract or a destination contract depends on the delivery terms used in the contract.

1) Shipment Contract

If the contract authorizes or requires the seller to ship the goods by carrier but does not require him to deliver them at a particular destination, it is a shipment contract and risk of loss passes to the buyer when the goods are ***delivered to the carrier***. The UCC presumes a contract is a shipment contract in the absence of a contrary agreement. A "ship to" address does not overcome this presumption. [UCC §2-509(1)(a)]

Example: Seller in New York sells 10,000 tons of steel to Buyer in California. The contract authorizes shipment by carrier but does not require Seller to tender the goods in California. Risk passes to Buyer when the goods are placed in possession of the carrier. If the goods are damaged in transit, the loss falls on Buyer.

2) Destination Contracts

If the contract requires the seller to deliver the goods at a particular destination, the risk of loss passes to the buyer when the goods are ***tendered to the buyer at the destination***. [UCC §2-509(1)(b)] Specifying a destination in this context means more than just indicating an address for shipment. Otherwise, all contracts would be destination contracts. A contract that contains neither an F.O.B. term nor any other term explicitly allocating the risk of loss is a shipment contract.

Example: If, in the last example, the contract provided that the goods must be tendered in California, risk of loss during transit to California would have been on Seller.

3) Common Delivery Terms

A number of abbreviations are often used in commercial contracts to set out the shipping terms. When used, these abbreviations determine whether the contract is a shipment or a destination contract. If the contract contemplates delivery by a carrier and no delivery term is used, the contract is a shipment contract.

a) F.O.B.

F.O.B. stands for "free on board." The letters F.O.B. are always followed by a location, and the risk of loss passes to the buyer at the named location. The seller bears the risk and expense of getting the goods to the named location. These contracts can be either shipment contracts or destination contracts, depending on the location named.

Examples: 1) Seller in New York sells 10,000 widgets to Buyer in California, "F.O.B. New York," or "F.O.B. Seller's materials yard." This is a shipment contract and risk of loss and expenses of shipment must be borne by the buyer during shipment.

2) Same facts as above, but the contract is "F.O.B. California" or "F.O.B. Buyer's warehouse." This is a destination contract and Seller must bear the risk of loss and expenses of shipping to the named destination.

b) F.A.S.

F.A.S. stands for "free alongside." The term is generally used only when goods are to be shipped by boat. The risk of loss passes to the buyer once the goods are delivered to the dock.

c. Effect of Breach on Risk of Loss

1) Defective Goods

If the buyer has a right to reject the goods, the risk of loss does not pass to the buyer until the defects are ***cured*** or she ***accepts*** the goods in spite of their defects. [UCC §2-510(1)] Note that a buyer generally has the right to reject for any defect. (*See* VII.C., *infra*.)

Example: Buyer has ordered blue widgets from Seller, F.O.B. Seller's plant. Seller ships blue-black widgets, giving Buyer a right to reject. The widgets are damaged in transit. The risk of loss falls on Seller, although the risk would have been on Buyer if blue widgets had been shipped.

2) Revocation of Acceptance

If the buyer rightfully revokes acceptance, the ***risk of loss*** is treated as having rested ***on the seller from the beginning*** to the extent of any deficiency in the

buyer's insurance coverage, the risk of loss at issue being that between the time of acceptance and the time of revocation of acceptance. [UCC §2-510(2)] However, revocation of acceptance is rightful only if it occurs "before any substantial change in condition of the goods which is not caused by their own defects." [UCC §2-608(2)] Thus, there can be no revocation of acceptance after a casualty loss to the goods.

d. Risk in Sale or Return and Sale on Approval Contracts

1) Sale or Return

For the purpose of determining the risk of loss, a sale or return contract (e.g., the buyer takes goods for resale but may return them if she is unable to resell them) is treated as an ordinary sale and the above rules apply. If the goods are returned to the seller, the ***risk remains on the buyer*** while the goods are in transit. [UCC §2-327(2)]

Example: A magazine distributor delivers 1,000 magazines to a newsstand. The parties agree that the buyer need only pay for any magazines that are not returned to the seller within 40 days. This is a sale or return, and the buyer has the risk of loss until the seller receives any returned magazines.

2) Sale on Approval

In a sale on approval (i.e., the buyer takes goods for use but may return them even if they conform to the contract), the risk of loss does not pass to the buyer until she ***accepts***. Acceptance may take place by failure to return or notify the seller of an intention to return within the required time. If the buyer decides not to take the goods, return is ***at the seller's risk***. [UCC §2-327(1)]

Example: A door-to-door vacuum seller offers to leave a vacuum with a homeowner for 30 days on approval—and the homeowner is not obligated to buy unless completely satisfied at the end of the 30-day period. This is a sale on approval. The risk of loss remains with the seller during the approval period. Thus, if the vacuum is destroyed during the trial period, the buyer is not liable to the seller for its price.

e. Goods Destroyed Before Risk of Loss Passes

If goods that were ***identified when the contract was made*** are destroyed (i) without fault by either party and (ii) before the risk of loss passes to the buyer, the contract is avoided (i.e., the seller's performance is excused). If the goods were not identified until after the contract was made, the seller in this situation would have to prove impracticability (VI.E.5.b., *infra*) to be discharged.

3. Insurable Interest and Identification

As noted above, a buyer often bears the risk of loss before receiving the goods purchased. To aid buyers in this situation (and a few others), Article 2 gives buyers a special property interest in goods as soon as they are identified as the ones that will be used to satisfy the contract (e.g., as soon as the seller sets them aside for the buyer). This special property interest is insurable, so that a buyer may obtain insurance for goods while they are being shipped to prevent loss in case of damage or destruction during shipment. [*See* UCC §2-501]

4. Bilateral Contracts Formed by Performance
Recall that a contract may be formed by the parties' performance where the mirror image rule is not satisfied and under certain circumstances under Article 2's "battle of the forms" provision [UCC §2-207]. (*See* II.D.5.b., *supra*.) In such cases, under Article 2, the contract includes all of the terms on which the writings of both parties agree. Any necessary missing terms are filled in by the supplemental terms provided for in Article 2. [UCC §2-207(3)]

a. Compare—Common Law Last Shot Rule
The rule is different in common law contracts. At common law, the contract will include the terms of the last communication sent to the party who performed. *Rationale:* That communication was a rejection of any prior offer and a counteroffer, and the performance was an acceptance of the terms in that counteroffer.

5. Warranties
Contracts for the sale of goods automatically include a warranty of title (in most cases). They also may include certain implied warranties and express warranties.

a. Warranty of Title and Against Infringement

1) Warranty of Title
Any seller of goods warrants that the title transferred is good, that the transfer is rightful, and that there are no liens or encumbrances against the title of which the buyer is unaware at the time of contracting. [UCC §2-312] This warranty arises automatically and need not be mentioned in the contract.

2) Warranty Against Infringement
A ***merchant seller*** regularly dealing in goods of the kind sold also automatically warrants that the goods are delivered free of any patent, trademark, copyright, or similar claims. But a ***buyer who furnishes specifications*** for the goods to the seller must hold the seller harmless against such claims. If this warranty is breached and the buyer is sued, she must give the seller notice of the litigation within a reasonable time or lose her right to any remedy. In such a case, the seller can give the buyer notice of his wish to defend the lawsuit and, if the seller agrees to bear all expenses and satisfy any adverse judgment, the buyer must let him defend or lose any rights against him arising out of the breach. [UCC §2-607(3), (5)]

b. Implied Warranty of Merchantability

1) When Given
Implied in every contract for sale by ***a merchant who deals in goods of the kind sold***, there is a warranty that the goods are merchantable. The serving of food or drink for consumption on the premises is a sale of goods subject to the warranty of merchantability. [UCC §2-314(1)]

2) Elements of Warranty of Merchantability
To be merchantable, goods must at least:

(i) ***Pass without objection*** in the trade under the contract description;

(ii) In the case of fungible goods, ***be of fair average quality*** within the description;

(iii) ***Be fit for the ordinary purposes*** for which such goods are used;

(iv) Be, within the variations permitted by the agreement, ***of even kind, quality, and quantity*** within each unit and among all units involved;

(v) ***Be adequately contained, packaged, or labeled*** according to the contract; and

(vi) ***Conform to any promises or affirmations of fact made on the label.*** Other warranties of merchantability may arise from the course of dealing or usage of trade.

[UCC §2-314(2)] The most important test is "***fit for the ordinary purposes for which such goods are used***," and a failure to live up to this test is the usual claim in a merchantability suit.

3) Seller's Knowledge of Defect Not Relevant
As in all implied warranty cases, it makes no difference that the seller himself did not know of the defect or that he could not have discovered it. Implied warranties are not based on negligence but rather on ***absolute liability*** that is imposed on certain sellers.

c. Implied Warranty of Fitness for a Particular Purpose
A warranty will also be implied in a contract for the sale of goods whenever (i) ***any seller***, merchant or not, ***has reason to know the particular purpose*** for which the goods are to be used and that the ***buyer is relying*** on the seller's skill and judgment to select suitable goods; and (ii) the ***buyer in fact relies*** on the seller's skill or judgment. [UCC §2-315] The comment to section 2-315 says, "A particular purpose differs from the ordinary purpose for which goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability."

Examples: 1) Seller, who as a hobby prepared an automobile for dirt track racing, sold it to Buyer for racing purposes. Buyer was a novice in racing. The steering mechanism collapsed in a turn during a race. The mechanism would not have collapsed in ordinary driving. There was a breach of warranty of fitness for "particular purposes" if the seller had reason to know that the buyer was relying on him to provide a suitable racing vehicle.

2) Seller, a law student, sells his used automobile to Buyer. The steering mechanism collapses during an ordinary Sunday afternoon drive. There is no breach of a warranty of fitness for particular purposes because the element of selection based on Seller's purported skill is not present.

3) Note that in both of the above examples, if the seller knew that the automobile had a particular defect and did not disclose this fact to the buyer, he might be subject to liability because of a lack of good faith. Section 1-304 provides that every contract or duty within the UCC imposes an obligation of good faith in its performance or enforcement.

d. Express Warranties

Any affirmation of fact or promise made by the seller to the buyer, any description of the goods, and any sample or model creates an express warranty if the statement, description, sample, or model is part of the ***basis of the bargain***. For the statement, description, sample, or model to be a part of the basis of the bargain, it need only come at such a time that the ***buyer could have relied*** on it when she entered into the contract. The buyer does not need to prove that she actually did rely, although the seller may negate the warranty by proving that the buyer as a matter of fact did not rely. It is not necessary that the seller intended the affirmation of fact, description, model, or sample to create a warranty. [UCC §2-313]

1) Distinguish—Statements of Value or Opinion

A statement relating merely to the value of the goods, or a statement purporting to be only the seller's opinion or commendation of the goods, does not create an express warranty.

Examples: 1) "Chevrolet cars are better." No warranty.

2) "You will like this." No warranty.

Compare: A number of courts have held that such statements as "this tractor is in A-1 condition" or "this automobile is in top mechanical condition" do create express warranties that are breached if the statement is not a proper characterization of the condition of the thing sold.

e. Disclaimer of Warranties

1) Warranty of Title

The title warranty can be disclaimed or modified only by specific language or by circumstances which give the buyer notice that the seller does not claim title or that he is selling only such rights as he or a third party may have (e.g., a sheriff's sale).

2) Implied Warranties

The implied warranties of merchantability and fitness for a particular purpose can be disclaimed by either specific disclaimers or general methods of disclaimer.

a) Specific Disclaimers

Article 2 provides specific methods for disclaiming the implied warranties of merchantability and fitness. Use of these methods is the best way for a seller to ensure that a disclaimer is effective.

(1) Disclaimer of Warranty of Merchantability

The warranty of merchantability can be specifically disclaimed or

modified only by ***mentioning merchantability***. If the sales contract is in writing, the disclaimer must be ***conspicuous***. [UCC §2-316(2)]

(2) Disclaimer of Warranty of Fitness for a Particular Purpose
The warranty of fitness for a particular purpose can be specifically disclaimed only by a ***conspicuous writing***. A written disclaimer, according to the statute, is sufficient if it says, for example, "[t]here are no warranties which extend beyond the description on the face hereof." [UCC §2-316(2)]

(3) "Conspicuous" Defined
A term is conspicuous when it is "so written, displayed, or presented that a reasonable person against whom it is to operate ought to have noticed it." Language in the body of a writing is conspicuous if: (i) it is in larger type than surrounding text; (ii) it is in a contrasting type, font, or color; or (iii) it is set off from the text by marks that call attention to it. [UCC §1-201(b)(10)] The court, not the jury, decides any fact question as to conspicuousness.

b) General Disclaimer Methods
The UCC also provides several general methods for disclaiming implied warranties. These methods are more dependent on the circumstances than the specific methods, and so are less certain to be effective than specific disclaimers.

(1) By General Disclaimer Language
Unless the circumstances indicate otherwise, the implied warranties of merchantability and fitness can be disclaimed by expressions such as "***as is***," "with all faults," or other expressions that in common understanding call the buyer's attention to the fact that there are no implied warranties.

(2) By Examination or Refusal to Examine
When the buyer, before entering into the contract, has examined the goods or a sample or model as fully as she desires or has refused to examine, there is no warranty as to defects that a reasonable examination would have revealed to her.

(3) By Course of Dealing, Etc.
Implied warranties may also be disclaimed by the course of dealing, course of performance, or usage of trade.

3) Express Warranties
As discussed above, any affirmation of fact or promise, description of the goods, model, or sample will create an express warranty. If there are also words or conduct negating the express warranty, problems of interpretation will arise. The UCC provides that words or conduct relevant to the creation of express warranties and words or conduct tending to negate such warranties shall wherever possible be

construed as consistent with each other, but "***negation or limitation is inoperative to the extent that such construction is unreasonable***." [UCC §2-316] Practically every sale will involve some description of the goods, and the comment to section 2-313 suggests that the ***basic obligation*** created by this description cannot be read out of the contract by a disclaimer clause.

Example: Seller sells to Buyer something that Seller describes as an "automobile" being sold "as is," and with sufficient disclaimers of all implied warranties. The thing delivered is an automobile body without an engine, a transmission, or wheels. While an automobile with very substantial defects would have fulfilled this contract, what was delivered was not an "automobile" at all. Seller's description "automobile" created an express warranty that an automobile would be delivered, and the disclaimer did not negate this basic obligation.

Of course, the language of disclaimer in the example would substantially reduce the quality of the automobile that must be delivered.

a) Parol Evidence Rule

The parol evidence rule might be an obstacle to a buyer to whom an express warranty was made when the contract contains a broad disclaimer of warranties. In a typical situation, the seller makes an express warranty verbally, but the written contract contains no such warranty and instead contains a clause disclaiming all warranties not set forth in the contract. Here, the parol evidence rule could prevent the buyer from introducing evidence of the verbal warranty. *But note:* The buyer can often avoid the rule by a showing that he did not intend that the writing be the complete and exclusive expression of the parties' agreement (*see* V.C.2., *supra*) or that the disclaimer is unconscionable under the circumstances (*see* 6), *infra*).

4) Limitations on Damages

Parties may include in their contract a clause limiting the damages available in the case of breach of warranty (e.g., "remedy for breach of warranty is limited to repair or replacement of the defective goods"). However, such a limitation generally will not be upheld if it is unconscionable (e.g., causes the remedy to fail of its essential purpose; *see* IV.G.1.d., *supra*). Moreover, warranty disclaimers that limit damages for personal injury caused by a breach of warranty on consumer goods are prima facie unconscionable.

5) Timing—Disclaimers and Limitations in the Box

To be effective, a disclaimer of warranty or limitation on remedies must be agreed to during the bargaining process. Thus, although a few courts hold otherwise, most hold that a warranty disclaimer or limitation on remedy included inside the packaging of goods is not effective against the buyer. However, there are ways around this (e.g., the outside of the box could indicate that the sale is subject to the conditions stated inside the box; a registration card within the box can indicate that by registering, the owner agrees to all of the conditions set out in the documents in the box (modifying the contract), etc.).

a) Compare—"Clickwrap"
Computer software often comes with terms that appear on the user's computer screen during the installation process, and the purchaser must click to agree to the terms before installing. Such limitations and disclaimers typically are upheld on the rationale that the purchaser can return the software if he disagrees with the conditions.

6) Unconscionability and Warranty Disclaimers
Some courts will, in addition to determining whether disclaimers have met the formal requirements discussed above, test warranty disclaimers by the conscionability standards of UCC section 2-302. Such things as lack of bargaining position, lack of choice, and failure to understand would be relevant in determining whether a disclaimer is unconscionable. (*See* IV.G., *supra*.)

f. Damages for Breach of Warranty

1) In General—Difference Between Goods Tendered and as Warranted
Generally, the measure of damages for breach of any warranty is the difference between the value of the goods accepted and the value of the goods as warranted, measured at the time and place of acceptance. When, however, there are special circumstances that show proximate damages of a different amount, that amount is the proper measure. [UCC §2-714(2)]

2) Breach of Warranty of Title
In the case of a breach of warranty of title, the buyer may rescind the contract, revoke acceptance of the goods, or sue for damages. In these cases, the goods are reclaimed by the true owner or lien holder, thus dispossessing the purchaser. The value of the goods accepted is deemed to be nothing; so the damages are the value of the goods as warranted. Often, but not always, that is the same as the purchase price.

a) Special Circumstances—Appreciation and Depreciation
As noted above, damages may be measured differently if there are special circumstances. A great appreciation or depreciation in the value of the goods from the time of delivery until the purchaser is dispossessed of the property is usually considered such a special circumstance. In that case, the value is measured at the time of the dispossession rather than at the time of acceptance.

Examples: 1) Buyer purchases a painting for $10,000 from Seller, who in turn purchased the painting from Gallery. Unbeknownst to any of the parties, the person who sold the painting to Gallery had stolen it. Several years after Buyer's purchase, Owner, the painting's true owner, sues Buyer and recovers the painting, which is now worth $100,000. The appreciation is a special circumstance, so Buyer's damages will be the value of the painting at dispossession—$100,000. [*See* Menzel v. List, 24 N.Y.2d 91 (1969)]

2) Buyer purchases a used truck for $5,000 from Seller's used car dealership. After driving it for one year, Buyer is pulled over in a routine traffic stop. The police inform Buyer the truck is stolen and impound it. When taken by the police, the truck was worth $4,200. Having use and possession of the truck for a substantial period of time is a special circumstance, and Buyer is entitled only to the value of the truck on the date it was impounded. [*See* City Car Sales v. McAlpin, 380 So. 2d 865 (Ala. 1979); Schneidt v. Absey Motors, Inc., 248 N.W.2d 792 (N.D. 1976)]

g. To Whom Do Warranties Extend?

Article 2 provides alternative provisions for determining to whom warranty liability extends. [UCC §2-318] Most states have adopted ***Alternative A***, which provides that the seller's warranty liability extends to any natural person who is in the ***family*** or ***household*** of the buyer or who is a ***guest*** in the buyer's home if it is reasonable to expect that the person may use, consume, or be affected by the goods and that person suffers ***personal injury*** because of a breach of warranty. The seller cannot escape the effect of this section by contract. (The comments say that beyond this, the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties given to his buyer who resells extend to other persons in the distributive chain.) Alternative B extends a seller's express or implied warranty liability to ***any natural person*** reasonably expected to use, consume, or be affected by the goods and who suffers ***personal injury*** because of a breach of warranty. The broadest alternative, Alternative C, extends warranty liability to ***any person*** reasonably expected to use, consume, or be affected by the goods and who is ***injured*** by breach of the warranty (this includes property damage). The seller may not exclude or limit the operation of the section with respect to ***personal injury***.

E. MODIFICATION OF CONTRACT TERMS

1. Consideration

Under general contract law, a final contract cannot be modified unless the modification is supported by new consideration. The modern view, however, permits modification without consideration if: (i) the modification is due to circumstances that were unanticipated by the parties when the contract was made and (ii) it is fair and equitable. [*See* Restatement (Second) of Contracts §89] ***The bar examiners have indicated that they are looking for the modern view on the MBE.*** The UCC is even more liberal with regard to modification. Under the UCC, promises of new and different terms by the parties to a sales contract are valid without consideration, but good faith is required to make a modification enforceable.

2. Writing

A written contract can be modified orally. For sales of goods contracts, however, the modification must be in writing if the contract as modified falls within the Statute of Frauds. Thus, if the contract ***as modified*** is for $500 or more, it must be evidenced by a writing; if the contract ***as modified*** is for less than $500, no writing is necessary. [UCC §2-209]

Examples: 1) Seller agrees to sell Buyer his car for $525 and the parties put the contract in writing to satisfy the Statute of Frauds. Subsequently, Buyer discovers that

he can afford to spend only $475 on a car. Buyer calls Seller and tells Seller of his trouble. Seller agrees to lower the price to $475. A writing is no longer necessary, and either party can enforce the oral modification.

2) Mary phones Paul and asks Paul for his price on widgets. Paul informs Mary that he currently is selling widgets for $3 each. Mary asks Paul to send her 150 widgets. Paul agrees, and tells Mary that he will ship them the next day. The contract is enforceable without a writing. A few hours later, Mary phones Paul back and asks Paul whether he could send her 200 widgets instead of 150. Paul agrees. The contract as modified is not enforceable absent a written memorandum satisfying the Statute of Frauds. The original contract remains enforceable.

a. Provisions Prohibiting Oral Modification Not Effective at Common Law
The common law rule is that even if a written contract expressly provides that it may be modified only by a writing, the parties can orally modify the contract.

b. UCC Recognizes No-Modification Clauses
Under the UCC, even if a contract is not within the Statute of Frauds, if it explicitly provides that it may not be modified or rescinded except by a signed writing, that provision will be given effect. [UCC §2-209]

1) Contract Between Merchant and Nonmerchant
If a contract is between a merchant and a nonmerchant and the provision requiring written modification is on the merchant's form, the provision will not be given effect unless it is ***separately signed*** by the nonmerchant.

2) Waiver
If the parties attempt to orally modify a contract that requires written modification (either because of a contract clause or the Statute of Frauds), it is technically ineffective as a modification, but can operate as a waiver. Such a waiver will be found whenever the other party has changed position in reliance on the oral modification.

a) Retraction of Waiver
A party who makes a waiver affecting an executory (not yet performed) portion of the contract may retract the waiver if she notifies the other party that strict performance of the waived terms is required. The waiver may not be retracted, however, if the other party detrimentally relied on it. [UCC §2-209(5)]

Example: A contract between Buyer and Seller for 800 widgets contains a clause requiring all modifications to be in writing. The parties orally agree to reduce the number to 400 widgets. Buyer later decides he wants 800 widgets after all. If Seller relied on the oral modification in making contracts with other parties for widgets and does not have stock available, Buyer cannot retract the waiver. If, however, Seller did not change his position in reliance on the waiver, Buyer may retract the waiver and enforce the contract for the full 800 widgets.

3. Parol Evidence Rule Does Not Apply

As noted above, parol evidence is admissible to show subsequent oral modifications of a written contract.

VI. PERFORMANCE AND EXCUSE OF NONPERFORMANCE

A. INTRODUCTION

Having established that there is a contract and having determined what are the terms of the contract, the next issue to consider is what performance is due and whether any nonperformance is excused.

B. PERFORMANCE AT COMMON LAW

A party's basic duty at common law is to ***substantially perform*** all that is called for in the contract.

C. PERFORMANCE UNDER ARTICLE 2

Article 2 generally requires a ***perfect tender***—the delivery and condition of the goods must be exactly as promised in the contract. Note the following:

1. Obligation of Good Faith

As noted in I.B.5., *supra*, in performance or enforcement of a contractual duty, Article 2 requires all parties to act in good faith, which is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing." [UCC §1-201(2)] This obligation cannot be waived by the parties.

2. Seller's Obligation of Tender and Delivery

a. Noncarrier Cases

Recall that a noncarrier case is a sale in which it appears that the parties did not intend that the goods be moved by carrier. (*See* V.D.2.a., *supra*.)

1) Tender of Delivery

In a proper tender of delivery, the seller must put and hold conforming goods at the buyer's disposition for a time sufficient for the buyer to take possession. The seller must ***give the buyer notice*** reasonably necessary to enable her to take possession of the goods. The ***tender must be at a reasonable hour***. [UCC §2-503(1)]

2) Place of Delivery

In the absence of an agreement otherwise, the place of delivery is the ***seller's place of business***, or if he has none, his residence. However, if at the time of contracting, the goods are, to the knowledge of both parties, at some other place, that place is the place of delivery. [UCC §2-308]

b. Carrier Cases

Recall that a carrier case is a sale in which, due either to the circumstances or to the express terms of the agreement, it appears that the parties intended that a carrier be used to move the goods. (*See* V.D.2.b., *supra*.)

1) Shipment Contracts—Where Seller Has Not Agreed to Tender at Particular Destination
In the absence of an agreement otherwise, the seller need not see that the goods reach the buyer, but need only:

a) Put the goods into the hands of a reasonable carrier and make a reasonable contract for their transportation to the buyer;

b) Obtain and promptly tender any documents required by the contract or usage of trade or otherwise necessary to enable the buyer to take possession; and

c) Promptly notify the buyer of the shipment.

2) Destination Contracts—Where Seller Has Agreed to Tender at Particular Destination
If the contract requires the seller to tender delivery of the goods at a particular destination, the seller must, at the destination, put and hold conforming goods at the buyer's disposition. He must also give the buyer any notice of tender that is reasonably necessary and provide her with any documents of title necessary to obtain delivery. Tender of documents through ordinary banking channels is sufficient. [UCC §2-503]

3. Buyer's Obligation to Pay—Right to Inspect

a. Delivery and Payment Concurrent Conditions
In ***noncarrier cases***, unless the contract provides otherwise, a sale is for cash and the price is due concurrently with tender of delivery. However, unless otherwise agreed, when goods are shipped ***by carrier***, the price is due only at the time and place at which the buyer receives the goods. Therefore, in a shipment case, the price is due when the goods are put in the hands of the carrier, and in a destination contract, the price is due when the goods reach the named destination.

b. Payment by Check
Tender of payment by check is sufficient unless the seller demands legal tender and gives the buyer time to get cash. If a check is given, the buyer's duty to pay is suspended until the check is either paid or dishonored. If the check is paid, the buyer's duty to pay is discharged. If the check is dishonored, the seller may sue for the price or recover the goods. [UCC §2-511]

c. Installment Contracts
In an installment contract (i.e., one that requires or authorizes delivery in separate installments), the seller may demand payment for each installment if the price can be so apportioned, unless a contrary intent appears. [UCC §2-307]

d. Buyer's Right of Inspection
Unless the contract provides otherwise, the buyer has a right to inspect the goods before she pays. Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected. A buyer may inspect at any reasonable time and in any reasonable manner. [UCC §2-513]

Note: If the contract between the parties provides for payment C.O.D. or otherwise indicates that the buyer has promised to pay without inspecting the goods, there is no right of inspection prior to payment. If payment is due before inspection, the fact that the goods are defective does not excuse nonpayment unless the defect appears without inspection or there is fraud in the transaction. [UCC §§2-512, 2-513]

Examples: 1) Buyer in California and Seller in New York contract for sale of steel to be shipped to California. Nothing is said as to payment. Buyer has a right to inspect the goods before payment.

2) Same situation as above, except that the contract provides for payment of cash on delivery. Buyer must pay when the steel is delivered, and she does not have a right of inspection prior to payment.

3) Same situation as last example, except that the goods are defective. To put Seller in breach, Buyer must pay, unless the defect appears without inspection.

D. CONDITIONS—HAS THE DUTY TO PERFORM BECOME ABSOLUTE?

A contract may provide that a party does not have a duty to perform unless some condition is fulfilled. In such a case, the party's failure to perform will normally be ***justified*** if the condition was not fulfilled.

1. Distinction Between Promise and Condition

It is important to understand that there is a difference between whether a party is bound under a contract and whether a party who is bound has come under a duty to perform. A person is bound if there has been an offer, an acceptance, and an exchange of consideration. However, the contract may provide (impliedly or explicitly) that a party who is bound does not come under a duty to perform unless or until some specified condition occurs. In looking at the terms of a contract, a distinction has to be drawn between an absolute promise on the one hand and a condition on the other.

a. Definitions

1) Promise

A promise is a commitment to do or refrain from doing something. If a promise is unconditional, the failure to perform according to its terms is a breach of contract.

2) Condition

In this context, the term "condition" normally means ***either***: (i) an event or state of the world that must occur or fail to occur ***before*** a party has a duty to perform under a contract; or (ii) an event or state of the world the occurrence or nonoccurrence of which ***releases*** a party from its duty to perform under a contract. In other words, a condition is a provision, the fulfillment of which creates or extinguishes a duty to perform under a contract. A condition is a ***"promise modifier."*** There can be no breach of promise until the promisor is under an immediate duty to perform. He may insert conditions on his promise to prevent that duty of immediate performance from arising until the conditions are met.

a) Failure of Condition vs. Breach of Contract
The failure of a contractual provision that is only a condition is ***not a breach of contract***, but it discharges the liability of the promisor whose obligations on the conditional promise never mature.

Example: Gene agrees to sell his horse to Roy, the contract providing that delivery of possession will take place on June 1. On May 25, the horse dies. Was delivery of possession of the horse a condition? If so, its failure to occur will discharge Roy's duty to pay; however, Roy will not have a cause of action against Gene for nondelivery. Or was it a promise by Gene, the breach of which will give to Roy both an action against Gene for breach of contract and release him from his duty to pay?

An unexcused failure to perform a ***promise*** is always a breach of contract and always gives rise to liability, however minimal. On the other hand, nonfulfillment of a ***condition*** is ***not*** a breach of contract and does not give rise to liability.

b) Excuse of Performance
Breach of a ***promise*** by one party may or may not excuse the other party's duty to perform under the contract (*see* 6.b., *infra*). Nonfulfillment of a ***condition*** normally will excuse a duty to perform that was subject to the condition.

c) Interrelation of Conditions and Promises
If a party's ***promise*** to perform is subject to a condition, there can be no breach of contract by that party until the condition has been fulfilled.

b. Interpretation of Provision as Promise or Condition
As the above example indicates, it is of considerable importance whether any given contractual provision is to be interpreted as a promise or condition. The basic test is one of ***"intent of the parties."*** The courts employ several basic criteria in reaching a determination as to intent.

1) Words of Agreement
Words such as "provided," "if," and "when" usually indicate that an express condition rather than a promise was intended. Words such as "promise" and "agree" usually indicate a promise. However, words by themselves might not be determinative. Both the specific words of the phrase and the words of the rest of the agreement (thus the context of the entire contract) will be examined by the courts in drawing a conclusion.

2) Prior Practices
The prior practices of the contracting parties, particularly with one another, will be taken into consideration.

3) Custom
The custom with respect to that business in the community will be examined.

4) Third-Party Performance
If performance is to be rendered by a third party, it is more likely to be a condition than an absolute promise.

5) Courts Prefer Promise in Doubtful Situations
In doubtful situations, most courts will hold that the provision in question is a ***promise***. The underlying rationale is that this result will serve to support the contract, thereby preserving the expectancy of the parties. This preference is particularly significant in situations where the breaching party has ***substantially performed***, because if the provision is treated as a ***condition***, the nonbreaching party is completely discharged from her obligation; whereas, if the provision is treated as a ***promise***, the nonbreaching party must perform, although she may recover for the damage she has suffered as a result of the breach.

Example: Stan contracts to build a house for Natasha using pipe of Reading manufacture. In return, Natasha agrees to pay Stan $100,000. Without Stan's knowledge, a subcontractor mistakenly uses pipe of Cohoes manufacture, which is identical in quality and is virtually indistinguishable from Reading pipe. The substitution is not discovered until the house is completed, when replacement of the pipe would require substantial destruction of the house. Natasha refuses to pay Stan. The installation of Reading pipe was a promise, not a condition, of the contract; therefore, Stan has a claim against Natasha for $100,000, subject to her claim against him for breach of duty to use Reading pipe. To treat it as a condition would be unfair to Stan, because he would be penalized in an amount far greater than the amount of the damage suffered by Natasha.

Note: When seeking to establish the reasonable expectations of the parties, one should determine whether the performance of the stipulation goes to the "very root" of the contract's consideration. If so, it is probably a condition rather than a promise.

6) Reference to Time
A provision that states that a duty is to be performed "when" an event occurs raises an issue of whether the event is a condition or is intended to merely mark the passage of time. Courts prefer the time interpretation, which reduces the obligee's risk of forfeiture, unless the event is within the obligee's control. [*See* Restatement (Second) of Contracts §227]

Example: A subcontractor's contract with the general contractor provides that the general contractor will pay the subcontractor's fee when the general contractor is paid by the landowner. Absent language such as "on condition that," this contract language is interpreted as a time for payment, not a condition. Payment by the landowner is not within the subcontractor's control. Therefore, the general contractor must pay the subcontractor within a reasonable time regardless of whether the landowner pays the general contractor.

c. Provision Both Promise and Condition

1) Condition May Imply a Promise

When the occurrence of a condition is within the benefiting party's control, that party impliedly promises to act in good faith and use reasonable effort to cause the condition to occur.

Example: Buyer and Seller enter into an agreement for the sale of Blackacre. The written contract provides that the contract is contingent on Buyer obtaining a 30-year mortgage at 5%. Buyer changes his mind about the purchase and does not apply for any mortgages. Because of his lack of good faith reasonable effort to obtain a mortgage, Buyer's duty to perform under the contract will not be excused by the failure of the condition.

2) Express Promise and Condition

In some cases, a provision may be both a promise and a condition—i.e., a party may commit (promise) to bring about a given state of events, and the contract containing that commitment may also expressly state that the other party's duty to perform under the contract is conditioned on the occurrence of the state of events.

Example: Carrier promises to get Manufacturer's goods to Los Angeles by October 1, and the contract expressly provides that Manufacturer will have no duty to pay Carrier unless the goods arrive by that time. Getting the goods to Los Angeles by October 1 is both a promise by Carrier and a condition to Manufacturer's liability.

2. Classification of Conditions

a. Condition Precedent

A condition precedent is one that must occur ***before*** an absolute duty of immediate performance arises in the other party.

Example: Sal and Mary agree that "in consideration of Mary's promise to repay principal plus 8% interest, Sal hereby promises to loan Mary $50,000 for one year, provided that on July 1, the market value of Mary's country home is not less than $100,000." On July 1, Mary's country home is appraised at a market value of $80,000. Sal refuses to make the loan, and Mary sues. Sal wins because his duty to loan the $50,000 is subject to an express condition precedent. Because the condition was not satisfied, Sal's contingent liability never matured.

b. Conditions Concurrent

Conditions concurrent are those that are capable of occurring ***together***, and that the parties are bound to perform at the same time (e.g., tender of deed for cash). Thus, in effect, each is a condition "precedent" to the other.

Example: Smith and Jones agree that "in consideration of Jones's promise to pay the sum of $500, Smith promises to convey his 1970 Buick." Having signed this agreement, Jones never tenders the $500 and Smith does not tender the car. Neither party is in breach of contract. The contract is silent regarding the time and place of performance, but the promises exchanged as consideration can obviously be performed at the same time and place. Hence, tender of the promised performance by each party is a

constructive condition concurrent to liability of the other. Because both parties failed to tender performance, neither obligation matured.

c. Condition Subsequent

A condition subsequent is one the occurrence of which ***cuts off*** an already existing absolute duty of performance.

Example: Will and Grace enter the following contract: In consideration of Will's conveying his painting to her, Grace promises to pay Will $5,000 on July 1. Grace further promises to permit Will to retain the painting for purposes of exhibition during the months of July and August, provided security precautions for the safety of the painting are approved by Captain Smith. On July 1, Grace pays Will $5,000, and Will begins to exhibit the painting. On July 10, Captain Smith inspects security at the exhibition and declares it to be inadequate. Grace immediately asserts her right to possession, but Will refuses to surrender the painting. Grace is entitled to immediate possession of the painting. Her allowing Will to retain the painting for exhibition was subject to an express condition subsequent based on Captain Smith's approval of security precautions. Because the condition subsequent has ripened, Grace's conditional obligation to allow Will to retain the painting is extinguished.

3. Express Conditions

The term "express condition" normally refers to an ***explicit contractual provision***. It is an express statement in the contract providing that either (i) a party does not have a duty to perform unless some event occurs or fails to occur; or (ii) if some event occurs or fails to occur, the obligation of a party to perform one or more of his duties under the contract is suspended or terminated. Conditions of satisfaction are common express conditions.

a. Promisor's Satisfaction as Condition Precedent

Many contracts include an express condition that a party will pay only if "satisfied" with the other party's performance. Because it is a condition, the promisor is under no duty to pay unless she is satisfied. The issue is how the promisor's satisfaction is to be measured; i.e., whether the performance must meet with promisor's ***actual personal*** satisfaction, or must only be a performance that would meet with the satisfaction of a ***reasonable person***. The provision requiring the promisor's satisfaction is construed according to the ***subject matter*** of the contract.

1) Mechanical Fitness, Utility, or Marketability

In contracts involving mechanical fitness, utility, or marketability (e.g., construction or manufacturing contracts), a condition of satisfaction is fulfilled by a performance that would satisfy a ***reasonable person***. It is therefore immaterial that the promisor was not personally satisfied if a reasonable person would have accepted and approved the performance tendered.

2) Personal Taste or Judgment

If the contract involves personal taste or personal judgment, a condition of satisfaction is fulfilled only if the promisor is ***personally satisfied***. For example, contracts for portraits, dental work, or tailoring all require the promisor's personal satisfaction.

a) Lack of Satisfaction Must Be Honest and in Good Faith
Even if a condition requires personal satisfaction, it will fail to be fulfilled only if the promisor's lack of satisfaction is honest and in good faith. Therefore, if the promisor refuses to examine the promisee's performance, or otherwise rejects the performance in bad faith, the condition of satisfaction will be ***excused***.

b. Satisfaction of Third Person as Condition
In many contracts, an express condition requires the satisfaction of a third person rather than a party to the contract. In particular, construction contracts often include a condition requiring the satisfaction of the owner's architect or engineer. When the satisfaction of a third person is a condition, most courts take the position that the condition requires the ***actual personal satisfaction*** of the third person. As in the case where a party's personal satisfaction is required, however, a condition that requires a third person's personal satisfaction will be excused if the third person's dissatisfaction is not ***honest and in good faith***.

4. Constructive (Implied) Conditions
Sometimes it is implied that the duty to render performance under a contract is conditional upon the occurrence of some event or state of the world, even though the contract does not explicitly so state. In that case, there is said to be an "implied" or "constructive" condition that the relevant event or state of the world must occur before the performance of one or both parties comes due.

a. Constructive Conditions of Performance
By far the most important and common implied condition is that the duty of each party to render performance is conditioned on the ***other party*** either rendering ***his*** performance or making a tender of his performance.

Example: Owen and Pete make a contract under which Pete will paint Owen's house by May 30, and Owen will pay Pete $8,000 on June 1. It is an implied condition to Owen's duty to pay $8,000 that Pete shall have painted the house. If Pete fails to paint Owen's house by June 1, it has a dual effect: (i) it is a breach of contract for which Pete will be liable in damages, and (ii) it is a nonfulfillment of an implied condition to Owen's duty to pay, so Owen does not have a duty to pay Pete.

b. Constructive Conditions of Cooperation and Notice
Constructive conditions of cooperation and notice are common. Under a constructive condition of cooperation, the obligation of one party to render performance is impliedly conditioned on the other party's cooperation in that performance. Also, it is often a condition to one party's performance of a duty under a contract that the other party give him ***notice*** that the performance is due. A condition of notice is most commonly applied where a party could not reasonably be expected to know a fact that triggered the duty to perform unless such notice was given.

Examples: 1) Seller promises to deliver certain goods to the "No. 2 loading dock" of Buyer's factory. It is an implied condition to Seller's duty to deliver the goods that such a loading dock exists, that the dock is reasonably accessible for making a delivery, and that Buyer permits Seller to make the delivery at the dock.

2) Landlord leases a building to Tenant and promises to maintain and repair the interior of the building as necessary. It is an implied condition to Landlord's promise to repair that Tenant will give her reasonable notification of the need for repairs and will permit her to enter to make the repairs. Tenant therefore cannot sue Landlord for failure to make a needed repair unless he has first notified Landlord that the repair is required, and given Landlord an opportunity to make the repair.

c. Order of Performance
The courts will also imply conditions relating to the time for performing under the contract.

1) Simultaneous Performance Possible—Conditions Concurrent
If both performances can be rendered at the same time, they are constructively concurrent; thus, each is a condition "precedent" to the other. Hence, absent excuse, each party must first tender his own performance if he wishes to put the other under a duty of immediate performance resulting in breach if he fails to perform.

Example: Lulu agrees to sell Hank her old tractor for $4,000. Because Lulu can sign over title and Hank can hand over money at the same time, the conditions are constructively concurrent.

2) One Performance Takes Time—Conditions Precedent
If one performance will take a period of time to complete while the other can be rendered in an instant, completion of the longer performance is a constructive condition precedent to execution of the shorter performance.

Example: Lulu agrees to paint Hank's barn for $400. In absence of a contract provision to the contrary, Lulu must paint the barn before Hank must pay.

5. Effect of Condition—Equitable Remedy
If a contract is not enforceable due to the failure or occurrence of a condition, and one of the parties has fully or partially performed, he can usually recover under unjust enrichment theories (*see* VIII.C., *infra*), although the measure of damages in that case may be less advantageous than the contract price.

6. Have the Conditions Been Excused?
A duty of immediate performance with respect to a conditional promise does not become ***absolute*** until the conditions (i) have been ***performed***, or (ii) have been ***legally excused***. Thus, in analyzing a question, if the facts do not reveal performance of the applicable condition precedent or concurrent, look to see whether the condition has been excused. Excuse of conditions can arise in a variety of ways.

a. Excuse of Condition by Hindrance or Failure to Cooperate
If a party having a duty of performance that is subject to a condition (i.e., she is the party protected by the condition) prevents the condition from occurring, the condition will be excused if such prevention is ***wrongful***. Note, however, that it is not necessary to prove bad faith or malice. Courts construe the requirement simply to mean that the

other party would not have reasonably contemplated or assumed the risk of this type of conduct.

Example: Franz agrees to paint Worthington's portrait. Worthington's promise to pay for the portrait is conditional upon her being satisfied with it. Worthington refuses to even look at the portrait. Because of her refusal, the condition is excused and her promise to pay becomes absolute.

Note: It appears fairly well settled today that a condition will be excused not only by "active" noncooperation but by "passive" noncooperation as well.

b. Excuse of Condition by Actual Breach

An actual breach of the contract when performance is due will excuse the duty of counterperformance. Note, however, that counterperformance will be excused at common law ***only*** if the ***breach is material***. A minor breach may suspend this duty, but it will not excuse it. Even if the minor breach may be cured, it will not suffice to excuse conditions. Rather, the courts will make the nonbreaching party whole by either giving him damages or otherwise mitigating his promised performance so as to account for the breach. (As to rules determining materiality of breaches, *see* VII.B., *infra*.)

c. Excuse of Condition by Anticipatory Repudiation

Anticipatory repudiation occurs if a promisor, prior to the time set for performance of his promise, indicates that he will not perform when the time comes. If the requirements set forth below are met, this anticipatory repudiation will serve to excuse conditions.

1) Executory Bilateral Contract Requirement

Anticipatory repudiation applies only if there is a bilateral contract with ***executory (unperformed) duties on both sides***. If the nonrepudiating party has nothing further to do at the moment of repudiation, as in the case of a unilateral contract or a bilateral contract fully performed by the nonrepudiator, the doctrine of anticipatory repudiation does not apply. The nonrepudiator must wait until the time originally set for performance by the repudiating party. Until such time, the repudiator has the option to change his mind and withdraw the repudiation and perform in accordance with the contract. [*Accord:* UCC §2-611]

Example: Winston promises to pay Salem $2,000 on November 15 as consideration for Salem's car, the latter to be delivered on October 20. Salem delivers the car to Winston on October 20; on November 3, Winston repudiates. Because Salem does not have any more duties to perform, he will not have a cause of action until November 15.

2) Requirement that Anticipatory Repudiation Be Unequivocal

An anticipatory repudiation stems from the words or conduct of the promisor ***unequivocally*** indicating that he cannot or will not perform when the time comes. This statement must be positive.

Example: Wright states to Jones, "Business has not been going well and I have doubts about whether I will be able to perform my contract with you." This is ***not*** an anticipatory repudiation; mere expressions of doubt or fear will not suffice (although such expressions may establish prospective inability to perform, discussed below).

3) Effect of Anticipatory Repudiation
In the case of an anticipatory repudiation, the nonrepudiating party has four alternatives:

(i) Treat the anticipatory repudiation as a total repudiation and ***sue immediately***;

(ii) Suspend his own performance and ***wait to sue*** until the performance date;

(iii) Treat the repudiation as an offer to rescind and ***treat the contract as discharged***; or

(iv) Ignore the repudiation and ***urge the promisor to perform*** (but note that by urging the promisor to perform, the nonrepudiating party is not waiving the repudiation—she can still sue for breach and is excused from performing unless the promisor retracts the repudiation).

Note: UCC section 2-610 provides substantially identical alternatives to a nonrepudiating party when there is an anticipatory repudiation in the case of the sale of goods.

4) Retraction of Repudiation
A repudiating party may at any time before his next performance is due withdraw his repudiation unless the other party has ***canceled, materially changed*** her ***position*** in reliance on the repudiation, or otherwise indicated that she considers the ***repudiation final.*** Withdrawal of the repudiation may be in any manner that clearly indicates intention to perform, but must include any assurances justifiably demanded. [*See* UCC §2-611]

d. Excuse of Condition by Prospective Inability or Unwillingness to Perform
Prospective failure of condition occurs when a party has reasonable grounds to believe that the other party will be unable or unwilling to perform when performance is due.
Example: John contracts with Barbara to buy her house for $150,000. Payment is due on August 1. On July 10, John goes into bankruptcy (or Barbara transfers title to the house to Emily). Prospective inability to perform has occurred.

1) Distinguish from Actual and Anticipatory Repudiation
Prospective inability or unwillingness to perform is not an anticipatory repudiation because such a repudiation must be ***unequivocal***, whereas prospective failure to perform involves conduct or words that merely raise doubts that the party will perform. (In short, the distinction between anticipatory repudiation and prospective inability to perform is one of degree.)

2) What Conduct Will Suffice?
Any conduct may suffice for a finding that there is prospective inability or unwillingness to perform. Note that in judging this conduct, a ***reasonable person*** standard will be applied.

3) Effect of Prospective Failure
The effect of this prospective failure is to allow the innocent party to suspend further performance on her side until she receives ***adequate assurances*** that performance will be forthcoming. If she fails to obtain adequate assurances, she may be excused from her own performance and may treat the failure to provide assurances as a repudiation. (This same basic right is provided in UCC section 2-609—*see* VIII.A.2.c., *infra*.)

4) Retraction of Repudiation
As with anticipatory repudiation, retraction is possible if the defaulting party regains his ability or willingness to perform. However, this fact must be communicated to the other party in order to be effective. If the other party has already changed her position in reliance on the prospective failure, an attempted retraction may be ineffective.

e. Excuse of Condition by Substantial Performance
The performance of one contractual promise is usually a condition precedent to the duty of immediate performance of the return promise (*see* 4., *supra*). Technically, if the promise has not been completely performed, the other performance is not yet due. This can cause forfeiture if the breach is minor, because the promisee can receive almost complete performance with no duty to perform in return. To avoid this harsh result, the courts have adopted the "substantial performance" and "divisibility" concepts.

1) Rule of Substantial Performance
Generally, the condition of complete performance may be excused if the party has rendered substantial performance. In this case, the other party's duty of counter-performance becomes absolute. It should be noted, however, that courts generally apply this doctrine only where a ***constructive*** (implied in law) condition is involved. They will not apply it where there is an ***express*** condition for fear this would defeat the express intent of the parties.

2) Substantial Performance Arises If Breach Is Minor
Rules for determining substantiality of performance are the same as those for determining materiality of breach. (*See* VII.B.2., *infra*.) In other words, the test is whether the breach of contract by the performing party is material or minor. If it is material, then performance ***has not*** been substantial; if it is minor, performance ***has*** been substantial.

3) Inapplicable Where Breach "Willful"
Most courts will not apply the substantial performance doctrine if the breach was "willful." (This is so even though willfulness is only one of the six factors usually relied on in determining materiality of a breach. *See* VII.B.2., *infra*.) Trivial defects, however, even if willful, will be ignored by the courts as de minimis.

4) Damages Offset
Even though the party who has substantially performed is able to enforce the contract, the other party will be able to mitigate by deducting damages suffered due to the first party's incomplete performance.

5) Generally Inapplicable to Contracts for the Sale of Goods
For contracts for the sale of goods, the UCC's "***perfect tender rule***" gives the buyer the right to reject goods that do not conform to the contract in any manner, with a few exceptions (*see* VII.C., *infra*). [UCC §2-601]

f. Excuse of Condition by "Divisibility" of Contract
Divisibility, like the doctrine of substantial performance, is a concept designed to mitigate the harsh result of a potential forfeiture.

1) Rule of "Divisibility"
If a party performs one of the units of a divisible contract, he is entitled to the agreed-on equivalent for that unit even if he fails to perform the other units. It is not a condition precedent to the other party's liability that the whole contract be performed. However, the other party has a cause of action for failure to perform the other units and may withhold his counterperformance for those units.

Example: Cambridge Construction Co. is to build 10 houses for $800,000, at $80,000 per house, for Beth. Because the building takes a long time and payment can be rendered in one instant, the substantial completion of 10 houses would normally be a constructive condition precedent to payment. Completion of seven houses would leave Cambridge without any remedy on the contract itself (whatever rights it might have as a defaulting party would be by way of quasi-contractual relief). The divisibility doctrine allows Cambridge to sue for the pro rata price each time it completes a house.

2) What Is a "Divisible" Contract?
Obviously, the rule applies only if there is a finding that the contract is "divisible" (as compared to "entire"). ***Three tests*** must be ***concurrently*** satisfied in order to make this finding.

(i) The ***performance of each party is divided into two or more parts*** under the contract;

(ii) The ***number of parts due from each party is the same***; and

(iii) The ***performance of each part by one party is agreed on as the equivalent of the corresponding part*** from the other party, i.e., each performance is the quid pro quo of the other.

[Restatement (Second) of Contracts §240]

a) Interpretation
Decisions on divisibility are questions of interpretation. The underlying consideration is one of fairness. Generally, the courts will construe contracts as divisible so as to avoid hardships and forfeitures that might otherwise result.

b) Contract Expressly Indivisible
If the contract by its own terms is expressly indivisible, the court may not construe it as otherwise.

3) Sales of Goods—Installment Contracts
Like the common law, Article 2 assumes that a contract is not divisible unless it authorizes deliveries in several lots, in which case the contract is called an installment contract. In installment contracts, the price, if it can be apportioned, may be demanded for ***each lot*** unless a contrary intent appears. [UCC §§2-307, 2-612]

g. Excuse of Condition by Waiver or Estoppel
One having the benefit of a condition under a contract may indicate by ***words or conduct*** that she will not insist on that condition's being met. Consideration is not required for a valid waiver of condition. The courts, in certain circumstances, will enforce this expression on the basis that the party has "waived" the condition or is "estopped" from asserting it.

1) Estoppel Waiver
Whenever a party indicates that she is "waiving" a condition before it is to happen, or she is "waiving" some performance before it is to be rendered, and the person addressed ***detrimentally relies*** on the waiver, the courts will hold this to be a binding (estoppel) waiver. Note, however, that the promise to waive a condition may be retracted at any time ***before*** the other party has changed his position to his detriment.

2) Election Waiver
When a condition does not occur or a duty of performance is broken, the beneficiary of the condition or duty must make an election; she may: (i) terminate her liability, ***or*** (ii) continue under the contract. If she chooses the latter course, she will be deemed to have waived the condition or duty. This election waiver requires neither consideration nor estoppel (although estoppel elements are often present). Note that, unlike an estoppel waiver, an election waiver ***cannot be withdrawn***—even if the other party has not relied on it.

Example: Frederick contracted with Karen to sell her a new MP3 player in "perfect working order." In fact, the player when delivered had some minor mechanical troubles that Karen was apprised of at the time. Karen, nonetheless, elects to accept the player. She will be deemed to have waived the "perfect working order" condition.

3) Conditions that May Be Waived
If ***no consideration*** is given for the waiver, the condition must be ***ancillary or collateral*** to the main subject and purpose of the contract for the waiver to be effective. In other words, one cannot "waive" entitlement to the entire or substantially entire return performance. This would amount to a new undertaking that is really a gift in the disguise of a waiver.

Example: Robinson, a contractor, breaches a promise to build a garage for Hortense at a price of $6,000. Hortense says, "Even though you have not built the garage, I shall pay you the $6,000, waiving the constructive condition of performance." This waiver will not be enforceable; Robinson did not give consideration for the waiver, and the condition concerned the main subject and purpose of the contract.

4) Waiver in Installment Contracts
In an ***installment contract***, if a waiver is not supported by consideration, the beneficiary of the waived condition can insist on strict compliance with the terms of the contract for future installments (so long as there has been no detrimental reliance on the waiver) by giving notice that he is revoking the waiver.

Example: Carrie, a boutique owner, entered into an installment contract with Jimmy Shoos. Jimmy was to deliver 20 pairs of shoes to Carrie every week, payment due in cash on delivery ("C.O.D.") of each shipment. Once the deliveries started, Jimmy allowed Carrie to mail him a check one week after delivery for the first three deliveries, rather than demanding payment at the time the shoes were delivered. Jimmy will be held to have waived the C.O.D. term because he did not demand immediate payment for the first three shipments, but Jimmy may insist on compliance with the original terms for any future deliveries (so long as Carrie is given notice and has not detrimentally relied on the waiver).

5) Right to Damages for Failure of Condition
It is important to note that a waiver severs only the right to treat the failure of the condition as a total breach excusing counterperformance. However, the waiving party does ***not*** thereby waive her right to damages. Thus, for instance, in the example above involving delivery of the MP3 player in "perfect working order," the waiving party still has her right to damages for the defects in the player—she merely waived her right to treat the failure as a total breach excusing counterperformance.

h. Excuse of Condition by Impossibility, Impracticability, or Frustration
Conditions may be excused by impossibility, impracticability, or frustration of purpose. (*See* E.5., *infra*.)

E. HAS THE ABSOLUTE DUTY TO PERFORM BEEN DISCHARGED?

Once it is determined that a party is under an immediate duty to perform, the duty to perform must be discharged.

1. Discharge by Performance
The most obvious way to discharge a contractual duty is, of course, by full and complete performance.

2. Discharge by Tender of Performance
Good faith tender of performance made in accordance with contractual terms will also discharge contractual duties. Note that to tender performance the party must offer to perform and possess the ***present ability*** to perform; a mere promise of performance will not suffice.

3. Discharge by Occurrence of Condition Subsequent
The occurrence of a condition subsequent will serve to discharge contractual duties.

4. Discharge by Illegality
If the subject matter of the contract has become illegal due to a subsequently enacted law or

other governmental act, performance will be discharged. This is often referred to as "supervening illegality."

Example: Jim and Beam enter into a partnership contract to operate a tavern in the city of Clover. Subsequently, the Clover legislature enacts a prohibition law. The contract is discharged.

Note: If the illegality existed at the time the agreement was made, no contract was formed because of the illegality. (*See* IV.D., *supra*.)

5. Discharge by Impossibility, Impracticability, or Frustration

The occurrence of an unanticipated or extraordinary event may make contractual duties impossible or impracticable to perform or may frustrate the purpose of the contract. Where the nonoccurrence of the event was a ***basic assumption*** of the parties in making the contract and ***neither*** party has expressly or impliedly ***assumed the risk*** of the event occurring, contractual duties may be discharged.

Remember that the promisor's duties to perform serve as a condition precedent to the other party's duty to perform. Hence, if these duties should be excused by impossibility, impracticability, or frustration, the other party's contractual duties will also be discharged.

a. Discharge by Impossibility

Contractual duties will be discharged if it has become impossible to perform them.

1) Impossibility Must Be "Objective"

For this rule to operate, the impossibility must be "objective"; i.e., the duties could not be performed by anyone. "Subjective" impossibility will not suffice, i.e., where the duties could be performed by someone but not the promisor.

2) Timing of Impossibility

The impossibility must arise ***after*** the contract has been entered into. If the facts giving rise to impossibility already existed when the contract was formed, the question is not really one of "discharge of contractual duties." Rather, it is a "contract formation" problem, namely, whether the contract is voidable because of mistake.

3) Effect of Impossibility

If a contract is discharged because of impossibility, each party is excused from duties arising under the contract that are yet to be fulfilled. Either party may sue for rescission and receive restitution of any goods delivered, payments made, etc.

4) Partial Impossibility

If the performance to be rendered under the contract becomes only partially impossible, the duty may be discharged ***only to that extent***. The remainder of the performance may be required according to the contractual terms. This is so even though this remaining performance might involve added expense or difficulty.

5) Temporary Impossibility

Temporary impossibility ***suspends*** contractual duties; it does not discharge them. When performance once more becomes possible, the duty "springs back" into

existence. Note, however, that a duty will not "spring back" into existence if the burden on either party to the contract would be substantially increased or different from that originally contemplated.

6) Part Performance Prior to Impossibility—Quasi-Contractual Recovery
If part performance has been rendered by either party prior to the existence of the facts leading to impossibility, that party will have a right to recover in quasi-contract at the contract rate or for the reasonable value of his performance if that is a more convenient mode of valuation. (Note that such recovery will also be available when contract duties are discharged by impracticability or frustration, discussed below.)

7) Specific Situations

a) Death or Physical Incapacity
Death or the physical incapacity of a person ***necessary*** to effectuate the contract serves to discharge it.

Example: Helmut agrees to teach German to Max. Helmut's death or physical incapacity would discharge the contract. Max's death or physical incapacity would similarly discharge the contract. (The death or physical incapacity may also be that of a third person. Thus, for example, if Helmut had contracted with Max to teach German to Max's son, the death or physical incapacity of the son would also serve to discharge the contract.)

Note: Most fact situations on this point involve personal service contracts. Check to see whether the services involved are ***"unique."*** If the services are the kind that could be delegated (*see* IX.C.2.b., *infra*), the contract is ***not*** discharged by the incapacity of the person who was to perform them.

b) Supervening Illegality
As we have seen, supervening illegality may serve to discharge a contract. Many courts treat such supervening illegality as a form of impossibility.

c) Subsequent Destruction of Contract's Subject Matter or Means of Performance
If the contract's subject matter is destroyed or the designated means for performing the contract are destroyed, contractual duties will be discharged. Note, however, that this destruction must not have been the fault of either party. Substantial damage to the subject matter will generally be construed by the courts as the equivalent of "destruction."

Example: Olivia hires Charlie to replace the shingles on the roof of her house. When Charlie has completed 90% of the work, the house is hit by lightning and is destroyed by fire. The contract will be discharged for impossibility because there no longer is a house needing reshingling. Charlie will be able to recover for the work done in quasi-contract. (*See* VIII.C., *infra*.)

(1) Compare—Contracts to Build

A contractor's duty to ***construct*** a building is ***not*** discharged by destruction of the work in progress. *Rationale:* Construction is not rendered impossible; the contractor can still rebuild. However, if the destruction was not caused by the contractor, most courts will excuse the contractor from meeting the original deadline.

Example: Olivia hires Charlie to build her a garage. When Charlie has completed 90% of the work, the garage is hit by lightning and is destroyed by fire. Charlie will not be discharged from his contractual duty to build the garage because it is not impossible to rebuild the garage.

(2) Specificity Required

(a) Subject Matter

Note that destruction of the subject matter will render a contract impossible only if the very thing destroyed is necessary to fulfill the contract. If the thing destroyed is not actually necessary, impossibility is not a defense.

Example: Linda contracts to sell her car to John. Subsequently, the car is destroyed through no fault of either party. The contract will be discharged because of impossibility because the only car that could fulfill the obligation no longer exists.

Compare: John orders a new car from his local Kia dealer. While the car that the dealer ordered for John is being delivered from the factory, it is destroyed in a crash. The contract is not discharged for impossibility because it is not impossible for the dealer to get another Kia that will satisfy the contract.

(b) Specificity of Source

As with the destruction of the subject matter, destruction of a source for fulfilling the contract will render the contract impossible only if the source is the one source specified by the parties.

Example: Jackson contracts to sell Daley 100 tons of iron ore from the Blarney Iron Mine, which Jackson owns. A nearby dam breaks and floods the mine. Jackson will be discharged from the contract for impossibility.

Compare: Jackson, who owns the Blarney Iron Mine, contracts to sell Daley 100 tons of iron ore. A nearby dam breaks and floods Jackson's mine. Jackson will not be discharged from the contract because the contract did not specify that the iron ore was to come from Jackson's mine. Thus, iron ore from any other mine can fulfill the contract.

(3) If Risk of Loss Has Already Passed to Buyer
The rules relating to discharge because of destruction of the subject matter ***will not apply*** if the risk of loss has already passed to the buyer. The usual situations involve contracts for the sale of goods under the UCC and contracts for the sale of land where equitable conversion has taken place. In such cases, the seller may enforce the contract and the buyer will have to pay.

b. Discharge by Impracticability
Modern courts will also discharge contractual duties where performance has become impracticable.

1) Test for Impracticability
The test for a finding of impracticability is that the party to perform has encountered:

(i) ***Extreme and unreasonable*** difficulty and/or expense; and

(ii) Its nonoccurrence was a ***basic assumption*** of the parties.

In effect, the courts will allow relief against performance where subjective impossibility is found. It should be noted, however, that a mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does ***not*** amount to impracticability, because these are the types of risks that a fixed-price contract is intended to cover. Thus, the fact that something is more expensive—even much more expensive—is not impracticability. [Restatement (Second) of Contracts §261]

2) Contracts for the Sale of Goods
Article 2 generally follows the above rules for impossibility and impracticability. If performance has become impossible or commercially impracticable, the seller will be ***discharged to the extent of the impossibility or impracticability***. [U.C.C. §2-615]

a) Allocation of Risk
Generally, the seller assumes the risk of the occurrence of such unforeseen events and must continue to perform. However, if it is fair to say that the parties would not have placed on the seller the risk of the extraordinary occurrence, the seller will be discharged.

b) Events Sufficient for Discharge
Events sufficient to excuse performance include a ***shortage of raw materials*** or the inability to convert them into the seller's product because of contingencies such as war, strike, embargo, or unforeseen shutdown of a major supplier. Catastrophic local crop failure (as opposed to a mere shortage) also is sufficient for discharge. However, mere increases in costs are rarely sufficient for discharge unless they change the nature of the contract.

Example: Assume StoneOil contracted with Manuco to sell Manuco one million gallons of Persian Gulf crude oil. If a war subsequently breaks out in the Gulf, and supplies of Gulf oil are interrupted, StoneOil is discharged. However, if instead a war breaks out between Israel and Egypt and the Suez Canal is blocked, thus forcing StoneOil to ship the oil around the Cape of Good Hope, StoneOil will probably not be discharged merely because of the increase in the cost of shipping. [*See* Transatlantic Financing Co. v. United States, 363 F.2d 312 (D.C. Cir. 1966)]

Note: There is no bright line test for determining when a rise in price changes the nature of the contract, but increases in costs of more than 50% have been held to be insufficient. [*See, e.g.,* Iowa Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978)]

c) Seller's Partial Inability to Perform
If the seller's inability to perform as a result of the unforeseen circumstance is only partial, he ***must allocate deliveries*** among his customers and, at his option, may include in the allocation regular customers not then under contract. The seller must reasonably notify his buyers of any delay or reduction in deliveries because of unforeseen circumstances. A buyer who receives such a notification may refuse any particular delivery affected, and if the deficiency substantially impairs the whole contract, she may treat the contract as at an end.

3) Temporary or Partial Impracticability
The rules spelled out above for temporary and partial impossibility are equally applicable to temporary and partial impracticability.

c. Discharge by Frustration
Frustration will exist if the purpose of the contract has become valueless by virtue of some supervening event not the fault of the party seeking discharge. (Recall the *Coronation Cases* if you studied them.) If the purpose has been frustrated, a number of courts will discharge contractual duties even though performance of these duties is still possible. The elements necessary to establish frustration are as follows:

(i) There is some ***supervening act*** or event leading to the frustration;

(ii) At the time of entering into the contract, the parties ***did not reasonably foresee*** the act or event occurring;

(iii) The ***purpose*** of the contract has been completely or almost completely ***destroyed*** by this act or event; and

(iv) The purpose of the contract was realized by ***both parties*** at the time of making the contract.

Example: Sports, Inc. contracted to rent a sports stadium for a boxing match to be held on August 1 in the town of Greensville. On July 31, a sudden hurricane resulted in tremendous damage in Greensville, causing it to be classified as a "disaster area." No one could get in or out of the area. Sports, Inc.'s promise to rent the stadium (which was still intact) was discharged by frustration of purpose (a hurricane was not anticipated by the parties and it completely destroyed the value of the contract).

Note: Article 2's rules on impracticability apply equally to frustration situations.

d. Distinguish Uses of Defenses of Impossibility/Impracticability and Frustration
A seller of land, goods, or services will raise impossibility or impracticability as a defense that discharges performance. By contrast, the party who is supposed to pay (usually the buyer) will raise frustration of purpose as a defense discharging performance. Paying money is never impracticable.

Example: Caretaker is hired to tend to the mansion on Blackacre and signs a three-year employment contract to that effect at a rate of $30,000 per year. In the second year of Caretaker's contract, the mansion is destroyed by fire and the employer stops paying Caretaker. Caretaker sues the employer for breach and the employer countersues Caretaker. Caretaker will raise the defense of discharge by impossibility because the subject matter of the contract was destroyed. The employer will raise the defense of discharge by frustration of purpose for the same reason. The employer cannot claim impossibility because he is still able to pay money.

6. Discharge by Rescission
Rescission will serve to discharge contractual duties. Rescission may be either mutual or unilateral.

a. Mutual Rescission
The contract may be discharged by an ***express agreement*** between the parties to rescind. The agreement to rescind is itself a binding contract supported by consideration, namely, the giving up by each party of her right to counterperformance from the other. The reasons for entering into such an agreement are immaterial absent duress or fraud.

1) Contract Must Be Executory
For a contract to be effectively discharged by rescission, the duties must be executory on ***both*** sides.

a) Unilateral Contracts
If the contract is unilateral (i.e., only one party owes an absolute duty), a contract to mutually rescind where one party still has a duty to perform will be ineffective. The courts reason that the original promisor, who has not suffered a legal detriment, has not given consideration. Thus, for an effective rescission in a unilateral contract situation where the offeree has already performed, the rescission promise must be supported by one of the following:

(1) An offer of ***new consideration*** by the nonperforming party;

(2) Elements of ***promissory estoppel***, i.e., detrimental reliance; or

(3) Manifestation of an ***intent*** by the original offeree to make a ***gift*** of the obligation owed her.

b) Partially Performed Bilateral Contracts
A mutual agreement to rescind will usually be enforced when a bilateral contract has been partially performed. Whether the party who has partially performed will be entitled to compensation will depend on the terms of the rescission agreement. The party seeking such compensation must affirmatively prove his right to the compensation in order to recover.

2) Formalities
Mutual rescission may be made ***orally***. This is so even though the contract to be rescinded expressly states that it can be rescinded only by a written document. Several ***exceptions*** should be noted, however:

a) Subject Matter Within Statute of Frauds
If the subject matter of the contract to be rescinded falls within the Statute of Frauds (e.g., transfer of land), then the rescission should generally be in writing. Some courts, however, hold that even when the Statute of Frauds comes into play, the oral rescission will still be enforceable if it is "executed" or promissory estoppel is present.

b) Contracts for the Sale of Goods
In addition to the Statute of Frauds requirement with respect to contracts for the sale of goods, Article 2 requires a written rescission or modification if the original contract to be rescinded or modified expressly requires a written rescission. [U.C.C. §2-209(2)]

3) Contracts Involving Third-Party Beneficiary Rights
If the rights of third-party beneficiaries have already ***vested*** (*see* IX.B.2., *infra*), the contract may ***not*** be discharged by mutual rescission.

b. Unilateral Rescission
Unilateral rescission results when one of the parties to the contract desires to rescind it but the other party desires that the contract be performed according to its terms. For unilateral rescission to be granted, the party desiring rescission must have adequate legal grounds. Most common among these are mistake, misrepresentation, duress, and failure of consideration. If the nonassenting party refuses to voluntarily grant rescission, the other party may file an action in equity to obtain it. (*See* VIII.D., *infra*.)

7. Partial Discharge by Modification of Contract
If a contract is subsequently modified by the parties, this will serve to discharge those terms of the original contract that are the subject of the modification. It will ***not*** serve to discharge the ***entire contract***. To have such a partial discharge, the following requirements must usually be met.

a. Mutual Assent
The modifying agreement must have been mutually assented to. Note, however, that under the doctrine of ***reformation*** (VIII.E., *infra*), either of the parties to the contract may bring an equity action to have a contract's terms modified if the writing, through mistake or misrepresentation, does not incorporate the terms orally agreed on.

b. Consideration
Generally, consideration is necessary to modify a contract. However, the courts usually find consideration to be present because each party has limited his right to enforce the original contract as is. Check the facts to see whether the modification would operate to the benefit of one of the parties only. If so, it may be unenforceable without some consideration being given to the other party. (*See* discussion of the preexisting legal duty rule, III.B.2.c., *supra*.)

1) Requirement Where Modification Is Only "Correction"
No consideration is necessary where the effect of the modification is merely to correct an error in the original contract.

2) Contracts for the Sale of Goods
No consideration is needed for the modification of a contract for the sale of goods under Article 2, as long as the modification is sought in good faith. [U.C.C. §2-209(1)]

8. Discharge by Novation
A novation occurs when a new contract substitutes a new party to receive benefits and assume duties that had originally belonged to one of the original parties under the terms of the old contract. A novation will serve to discharge the old contract. The elements for a valid novation are as follows:

(i) A ***previous*** valid contract;

(ii) An ***agreement*** among all parties, including the new party (or parties) to the new contract;

(iii) The ***immediate extinguishment*** of contractual duties as between the original contracting parties; and

(iv) A valid and enforceable ***new*** contract.

Example: John contracts to sell his house to Jane for $150,000. Before the closing date, John, Jane, and Joanna execute a new agreement wherein all rights and duties in connection with the transaction are transferred by Jane to Joanna. The original John-Jane contract will be discharged by novation.

9. Discharge by Cancellation
The destruction or surrender of a written contract will not usually by itself discharge the contract. If, however, the parties manifest their ***intent*** to have these acts serve as a discharge, it will usually have this effect if consideration or one of its alternatives is present.

10. Discharge by Release

A release and/or contract not to sue will serve to discharge contractual duties. The release or contract not to sue usually must be in ***writing*** and supported by ***new consideration*** or ***promissory estoppel*** elements. [*Compare* U.C.C. §1-306—governing the sale of goods and requiring an authenticated record (such as a writing) but ***not*** requiring consideration]

11. Discharge by Substituted Contract

A contract may be discharged by a substituted contract. This occurs when the parties to a contract enter into a second contract that ***immediately revokes*** the first contract.

a. Revocation May Be Express or Implied

The second contract may revoke the first contract either expressly or impliedly. The first contract will be impliedly revoked if the second contract's terms are inconsistent with the terms of the first contract.

b. Intent Governs

Whether a second contract will constitute a substituted contract depends on whether the parties intend an immediate discharge or a discharge only after performance of the second contract. If an immediate discharge is intended, there is a substituted contract. If the parties intend the first contract to be discharged only after performance of the second contract, there is an executory accord (*see* 12.a., *infra*) rather than a substituted contract.

12. Discharge by Accord and Satisfaction

A contract may be discharged by an accord and satisfaction.

a. Accord

An accord is an agreement in which one party to an existing contract agrees to accept, in lieu of the performance that she is supposed to receive from the other party to the existing contract, some other, different performance.

Example: Mel owes Alice $1,000 under a contract. Mel promises to give his car to Alice in settlement of the debt, and Alice agrees to accept the car in settlement of the debt. This agreement is an accord.

1) Requirement of Consideration

In general, an accord must be supported by consideration. Where the consideration is of a lesser value than the originally bargained-for consideration in the prior contract, it will be sufficient if the new consideration is of a ***different type*** or if the claim is to be paid to a ***third party***.

Example: Fred owes Barney $700 under an existing contract. Fred offers Barney a new TV set worth $500 in lieu of the existing debt. Barney accepts. This new consideration is sufficient to form a valid accord, even though it is worth less than the consideration originally owed, because it is of a different type.

a) Partial Payment of Original Debt

One frequently encountered problem involves the offer of a smaller amount than the amount due under an existing obligation in satisfaction of the claim,

i.e., partial payment of an original debt. The ***majority view*** is that this will suffice for an ***accord and satisfaction*** if there is a ***"bona fide dispute"*** as to the claim or there is otherwise some alteration, even if slight, in the debtor's consideration. (*See* discussion of the preexisting legal duty rule, III.B.2.c., *supra*.)

2) Effect of Accord
The accord, taken alone, will not discharge the prior contract. It merely ***suspends*** the right to enforce it in accordance with the terms of the accord contract.

b. Satisfaction
Satisfaction is the performance of the accord agreement. Its effect is to discharge not only the original contract but also the accord contract as well.

c. Effect of Breach of Accord Agreement Before Satisfaction
What happens when the accord agreement is not followed by an immediate satisfaction, and one of the parties breaches the accord agreement?

1) Breach by Debtor
If the breach is by the debtor, the creditor may sue either on the original undischarged contract ***or*** for breach of the accord agreement.

2) Breach by Creditor
If the accord agreement is breached by the creditor, i.e., he sues on the ***original*** contract, the debtor has two courses of action available:

a) She may raise the accord agreement as an equitable defense and ask that the contract action be dismissed.

b) As an alternative, she may ***wait until she is damaged***, i.e., the creditor is successful in his action on the original contract, and then bring an action at law for damages for breach of the accord contract.

d. Checks Tendered as "Payment in Full"
If a monetary claim is ***uncertain*** or is subject to a ***bona fide dispute***, an accord and satisfaction may be accomplished by a ***good faith*** tender and acceptance of a check when that check (or an accompanying document) ***conspicuously states*** that the check is tendered in ***full satisfaction*** of the debt. [UCC §3-311]

13. Discharge by Account Stated
An account stated is a contract between parties whereby they agree to an amount as a ***final balance due*** from one to the other. This final balance encompasses a number of transactions between the parties and serves to merge all of these transactions by discharging all claims owed. In other words, all rights as to the individual, original transactions are discharged and the new agreement is enforceable. For an agreement to qualify as an account stated, the parties must have had ***more than one prior transaction*** between them.

a. Writing Generally Not Required
It is not necessary that the account stated be in writing. However, if one or more of

the original transactions was subject to the Statute of Frauds, a writing will usually be required.

b. Account May Be Implied

It is also not required that an account stated be "express." It may be implied.

Example: Cindy and Dave have entered into a number of transactions. Cindy presents Dave with a bill for $1,000 covering all of these previous transactions. Dave does not object to this amount within a reasonable period of time. It will be held that there is an account stated.

14. Discharge by Lapse

Where the duty of each party is a condition concurrent to the other's duty, it is possible that on the day set for performance, neither party is in breach and their contractual obligations lapse.

a. Time When Lapse Becomes Effective

If the contract states that time is "of the essence," the lapse will occur immediately; otherwise the contract will lapse after a reasonable time.

Example: Sally contracts with Bobby to sell 100 widgets to her for $1,000 on November 15. On November 15, Sally does not tender the widgets and Bobby does not tender the $1,000. Ten months afterward, Sally attempts to put Bobby in breach by tendering the widgets. Sally will not have a claim, as the contractual obligations of both parties have been discharged by lapse.

15. Effect of Running of Statute of Limitations

If the statute of limitations on an action has run, it is generally held that an action for breach of contract may be barred. Note, however, that only ***judicial remedies*** are barred; the running of the statute ***does not discharge the duties***. (Hence, if the party who has the advantage of the statute of limitations subsequently agrees to perform, new consideration will not be required.)

VII. BREACH

A. WHEN DOES A BREACH OCCUR?

If it is found that (i) the promisor is under an absolute duty to perform, and (ii) this absolute duty of performance has not been discharged, then this failure to perform in accordance with contractual terms will amount to a breach of the contract. The nonbreaching party who sues for breach of contract must show that she is ***willing and able*** to perform but for the breaching party's failure to perform.

B. MATERIAL OR MINOR BREACH—COMMON LAW CONTRACTS

Once you have determined that there is a breach of contract, the next determination to be made in a common law contract situation is whether that breach is material or minor.

1. Effect of Breaches

a. Minor Breach
A breach of contract is minor if the obligee gains the substantial benefit of her bargain despite the obligor's defective performance. Examples would be insignificant delays in completing performance or small deficiencies in the quality or quantity of performance when precision is not critical. The effect of a minor (immaterial) breach is to provide a remedy for the immaterial breach to the aggrieved party. The aggrieved party is ***not relieved*** of her duty of performance under the contract.

b. Material Breach
If the obligee does not receive the ***substantial benefit of her bargain*** as a result of failure to perform or defective performance, the breach is considered material. If the breach is material, the consequences are more severe. The nonbreaching party (i) may treat the contract as at an end, i.e., any duty of counterperformance owed by her will be discharged, and (ii) will have an ***immediate right*** to all remedies for breach of the entire contract, including total damages.

c. Minor Breach Coupled with Anticipatory Repudiation
If a minor breach is coupled with an anticipatory repudiation (*see* VI.D.6.c., *supra*), the nonbreaching party may treat it as a material breach; i.e., she may sue immediately for total damages and is permanently discharged from any duty of further performance. Indeed, the courts hold that the aggrieved party must not continue on, because to do so would be a failure to mitigate damages. The UCC modifies this to permit a party to complete the manufacture of goods to avoid having to sell unfinished goods at the lower salvage value. (*See infra.*)

d. Material Breach of Divisible Contract
In a divisible contract, recovery is available for substantial performance of a divisible part even though there has been a material breach of the entire contract.

2. Determining Materiality of Breach

a. General Rule
Whether a breach is material or minor is a fact question. To make this determination, the courts generally apply the following six criteria [Restatement of Contracts §275]:

1) Amount of Benefit Received
Look to the extent to which the nonbreaching party will receive substantially the benefit she could have anticipated from full performance. The greater the extent, the less material the breach.

2) Adequacy of Damages
Look to the extent to which the injured party may be adequately compensated in damages. The greater the extent, the less material the breach.

3) Extent of Part Performance
Look to the extent the party failing to perform completely has already performed or made preparations to perform. The greater the extent, the less material the breach.

4) Hardship to Breaching Party
Look to the extent of hardship on the breaching party should the contract be terminated. If a finding of materiality and termination of the contract would cause great hardship to the breaching party, the breach is less likely to be found to be material.

5) Negligent or Willful Behavior
Look to the extent of negligent or willful behavior of the party failing to perform. The greater the extent, the more material the breach.

6) Likelihood of Full Performance
Look to the extent of likelihood the party who has failed to perform will perform the remainder of his contract. The greater the extent, the less material the breach.

b. Failure of Timely Performance
The basic question here is whether the parties to the contract must perform on time. Assuming that the defaulting party had a duty of immediate performance when his failure to perform occurred, then his failure to perform on time will always be a breach of contract. There are, however, additional specific rules for determining the materiality of breach by failure of timely performance.

1) Nature of Contract or Time of the Essence Provision
Unless the nature of the contract is such as to make performance on the exact day agreed upon of vital importance (e.g., contract for use of a wedding chapel), or the contract by its terms provides that time is of the essence, failure by a promisor to perform at the stated time will not be material. Merely providing a date for performance does not make time of the essence.

a) Time of the Essence
Traditionally, courts have held that if the contract contains a "time is of the essence" provision, any delay is a material breach of contract. The modern trend, however, is for the court to consider all of the circumstances, including the time of the essence clause, in determining whether performance at the time specified is important. For example, if the parties sign a preprinted form contract that contains a "time is of the essence" clause and there are no surrounding circumstances indicating that performance on that date is of vital importance, a court could find that delayed performance is only a minor breach. [*See* Restatement (Second) of Contracts §242(c)]

2) When Delay Occurs
Delay at the onset of performance before the delaying party has rendered any part of his agreed-on performance is more likely to be considered material than delay where there has been part performance.

3) Mercantile Contracts
In mercantile contracts, timely performance as agreed is important, and unjustified delay is material.

4) Land Contracts
More delay in land contracts is required for materiality than in mercantile contracts.

5) Availability of Equitable Remedy
In equity, the courts generally are much more lenient in tolerating considerable delay. Hence, they will tend to find the breach immaterial and award compensation for the delay where possible.

c. Material Breach and Substantial Performance
Whether performance is "substantial" depends on the quantity and quality of the performance. If the performance is "substantial," the breach is not material.

C. PERFECT TENDER RULE—SALE OF GOODS

Article 2 generally does not follow the common law substantial performance doctrine. Instead, it follows the perfect tender rule—if ***goods or their delivery fail to conform to the contract in any way***, the buyer generally may reject all, accept all, or accept any commercial units and reject the rest.

1. Commercial Unit Defined

A "commercial unit" is one that by commercial usage is treated as a single whole for the purpose of sale, and division of which materially impairs its value (e.g., place setting of dishes). A commercial unit may be a single article (e.g., a machine) or a set of articles (e.g., a suite of furniture), a quantity (e.g., a bale, a gross), or any other unit treated in use or in the relevant market as a single whole. [UCC §2-105(6)] The test for "commercial unit" is "not only what unit has been the basis of contract, but also whether the partial acceptance produces so materially an adverse effect upon the remainder as to constitute bad faith." [UCC §2-601, comment 1]

Example: Widgets are always sold in units of 100. Buyer orders 500 widgets. They arrive but are found to be defective. Buyer keeps 25 and rejects 475. Buyer is probably required to reject in units of 100 and the rejection of the 75 above 400 is probably wrongful.

2. Right to Reject Cut Off by Acceptance

A buyer's right to reject under the perfect tender doctrine generally is cut off by acceptance. Under Article 2, a buyer accepts when:

(i) After a reasonable opportunity to inspect the goods, she ***indicates to the seller that they conform*** to requirements or that she will keep them even though they fail to conform;

(ii) She ***fails to reject*** within a reasonable time after tender or delivery of the goods or fails to seasonably notify the seller of her rejection; or

(iii) She does any ***act inconsistent with the seller's ownership***.

[UCC §2-606]

a. Notice
If in connection with rejection the buyer fails to state that the goods have a particular

defect that is ascertainable by reasonable inspection, she ***cannot rely on that defect*** to justify rejection or to show seller's breach ***if***:

(i) The ***seller could have cured*** the defect if he had been told about it; or

(ii) ***Between merchants*** when the ***seller has***, after rejection, ***made a request*** in writing for a full and final written statement of all defects upon which the buyer proposes to rely.

[UCC §2-605]

Example: Buyer has ordered blue widgets. Buyer rejects because the shipment did not contain the widget wrench that, under the contract, went with each widget. Buyer does not give the reason for rejection. If Seller had known the reason, he could have had the necessary number of widget wrenches at Buyer's business within hours. That probably would have constituted an adequate cure. If so, Buyer's rejection is unjustified; she will not be able to rely on the absence of the wrenches as a reason for rejection or as the basis for a claim for damages.

3. Buyer's Responsibility for Goods After Rejection

a. Buyer Must Hold Goods with Reasonable Care

After rejecting goods in her physical possession, the buyer has an obligation to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them. If the seller has no agent or place of business within the market area where the goods are rejected, a ***merchant*** buyer has an obligation to obey any reasonable instructions as to the rejected goods (i.e., she must arrange to reship the goods to a destination designated by the seller or resell on request of the seller, if reasonable). [UCC §2-602]

b. When Seller Gives No Instructions on Disposal of Goods

If a seller gives no instructions within a reasonable time after notification of rejection, the buyer may ***reship*** the goods to the seller, ***store*** them for the seller's account, or ***resell*** them for the seller's account. The buyer has a ***security interest*** in rejected goods in her possession for ***any part of the price already paid*** and for expenses reasonably incurred in connection with handling them after rejection. [UCC §2-604]

c. When Buyer Resells Goods

If the buyer does resell rejected goods, she is entitled to have her expenses of selling and any commission ordinarily paid in the trade or, if there is none, a reasonable commission not exceeding 10%. [UCC §2-603(2)]

4. Buyer's Right to Revoke Acceptance

Once goods are accepted, the buyer's power to reject the goods generally is terminated and the buyer is obligated to pay the price less any damages resulting from the seller's breach. However, under limited situations, a buyer may revoke an acceptance already made. A proper revocation of acceptance has the effect of a rejection.

a. When Acceptance May Be Revoked
The buyer may revoke her acceptance of goods if the goods have a defect that ***substantially impairs*** their ***value*** to her ***and***:

(i) She accepted them on the ***reasonable belief that the defect would be cured*** and it has not been; or

(ii) She accepted them because of the ***difficulty of discovering defects*** or because of the ***seller's assurance that the goods conformed*** to the contract.

[UCC §2-608]

b. Other Requirements for Revocation of Acceptance
Revocation of acceptance must occur:

1) ***Within a reasonable time*** after the buyer discovers or should have discovered the defects; and

2) ***Before any substantial change in the goods occurs*** that is not caused by a defect present at the time the seller relinquished possession. [UCC §2-608(2)]
Example: If the buyer receives defective goods and due to her own fault damages the goods in some other way, she can no longer revoke acceptance, because the damage is a substantial change in the goods not caused by the seller. Similarly, if the buyer receives damaged goods and then resells the goods, she cannot revoke acceptance and her only remedy is to recover damages for the defect (*see* VIII.B.2.a.2), *infra*). If the buyer sells some but not all of the defective units, she can revoke acceptance (within a reasonable time) of any unsold unit.

5. Exceptions to the Perfect Tender Rule

a. Installment Contracts
The right to reject when a contract is an installment contract (i.e., when there is to be more than one delivery) is much more limited than in a single delivery contract situation. Installment contracts follow a rule akin to the common law substantial performance doctrine. In an installment contract situation, an installment can be rejected only if the nonconformity ***substantially impairs*** the value of that installment ***and cannot be cured*** (*see* below). In addition, the whole contract is breached only if the nonconformity ***substantially impairs*** the value of the ***entire contract***.
Example: Steve and Becky enter into a contract under which Steve is to deliver to Becky 100 blue widgets on the first day of each month, and Becky is to pay Steve $275 by the 10th of each month. Steve makes a perfect delivery the first two months and Becky makes the required payments. On the first day of the third month, Steve sends only 90 widgets. The 10-widget shortfall would be a basis for rejection under the perfect tender rule, but because this is an installment contract, Becky cannot reject the installment unless she can show that the 10-widget shortfall substantially impairs the value of that installment, and she cannot cancel the entire contract unless she can show that the shortfall substantially impairs the value of the entire contract.

b. Seller's Right to Cure

1) Single Delivery Contracts

a) Seller Can Cure by Notice and New Tender Within Time for Performance

If the buyer has rejected goods because of defects, the seller may within the time originally provided for performance "cure" by giving ***reasonable notice*** of her intention to do so and making a ***new tender of conforming goods*** which the buyer must then accept. [UCC §2-508]

Example: Buyer ordered blue widgets for delivery during the first 15 days of June. The widgets are delivered on June 9, but the widget wrenches required by the contract are missing. Seller can cure this defect by giving reasonable notice of his intention to provide and subsequently providing wrenches for the widgets by June 15. If he does, Buyer must accept, or Buyer will breach the contract.

b) Seller's Right to Cure Beyond Original Contract Time

Ordinarily, the seller has no right to cure beyond the original contract time. However, in cases where the buyer rejects a tender of nonconforming goods that the seller ***reasonably*** believed would be acceptable "with or without money allowance," the seller, upon a reasonable notification to the buyer, has a ***further reasonable time*** beyond the original contract time within which to make a conforming tender. A seller will probably be found to have had reasonable cause to believe that the tender would be acceptable if the seller can show that (i) trade practices or prior dealings with the buyer led the seller to believe that the goods would be acceptable, or (ii) the seller could not have known of the defect despite proper business conduct (e.g., packaged goods purchased from a supplier).

Examples: 1) In the last example above, widgets are delivered without wrenches on June 15. Seller and Buyer have had a number of contracts over the years for the sale of widgets in which the wrench was a part of the contract. On several occasions, Seller has not been able to deliver the wrenches, and on each occasion, Buyer has accepted the widgets with a reduction in price and purchased the wrenches from another source. This time Buyer rejects the widgets. Seller will have a reasonable time after June 15 within which to cure by furnishing the wrenches.

2) Barry ordered 100 barrels of grade A oil from Sonya to be delivered on or before January 1. On January 1, Sonya delivered to Barry 100 barrels of oil that she had purchased from her supplier, Refineco. Upon delivery, Barry opened a barrel and found that the oil was grade B oil. Barry immediately rejected the delivery. Sonya checked with Refineco and discovered that Refineco had made a packaging error and

could replace the oil within two days. Assuming two days is a reasonable time under the circumstances (e.g., if Barry does not need the oil immediately), Sonya will have a right to cure even though the time for performance has passed.

2) Installment Contracts
Article 2 provides that a defective shipment in an installment contract cannot be rejected ***if the defect can be cured***. Ordinarily, defects in the particular goods themselves cannot be cured, so the buyer can reject them, but then might be required to accept substitute goods under the provisions discussed above. Note that a deficiency in quantity may be cured by an additional delivery, and a delivery of too much may be cured by acceptance or return of a part. [UCC §2-612]

D. ANTICIPATORY REPUDIATION

Recall that an anticipatory repudiation (*see* VI.D.6.c., *supra*) can be treated as an immediate breach of contract.

E. BREACH OF WARRANTY

At common law, the rule was caveat emptor—let the buyer beware. Once goods were accepted, the seller's obligations were discharged. However, as we have seen, today sellers give warranties as to the condition of the goods that apply even after acceptance. Failure to live up to these warranties constitutes a breach of warranty, for which a remedy is available.

VIII. REMEDIES

A. NONMONETARY REMEDIES

There are two broad branches of remedies available in breach of contract situations: nonmonetary and monetary. The primary nonmonetary remedy for exam purposes is specific performance, but Article 2 has a number of other specific nonmonetary remedies for certain situations involving contracts for the sale of goods.

1. Specific Performance

If the ***legal remedy is inadequate***, the nonbreaching party may seek specific performance, which is essentially an order from the court to the breaching party to perform or face contempt of court charges. The legal remedy (damages) generally is inadequate when the ***subject matter of the contract is rare or unique***. The rationale is that if the subject matter is rare or unique, damages will not put the nonbreaching party in as good a position as performance would have, because even with the damages the nonbreaching party would not be able to purchase substitute performance.

a. Available for Land and Rare or Unique Goods

Specific performance is always available for land sale contracts because all land is considered to be unique. It is also available for goods that are rare or unique at the time performance is due (e.g., rare paintings, gasoline in short supply because of oil embargoes, etc.).

b. Not Available for Service Contracts

Specific performance is not available for breach of a contract to provide services, even if the services are rare or unique. This is because of problems of enforcement (it would be difficult for the court to supervise the performance) and because the courts feel it is tantamount to involuntary servitude, which is prohibited by the Constitution.

1) Injunction as Alternate Remedy

In contrast, a court may ***enjoin*** a breaching employee from working for a competitor throughout the duration of the contract if the services contracted for are rare or unique. This is allowed because less court supervision is required for a negative injunction than for a specific performance decree, and the prohibition against working (as opposed to the requirement of working) does not run afoul of the Constitution. The rationale for this approach is that an employee providing rare or unique services expressly or impliedly covenants that she will not work for a competitor during the contract term.

c. Covenant Not to Compete

Most courts will grant an order of specific performance to enforce a contract not to compete if: (i) the services to be performed are unique (thus rendering money damages inadequate); and (ii) the covenant is reasonable. To be reasonable:

(i) The covenant must be reasonably necessary to protect a ***legitimate interest*** of the person benefited by the covenant (i.e., an employer or the purchaser of the covenantor's business);

(ii) The covenant must be reasonable as to its ***geographic scope and duration*** (i.e., it cannot be broader than the benefited person's customer base and typically cannot be longer than one or two years); and

(iii) The covenant ***must not harm the public***.

Example: A locksmith agrees to sell his shop to a competitor and agrees not to open a new locksmith shop within 75 miles of his old shop within the next year. The covenant not to compete probably will be upheld.

d. Equitable Defenses Available

Because specific performance is an equitable remedy, it is subject to equitable defenses. The most frequently claimed equitable defenses are laches, unclean hands, and sale to a bona fide purchaser.

1) Laches

The equitable defense of laches arises when a party delays in bringing an equitable action and the delay prejudices the defendant (e.g., the delay has substantially increased the cost or difficulty of performance). Note that mere delay itself is not a ground for this defense.

2) Unclean Hands

The unclean hands defense arises when the party seeking specific performance is guilty of some wrongdoing in the transaction being sued upon (e.g., the defendant

entered into the contract because of the plaintiff's lies). Note that the wrongdoing must be related to the transaction being sued upon; it is not sufficient that the plaintiff has defrauded other persons in similar transactions.

3) Sale to a Bona Fide Purchaser
If the subject matter of a goods or land contract has already been sold to another who purchased for value and in good faith (i.e., a bona fide purchaser), the right to specific performance is cut off.

Example: Store contracts to sell a specific van Gogh painting to Ben. Before Store delivers the painting to Ben, Carla, who is unaware of Ben's contract with Store, offers to buy the same van Gogh from Store. Store accepts Carla's offer and gives the painting to Carla. Ben may not obtain specific performance.

2. Nonmonetary Remedies Under Article 2

a. Buyer's Nonmonetary Remedies

1) Cancellation
If a buyer rightfully rejects goods because they do not conform to the contract, one of her options is simply to cancel the contract.

2) Buyer's Right to Replevy Identified Goods

a) On Buyer's Prepayment
If a buyer has made at least ***part payment*** of the purchase price of goods that have been identified under a contract and the seller ***has not delivered*** the goods, the buyer may ***replevy*** the goods from the seller in two circumstances:

(i) The seller becomes ***insolvent*** within 10 days after receiving the buyer's first payment; or

(ii) The goods were purchased for ***personal, family, or household purposes.***

In either case, the buyer must ***tender*** any unpaid portion of the purchase price to the seller. [UCC §2-502]

b) On Buyer's Inability to Cover
In addition, the buyer may replevy undelivered, identified goods from the seller if the buyer, after reasonable effort, is ***unable to secure adequate substitute goods*** (i.e., cover). [UCC §2-716(3)]

Example: Buyer and Seller enter into a contract for the delivery of 10,000 widgets on December 31. Seller, who has identified goods to the contract (e.g., seller has set aside 10,000 widgets on his loading dock), refuses to deliver. Buyer makes reasonable efforts to find widgets from another source, but the earliest delivery date he can arrange is March 15. The widgets are needed for Buyer's manufacturing operations in February and March. Buyer can replevy the goods from Seller. However,

if the widgets were not to be used by Buyer until June, widgets for March 15 delivery would probably be reasonable substitute goods and Buyer could not recover the widgets from Seller.

3) Buyer's Right to Specific Performance
A right closely related to the buyer's right to replevy is her right to specific performance "where the goods are unique or in other proper circumstances." [UCC §2-716(1)] The court may order specific performance ***even where the goods have not yet been identified*** to the contract by the seller. The comments to section 2-716 say that inability to cover is "strong evidence of other circumstances." Thus, buyers in inability-to-cover situations have their choice of replevin or specific performance remedies. Of course, a specific performance remedy is always discretionary with the court, and unclean hands, laches, etc., might bar an equity action but would not affect a replevin recovery. In any case, keep in mind that ***replevin will lie only for identified goods***, while specific performance may be decreed even though the goods have not previously been identified.

b. Seller's Nonmonetary Remedies

1) Seller's Right to Withhold Goods
If the buyer fails to make a payment due on or before delivery, the seller may withhold delivery of the goods. The seller may also withhold goods when the goods are sold on credit and, before the goods are delivered, the seller discovers that the buyer is insolvent. However, in such a case, the seller must deliver the goods if the buyer tenders cash for their payment. [UCC §2-702]

2) Seller's Right to Recover Goods

a) Right to Recover from Buyer on Buyer's Insolvency
If a seller learns that a buyer has received delivery of goods on credit while insolvent, the seller may reclaim the goods upon demand made within 10 days after the buyer's receipt of the goods. However, the 10-day limitation does not apply if a misrepresentation of solvency has been ***made in writing*** to the particular seller ***within three months*** before delivery. Note that the seller's right to reclaim the goods is subject to the rights of a buyer in the ordinary course or any other good faith purchaser. [UCC §2-702]

b) Right to Recover Shipped or Stored Goods from Bailee

(1) On Buyer's Insolvency
The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent. Of course, the seller must deliver the goods if the buyer tenders cash for their payment. [UCC §2-705(1)]

(2) On Buyer's Breach
The seller may stop delivery of carload, truckload, planeload, or larger shipments of goods when the buyer breaches the contract or when the

seller has a right to withhold performance pending receipt of assurances. (*See* c., *infra,* on the right to demand assurances.) [UCC §2-705(1)]

(3) When Goods May Not Be Stopped
The seller may stop delivery of the goods to the buyer ***until*** the buyer receives: (i) the goods or a negotiable document of title covering the goods; or (ii) an acknowledgment from a bailee other than the carrier that it is holding the goods for the buyer. [UCC §2-705(2)]

(4) Obligation of Carrier or Bailee
The seller's notification must come in time to give the person in possession a ***reasonable time to stop delivery***. If a negotiable document covers the goods, the carrier or bailee is not obligated to obey a stop order until the document is surrendered.

3) Seller's Ability to Force Goods on Buyer Limited
The seller's ability to force goods on a buyer is limited to an action for price when the seller is unable to resell the goods to others at a reasonable price. (*See* B.2.b.2), *infra*.)

c. Right to Demand Assurances
Under Article 2, actions or circumstances that increase the risk of nonperformance by a party to the contract but do not clearly indicate that performance will not be forthcoming, may ***not*** be treated immediately as an anticipatory repudiation (*see* VI.D.6.c., *supra*). Instead, if there are ***reasonable grounds for insecurity*** with respect to the other party's performance, a party may demand assurances that the performance will be forthcoming at the proper time. The demand for assurances must be made ***in writing***. Until the party receives adequate assurances, he may suspend his own performance. [UCC §2-609] If the proper assurances are not given within a reasonable time (i.e., within 30 days after a justified demand for assurances), he may then treat the contract as repudiated. What constitutes an adequate assurance depends on the facts of the case.

Examples: 1) Seller hears a rumor, in fact false, that Buyer is in financial trouble. Seller reasonably believes that the rumor may have foundation in fact. He is justified in making a demand for assurances and withholding any goods for which he has not been paid. Buyer, within a reasonable time, sends a financial report from her banker showing good financial condition. This is adequate assurance and Seller must resume performance.

2) Same facts as above except that Buyer ***is*** in bad financial condition. Adequate assurance may require a third party of good credit to back up Buyer.

3) Same facts as above. Buyer does not give any assurances. Seller may treat the failure to give assurances as a repudiation of the contract.

B. MONETARY REMEDY—DAMAGES

The most frequently sought remedy for breach of contract is an action at law for damages. In cases of willful breach, courts are more likely to be flexible in determining the plaintiff's damages alternatives.

1. Types of Damages

a. Compensatory Damages

The purpose of contract damages is to give compensation for the breach—i.e., to ***put the nonbreaching party in the position she would have been in had the promise been performed*** so far as money can do this. The most common measure of this is the value of the breaching party's performance that was lost (expectation damages), plus incidental and consequential damages, less any loss or cost saved by not having to perform. [Restatement (Second) of Contracts §347]

1) "Standard Measure" of Damages—Expectation Damages

In most cases, the plaintiff's standard measure of damages will be based on an "expectation" measure, i.e., sufficient damages for her to buy a ***substitute performance***. This is also known as ***"benefit of the bargain"*** damages.

2) Reliance Damage Measure

If the plaintiff's expectation damages will be too speculative to measure (e.g., the plaintiff cannot show with sufficient certainty the profits she would have made if the defendant had performed the contract), the plaintiff may elect to recover damages based on a "reliance" measure rather than an expectation measure. Reliance damages award the plaintiff the cost of her performance; i.e., they are designed to ***put the plaintiff in the position she would have been in had the contract never been formed***.

Example: J-Mart gives Sam a "dealer franchise" to sell J-Mart's products in a stated area for one year. In preparation for performance, Sam spends money on advertising, hiring sales personnel, and acquiring premises that cannot be used for other purposes. J-Mart then repudiates before performance begins. If it cannot be established with reasonable certainty what profit Sam would have made if the contract had been performed (i.e., Sam's expectation damages), Sam can recover as reliance damages his expenditures in preparation for performance.

3) Consequential Damages

Consequential damages are special damages and reflect losses over and above standard expectation damages. These damages result from the nonbreaching party's particular circumstances. Usually, consequential damages are lost profits resulting from the breach. These damages may be recovered only if: (i) at the time the contract was made, a ***reasonable person*** would have ***foreseen*** the damages as a probable result of a breach, (ii) the damages could not have been avoided through reasonable efforts, and (iii) the damages can be proved with reasonable certainty. Whether damages were avoidable and whether they are certain are issues with respect to any recovery. Foreseeability is the key issue for consequential damages. To recover consequential damages, the plaintiff must show that the breaching party knew or had reason to know of the special circumstances giving rise to the damages.

Example: Alex and Becky make a written contract under which Alex is to recondition by a stated date a used machine owned by Becky so

that it will be suitable for sale by Becky to Cindy. Alex knows when they make the contract that Becky has contracted to sell the machine to Cindy but knows nothing of the terms of Becky's contract with Cindy. Because Alex delays in returning the machine to Becky, Becky is unable to sell it to Cindy and loses the profit that she would have made on that sale. Becky's loss of reasonable profit was foreseeable by Alex as a probable result of the breach at the time the contract was made. [Restatement (Second) of Contracts §351]

Compare: Suppose in the above example that the profit that Becky would have made was extraordinarily large because Cindy promised to pay an exceptionally high price as a result of a special need for the machine. Again Alex is aware of the contract with Cindy but unaware of its terms. Alex is not liable for Becky's loss of profit beyond what would ordinarily result from such a contract. The exceptionally high price paid by Cindy was not foreseeable by Alex as a probable result of the breach at the time the contract was made. [Restatement (Second) of Contracts §351]

Note that in contracts for the sale of goods, ***only a buyer*** may recover consequential damages.

4) Incidental Damages—Contracts for the Sale of Goods
In contracts for the sale of goods, compensatory damages may also include incidental damages. Incidental damages include expenses reasonably incurred by the buyer in inspection, receipt, transportation, care, and custody of goods rightfully rejected and other expenses reasonably incident to the seller's breach, and by the seller in storing, shipping, returning, and reselling the goods as a result of the buyer's breach.

5) Certainty Rule
The plaintiff must prove that the losses suffered were certain in their nature and ***not speculative***. Traditionally, if the breaching party prevented the nonbreaching party from setting up a new business, courts would not award lost profits from the prospective business as damages, because they were too speculative. However, modern courts may allow lost profits as damages if they can be made more certain by observing similar businesses in the area or other businesses previously owned by the same party.

b. Punitive Damages
Punitive damages, awarded to punish a defendant for wrongful conduct, are generally ***not*** awarded in contract cases.

c. Nominal Damages
Nominal (token) damages (e.g., $1) may be awarded where a breach is shown but no actual loss is proven.

d. Liquidated Damages

The parties to a contract may stipulate what damages are to be paid in the event of a breach. These liquidated damages must be in an amount that is reasonable in view of the actual or anticipated harm caused by the breach.

1) Requirements for Enforcement

Liquidated damage clauses will be enforceable if the following two requirements are met:

(i) Damages for contractual breach must have been ***difficult to estimate or ascertain at the time the contract was formed***.

(ii) The amount agreed on must have been a ***reasonable forecast*** of compensatory damages in the case of breach. The test for reasonableness is a comparison between the amount of damages prospectively probable at the time of contract formation and the liquidated damages figure. If the liquidated damages amount is unreasonable, the courts will construe this as a ***penalty*** and will not enforce the provision.

a) UCC Rule

The UCC allows a court to consider actual damages to validate a liquidated damages clause. Even if the clause was not a reasonable forecast of damages at the time of the contract formation, it will be valid if it was reasonable in light of the subsequent actual damages. [UCC §2-718(1)]

2) Recoverable Even If No Actual Damages

If the above requirements are met, the plaintiff will receive the liquidated damages amount. Most courts hold this is so even if no actual money or pecuniary damages have been suffered. Should one or both of the above requirements not be met, the provision fails and the plaintiff will recover only those damages that she can ***prove***.

3) Effect of Electing Liquidated or Actual Damages

Should a contract stipulate that the plaintiff may elect to recover liquidated damages set by a clause or actual damages, the liquidated damages clause may be unenforceable.

2. Contracts for Sale of Goods

a. Buyer's Damages

1) Seller Does Not Deliver or Buyer Rejects Goods or Revokes Acceptance

The buyer's basic damages where the seller does not deliver or the buyer properly rejects or revokes her acceptance of tendered goods consist of the difference between the contract price and either the market price or the cost of buying replacement goods (i.e., ***cover***), plus incidental and consequential damages (*see* above), if any, less expenses saved as a result of the seller's breach. In the case of a seller's anticipatory repudiation, the buyer's damages are measured as of the time she learns of the breach.

a) Difference Between Contract Price and Market Price
If the buyer measures damages by the difference between contract price and market price, market price usually is determined as of the time the buyer learns of the breach and at the place of tender. [UCC §2-713] Note that the ***buyer's damages*** are measured as of the ***time she learns of the breach***, while the ***seller's damages*** are measured as of the ***time for delivery***. (*See* b.1)a), *infra*.)

b) Difference Between Contract Price and Cost of Replacement Goods—"Cover"
Cover is the usual measure of damages for a buyer. Typically, if a buyer is not sent the goods contracted for, he will go out into the marketplace to buy replacement goods. If the buyer chooses the cover measure (i.e., difference between contract price and cost of buying replacement goods), the buyer must make a ***reasonable contract*** for substitute goods ***in good faith*** and ***without unreasonable delay.*** [UCC §2-712]

Example: Seller and Buyer have a contract for the sale of 10,000 widgets at $1 per widget. Seller does not deliver. At the time and place for determining market price, the average price of widgets is $1.05. However, Buyer made a replacement contract within a reasonable time and in good faith at a price of $1.07. Buyer can recover $700 based on her replacement costs. If, on the other hand, Buyer could have bought substitute widgets for $1.03 while the general market price was $1.05, but she chose not to cover, she could recover $500 based on the difference between contract and market prices, rather than being limited to her cover costs.

2) Seller Delivers Nonconforming Goods that Buyer Accepts

a) Warranty Damages
If the buyer accepts goods that breach one of the seller's warranties, the buyer may recover as damages "loss resulting in the normal course of events from the breach." The basic measure of damages in such a case is the difference between the ***value of the goods as delivered*** and the ***value they would have had if they had been according to contract***, plus incidental and consequential damages. [UCC §2-714] (*See* V.D.5.f., *supra*.)

b) Notice Requirement
To recover damages for any defect as to accepted goods, the buyer must, ***within a reasonable time after she discovers or should have discovered the defect***, notify the seller of the defect. If she does not notify the seller within a reasonable time, she loses her right to sue. "Reasonable time" is, of course, a flexible standard.

3) Seller Anticipatorily Breaches Contract
Under section 2-713, the measure of damages when the seller anticipatorily breaches the contract is the difference between the ***market price at the time the buyer learned of the breach*** and the ***contract price***.

4) Consequential Damages

As noted above, a seller is liable for consequential damages arising from his breach if: (i) he had reason to know of the buyer's general or particular requirements, and (ii) the subsequent loss resulting from those needs could not reasonably be prevented by cover. Particular needs must be made known to the seller, but general requirements usually need not be. [UCC §2-715(2)]

a) Goods for Resale

If the buyer is in the business of reselling the goods, the seller is deemed to have knowledge of the resale.

b) Goods Necessary for Manufacturing

If a seller knows that the goods he provides are to be used in the manufacturing process, he should know that his breach would cause a disruption in production leading to a loss of profits.

b. Seller's Damages

1) Buyer Refuses to Accept Goods or Anticipatorily Breaches Contract

The seller's basic damages when the buyer refuses to accept goods or repudiates are either the difference between the contract price and the market price or the difference between the contract price and the resale price of the particular goods, plus incidental (but ***not*** consequential) damages, if any, less expenses saved as a result of the breach. If damages based on the difference between the contract price and market or resale price do not put the seller in as good a position as performance would have, then the seller may recover lost profits plus incidental damages. [UCC §§2-706, 2-708, 2-710] In the case of a buyer's anticipatory breach, the seller's damages are measured as of the actual time for performance, unless the suit comes to trial before the time for performance, in which case damages are measured as the time the seller learned of the breach.

a) Difference Between Contract Price and Market Price

The market price is measured as of the time and at the place for ***delivery***.

b) Difference Between Contract Price and Resale Price

This is the usual measure of a seller's damages. If the seller chooses to resell, he must do so under the provisions of section 2-706, which requires a ***good faith, commercially reasonable sale*** that may be either private or public (auction). In the case of a private sale, the breaching buyer must be given reasonable notice of intention to resell. In the case of an auction sale, the sale must be at a usual market for such goods if such a market is reasonably available. Notice of the sale must be given to the breaching buyer unless the goods are perishable or threaten to decline rapidly in value. Only existing and identified goods may be sold, unless there is a market in futures for the particular goods. The seller may buy the goods at an auction sale.

c) Damages Based on Lost Profits

The previous two measures of damages might not give adequate compensation for the buyer's breach in situations where the seller can obtain or manufacture as many goods as he can sell (e.g., a car dealership). In such a

case, the seller is known as a ***lost volume seller***, because although he is able to resell the goods for the same or similar price as in the initial contract, he loses ***volume*** of business: But for the buyer's breach, the seller would have made ***two*** sales instead of one. Generally, lost profit is measured by the contract price with the breaching buyer minus cost to the seller.

Example: Seller, a distributor of widgets, can get all of the widgets he needs for sale. He makes a contract to sell 10,000 widgets to Buyer at a price of $1 per widget. Buyer repudiates the contract. Seller resells the widgets he had identified to Buyer's contract to Z for $1 per widget. If damages are measured by the difference between the contract price and resale price, Seller will be denied recovery. However, assuming Seller paid 85¢ per widget for these widgets, his lost profit on the Buyer deal is $1,500 ($10,000 less $8,500), because even if Buyer had not breached, Seller would have been able to supply Z with widgets. Because Buyer's breach did not ***enable*** Seller to make the sale to Z, and because the sale to Z would have been made in any event, the only way to make Seller whole is to allow him to recover his lost profits, i.e., $1,500. If Seller would have incurred sales commissions of $500 and delivery expenses of $100 if Buyer had taken the goods, but does not now incur those expenses, the saved expenses reduce the recovery. Therefore, the recovery would be $900 ($1,500 less saved expenses of $600).

Compare: Seller and Buyer enter into a contract for the sale of a particular painting by van Gogh at a price of $25,000. Seller paid $15,000 for the painting two years earlier. Buyer repudiates. Seller resells to Z at $24,000. Seller's measure of damages is $1,000 plus incidental damages. Seller cannot get the $10,000 lost profit measure (i.e., the difference between the contract price and what Seller paid for the painting) because there is only one painting, and Seller could not have made the sale to Z but for Buyer's repudiation.

2) Action for Price

If the buyer has accepted the goods and has not paid, or has not accepted the goods, and the seller is ***unable to resell*** them at any reasonable price, or if the goods have been lost or damaged at a time the risk of loss was on the buyer (*see* V.D.2., *supra*), the seller may maintain an action against the buyer for the full contract price. [UCC §2-709]

3. Contracts for Sale of Land

The standard measure of damages for breach of land sale contracts is the difference between the contract price and the fair market value of the land.

4. Employment Contracts

In employment contracts, check to see whether the breach was by the employer or the employee.

a. Breach by Employer
Irrespective of when the breach occurs—i.e., before performance, after part performance, or after full performance, the standard measure of the employee's damages is the ***full contract price***.

b. Breach by Employee
If an employee materially breaches an employment contract, the employer is entitled to recover the cost of replacing the employee (i.e., the wages the employer must pay to a replacement employee minus the breaching employee's wages). The breaching employee may offset money owed for work done to date.

5. Construction Contracts
If construction contracts are involved, check to see whether the owner or the builder is breaching.

a. Breach by Owner
If the owner has breached, check to see when the breach occurred.

1) Breach Before Construction Started
If the breach occurred before construction started, the builder is entitled to the ***profits*** he would have derived from the contract.

2) Breach During Construction
If the breach occurs during construction, the builder is entitled to any ***profit*** he would have derived from the contract ***plus*** any ***costs*** he has incurred to date. The formula is also stated as the contract price minus the cost of completion. Either formula will give the same result.

3) Breach After Construction Completed
If the breach occurs after construction has been completed, the builder is entitled to the full ***contract price plus interest*** thereon.

b. Breach by Builder
If the breach is by the builder, check to see when it occurred.

1) Breach Before Construction Started
If the builder breaches before construction, the owner's measure of damages is the ***cost of completion***, i.e., the amount above the contract price that it will cost to get the building completed ***plus*** reasonable compensation for any delay in performance.

2) Breach During Construction
If the builder breaches after partially performing, the owner is entitled to the ***cost of completion plus reasonable compensation for any delay*** in performance. If, however, completion would involve undue economic waste, the measure of damages will be the difference between the value of what the owner ***would have received*** if the builder had properly performed the contract and the value of what the owner ***actually received***.

Example: Homeowner and Builder enter into a contract to build a house. The contract provides, among other things, that all of the plumbing pipes will be copper. After the plumbing is installed throughout the house, but before construction of the house is completed, Homeowner discovers that the pipes installed were made of polyvinyl chloride ("PVC"), and not copper. Homeowner insists that Builder remove the entire plumbing system and replace the PVC pipes with copper pipes. The house with PVC pipes would be valued at $500 less than it would have been had copper pipes been installed. However, it would cost Builder $10,000 in labor and materials to rip out the PVC pipes and replace them with copper pipes. *Result:* Builder would not be compelled to replace the pipes, and Homeowner's damages would be $500, which may be offset against the amount owed to Builder.

3) Breach by Late Performance

If the builder completes performance, but it is late, the owner has a right to damages for any loss incurred by not being able to use the property when performance was due, e.g., loss of reasonable rental value when property could have been leased. However, if damages for this "lost use" are not easily determined or were not foreseeable at the time the contract was entered into, the owner can recover only the ***interest*** on the value of the building as a capital investment.

c. Restoration and Economic Waste

Usually, when a building contract is not properly performed, the owner is entitled to the cost of fixing the defect. However, as noted in the pipes example above, unless there is special significance attached to use of a particular item (e.g., the owner is the CEO of the particular brand of copper pipe specified) and that significance is communicated to the builder, a court will not order a remedy that results in undue economic waste. Moreover, courts are split on the result when a party contracts to restore property and willfully refuses to do so because it is much more costly than any diminution in value of the property.

Example: Farmer and GasCo enter into a two-year contract that permits GasCo to explore Farmer's property and extract any natural gas it finds in exchange for a fixed sum and a promise to restore the land to its pre-exploration status upon completion of the two-year term. At the end of the term, GasCo determines that it will cost $200,000 to restore the property. Although it cannot be used for farming, the land has lost only $5,000 in value. Courts are split on whether GasCo must pay the $200,000 to restore the property or only the $5,000 loss in value. GasCo will argue that to pay the $200,000 is economic waste. Farmer will argue that it bargained for the restoration and GasCo will be unjustly enriched if it does not have to follow through—giving GasCo a $195,000 windfall at Farmer's expense.

6. Contracts Calling for Installment Payments

If a contract calls for payments in installments and a payment is not made, there is only a partial breach. The aggrieved party is limited to recovering only the missed payment, not the entire

contract price. However, the contract may include an ***acceleration clause*** making the entire amount due on any late payment, in which case the aggrieved party may recover the entire amount. [Restatement (Second) of Contracts §243(3)]

7. Avoidable Damages (Mitigation)

Under the common law, the nonbreaching party cannot recover damages that could have been avoided with reasonable effort. Thus, she must refrain from piling up losses after she receives notice of the breach; she must not incur further expenditures or costs, and she must make reasonable efforts to cut down her losses by procuring a substitute performance at a fair price. Should she not do so, she will not be allowed to recover those damages that might have been avoided by such mitigation after the breach. Generally, a party may ***recover the expenses of mitigation***. Note the following specific contract situations:

a. Employment Contracts

If the breaching employer can prove that a comparable job in the same locale was available, then contract damages against that breaching employer for lost wages will be reduced by the wages that the plaintiff would have received from that comparable job.

b. Manufacturing Contracts

Generally, in a contract to manufacture goods, if the person for whom the goods are being manufactured breaches, the manufacturer is under a duty to mitigate by ***not continuing work*** after the breach. However, if the facts are such that completion of the manufacturing project will decrease rather than increase damages, the manufacturer has a right to continue.

Example: Partly manufactured goods may be without value because they cannot be sold. The nonbreaching manufacturer may complete production and recover for his expenses in doing so, because finished goods usually can be resold, and the damages will be decreased as a result.

c. Construction Contracts

A builder does not owe a duty to avoid the consequences of an owner's breach, e.g., by securing other work, but does have a duty to mitigate by ***not continuing work*** after the breach. Again, however, if completion will decrease damages, it will be allowed.

d. Contracts for Sale of Goods

Under Article 2, the rule of mitigation generally does not apply. An injured buyer is not required to cover, and an injured seller is not required to resell. Market damages are always available if the buyer does not cover or the seller does not resell. Recall, however, that the seller generally cannot bring an action against the buyer for the ***full contract price*** (rather than market or resale damages) unless the goods cannot be resold at a reasonable price or were damaged or lost when the risk of loss was on the buyer. (*See* 2.b.2), *supra*.)

C. RESTITUTION

As an alternative to the contract damages discussed above, restitution may be available in a contract-type situation. Restitution is not really part of contract law, but rather is a distinct concept. Restitution is based on preventing ***unjust enrichment*** when one has conferred a benefit on another without gratuitous intent. Restitution can provide a remedy not only when a contract

exists and has been breached, but also when a contract is unenforceable, and in some cases when no contractual relationship exists at all between the parties.

1. Terminology

When a contract is unenforceable or no contract between the parties exists, an action to recover restitutionary damages often is referred to as an action for an ***implied in law*** contract, an action in ***quasi-contract***, or an action for ***quantum meruit***.

2. Measure of Damages

Generally, the measure of restitution is the ***value of the benefit conferred***. Although this is usually based on the benefit received by the defendant (e.g., the increase in value of the defendant's property or the value of the goods received), recovery may also be measured by the "detriment" suffered by the plaintiff (e.g., the reasonable value of the work performed or the services rendered) if the benefits are difficult to measure or the "benefit" measure would achieve an unfair result.

Example: Homeowner hires Painter to paint Homeowner's house in exchange for $5,000. When the job is 70% complete, Homeowner orders Painter to stop because Homeowner does not like the new color. The value of the work performed thus far is $4,000. Although the value of Homeowner's house might not have been increased by the partially finished paint job, Painter may recover in a restitutionary action the $4,000 value of the services rendered.

3. Specific Applications

a. When Contract Breached

When a contract has been breached and the nonbreaching party has not fully performed, he may choose to cancel the contract and sue for restitution to prevent unjust enrichment. Note that if the plaintiff has fully performed, he is ***limited to his damages under the contract.*** This may be less than he would have received in a restitutionary action because a restitutionary remedy is not limited to the contract price (*see* example below).

1) "Losing" Contracts

A restitutionary remedy often is desirable in the case of a "losing" contract (i.e., a contract in which the actual value of the services or goods to be provided under the contract is higher than the contract price), because normal contract expectation damages or reliance damages would be for a lesser amount.

Example: Owner and Builder enter into a contract under which Builder is to remodel Owner's kitchen for $30,000, to be paid on completion. It turns out Builder underestimated the cost of the remodel by failing to take into account increasing supply costs. Builder estimated that the job would end up costing him $33,000. When the remodel was nearly complete, Owner told Builder that he was out of funds for home improvements and could not pay him. Builder ceased work on the job. At that point, Builder had spent $32,000 on the remodel. Builder may recover the $32,000 in restitution, even though his contract damages would have been only $30,000.

2) Breach by Plaintiff

Typically, the plaintiff will be seeking restitution because the defendant breached the contract. However, under some circumstances, a plaintiff may seek restitution even though the plaintiff is the party who breached. If the breach was intentional, some courts will not grant the breaching party restitution; modern courts, however, will permit restitutionary recovery but limit it to the contract price less damages incurred as a result of the breach.

Example: Client hires Attorney to represent Client in a contract dispute. Attorney prepares the case, but withdraws without good cause. The case is settled favorably for Client. Modern courts will allow Attorney to recover for the value of the services he rendered to Client, up to the contract price, reduced by the reasonable amount Client had to expend to hire another attorney.

a) Restitution of Advance Payments or Deposit If Buyer of Goods in Breach

Article 2 has very specific rules concerning whether and how much a breaching buyer can recover of advance payments. If the buyer has paid part of the purchase price in advance and then breaches the contract, he can usually recover some of the payments.

(1) General Offset Provision

When the buyer breaches, the seller may keep advance payments totaling 20% of the purchase price or $500, whichever is less. The balance must be returned to the buyer. [UCC §2-718(2)(b)]

(2) Effect of Liquidated Damages Provision

If there is a valid liquidated damages clause, the seller is required to refund only the excess of the buyer's payments over the amount of liquidated damages. [UCC §2-718(2)(a)]

(3) Seller's Right to Greater Damages

The general offset rule above applies only if the seller cannot prove greater actual damages. If the seller can prove damages in excess of 20% of the price or $500, he may recover them. Even if he cannot prove actual damages beyond the offset, he is additionally entitled to incidental damages and the value of any benefits received by the buyer. [UCC §2-718(3)]

b. When Contract Unenforceable—Quasi-Contract Remedy

Restitution may be available in a ***quasi-contract*** action when a contract was made but is unenforceable and unjust enrichment otherwise would result.

Examples: 1) Aristotle hires Derek to sign autographs in Aristotle's sporting goods store one day next month and gives Derek half of his $1,000 fee upon making the contract. Derek then dies and so is discharged from his obligation to perform. Aristotle can recover the $500 from Derek's estate as restitution in quasi-contract.

2) Owner hires Builder to repair Owner's house. After Builder has completed half of the repair work, the house is destroyed by a tornado.

Although the parties will be discharged for impossibility, Builder will be able to recover in restitution for the valuable improvements made to the house before it was destroyed.

3) Landlord promises to sell Tenant five acres of a 1,000-acre tract that Tenant is leasing, but the contract fails to state which five acres. Tenant plants fruit trees on the five acres that he thinks were intended. Tenant cannot enforce the promise because it does not specify which five acres were intended, but he can recover restitution in a quasi-contract action for the value of the fruit trees.

c. When No Contract Involved—Quasi-Contract Remedy

Restitution may also be available in a ***quasi-contract*** action when there is no contractual relationship between the parties if:

(i) The plaintiff has ***conferred a benefit*** on the defendant by rendering services or expending properties;

(ii) The plaintiff conferred the benefit with the ***reasonable expectation of being compensated*** for its value;

(iii) The defendant ***knew or had reason to know*** of the plaintiff's expectation; and

(iv) The defendant would be ***unjustly enriched*** if he were allowed to retain the benefit without compensating the plaintiff.

Example: Doctor witnesses an automobile accident and rushes to aid an unconscious victim. Doctor can recover the reasonable value of his services.

Note: Where the parties are in a ***close relationship*** to one another, it is usually presumed that the benefits were given gratuitously and the party claiming relief bears the burden of showing that they were conferred with an expectation of being paid therefor.

D. RESCISSION

Rescission is a remedy whereby the original contract is considered voidable and rescinded. The parties are left as though a contract had never been made.

1. Grounds

The grounds for rescission must have occurred either before or at the time the contract was entered into. The grounds are:

a. ***Mutual mistake*** of a material fact (*see* IV.B.1., *supra*);

b. Unilateral mistake if the ***other party knew*** or should have known of the mistake;

c. Unilateral mistake if ***hardship to the mistaken party is so extreme*** it outweighs the other party's expectations under the contract;

d. ***Misrepresentation of fact or law*** by either party as to a material factor in the negotiations that was relied upon; and

e. ***Other grounds***, such as duress, undue influence, illegality, lack of capacity, and failure of consideration.

2. Defenses
Generally all equitable defenses (e.g., laches, unclean hands) are available in a rescission action. Note that the plaintiff's negligence is not a defense.

3. Additional Relief
If the plaintiff has paid money to the defendant, she is entitled to restitution in addition to rescission.

E. REFORMATION

Reformation is the remedy whereby the writing setting forth the agreement between the parties is changed so that it conforms to the original intent of the parties.

1. Grounds

a. Mistake
To reform a contract because of mistake, there must be: (i) an agreement between the parties, (ii) an agreement to put the agreement in writing, and (iii) a variance between the original agreement and the writing.

b. Misrepresentation
If a writing is inaccurate because of a misrepresentation, the plaintiff can choose between reformation and avoidance. To qualify for reformation, the misrepresentation must relate to the content or the legal effect ***of the record***. The court will reform the writing to reflect the ***expressed*** intent of the parties. Misrepresentations as to the subject matter of the agreement are not grounds for reformation because the court will not remake the parties' bargain. Rescission and damages are the proper remedy for that.

Example: Seller owns Blackacre, which is encumbered by a mortgage. Seller and Buyer agree that Buyer will purchase Blackacre subject to the mortgage. Buyer does not agree to assume the mortgage. If Seller inserts a clause under which Buyer agrees to assume the mortgage and Buyer signs without knowledge of this, Buyer is entitled to reformation. [*See* Bradshaw v. Provident Trust Co., 158 P. 274 (Or. 1916)]

2. Negligence Does Not Bar Reformation
Failure to read the record of the agreement does not preclude a party from obtaining reformation. In nearly every case in which the record does not reflect the agreement, either one or both parties have failed to read it.

3. Clear and Convincing Evidence Standard
The variance between the antecedent agreement and the writing must be established by clear and convincing evidence.

4. Parol Evidence Rule and Statute of Frauds Do Not Apply
The parol evidence rule is not applied in reformation actions. Likewise, the majority rule is

that the Statute of Frauds does not apply—but many courts will deny reformation if it would add land to the contract without complying with the Statute of Frauds.

5. Defenses
In addition to the general equitable defenses, the existence of a bona fide purchaser for value is also a defense to reformation. If the subject matter of the contract is sold to a bona fide purchaser, reformation will not be allowed. Similarly, reformation is not permitted if the rights of third parties will be unfairly affected.

F. STATUTE OF LIMITATIONS UNDER UCC

States have enacted differing statutes of limitation for contracts actions in general, and some have specific limitations periods for specific types of contracts. For sales contracts, however, the UCC provides for a ***four-year statute*** of limitations. [UCC §2-725]

1. Parties May Agree to Shorter Period
The parties to a sales contract may shorten the limitations period by agreement to ***no less than one year***, but they may not lengthen the period.

2. Accrual of Action
The statutory period begins to run when the cause of action accrues. The cause of action accrues when a party can bring suit, i.e., when the breach occurs. The statutory period begins to run regardless of whether the aggrieved party knows about the breach. [UCC §2-725(2)]

3. Breach of Warranty Actions
For a breach of warranty action, the breach occurs and the limitations period begins to run upon ***delivery*** of the goods. This is true even if the buyer does not discover the breach until much later.

a. Warranty Extends to Future Performance
If there is an express warranty that explicitly extends to future performance of the goods, the four-year period does not begin to run until the buyer should have discovered the breach.

Example: Buyer purchases a lawnmower from Seller. In the contract, Seller specifically warrants that all parts will be free from defect for five years. Two years after the sale, one of the blades breaks in two. The four-year period begins to run on the day the blade broke.

b. Implied Warranties Breached on Delivery
Because implied warranties cannot "explicitly" extend to future performance, they are breached, if at all, upon delivery.

IX. RIGHTS AND DUTIES OF THIRD PARTIES TO THE CONTRACT

A. INTRODUCTION

The general rule is that a contract operates to confer rights and impose duties only on the parties to the contract and on no other person. However, two important exceptions exist: (i) contractual

rights involving third-party beneficiaries, and (ii) contractual rights or duties that are transferred to third parties. In the first situation, the original contract will confer the rights and duties on the third party; in the second situation, the original contract does not confer any rights or obligations on the third party, but subsequently one of the parties has sought to transfer his rights and/or duties under the contract to a third party (i.e., assignment of rights, delegation of duties).

B. THIRD-PARTY BENEFICIARIES

The basic situation to be dealt with here is: A enters into a valid contract with B that provides that B will render some performance to C. A is the promisee, B is the promisor, and C is a third party. Three main problems must be focused on:

(i) Is C an intended third-party beneficiary?

(ii) Can A and B alter the contract's terms to deprive C of her rights? That is, when do C's rights vest?

(iii) What are the rights of A and C against B; of C against A?

1. Which Third-Party Beneficiaries Can Sue?

a. Intended Beneficiaries Can Sue

Only intended third-party beneficiaries have contract rights. As the term "intended third-party beneficiary" suggests, whether a person is an intended beneficiary depends on the intent of the parties.

Example: Rich agrees to pay Erwin $1,000 to paint Paula's house, and Erwin agrees. Paula is an intended third-party beneficiary and has contract law rights even though she is not a party to the contract.

b. Incidental Third-Party Beneficiaries Have No Contract Rights

Incidental third-party beneficiaries benefit from the contract, but that is not the primary purpose of the contract. These beneficiaries have no contract rights.

Example: Rich agrees to pay Erwin $1,000 to paint Rich's house, and Erwin agrees. Rich's unpainted house has affected the property value of his neighbor Paula. Paula's property value will increase when Rich's house is painted; thus, she will benefit from the contract. Here, however, Paula has no contract rights. She is merely an incidental beneficiary; the purpose of the contract was to benefit Rich.

c. Determining the Promisee's Intention

1) Language of Contract

Often, but not always, whether a party is the intended beneficiary of a contract can be determined from the language of the contract itself. The issue is whether the purpose of the promisee was to confer a right on another directly.

Example: Alex offers to sell his car to Becky if Becky pays Cindy the $1,000 purchase price. Cindy is a third-party beneficiary because the contract appears to have been intended to directly benefit her.

Compare: Alex promises Becky that he will give her a brand new General Motors car if she will work for him for three months. General

Motors probably is not an intended beneficiary even though it is named in the contract (*see* factors to consider, below).

2) Factors
The courts generally look at the following ***factors*** in resolving the question of intention:

a) Is the third party expressly ***designated*** in the contract? If so, it is more likely that it is primarily for her benefit. But note that it is not necessary that the third-party beneficiary be named, or even identifiable, at the time the contract is made; she need only be identifiable at the time performance is due.

b) Is ***performance to be made directly*** to the third party? If so, it is more likely that the contract is primarily for her benefit.

c) Does the third party have any ***rights*** under the contract (e.g., the right to designate when and where performance is to be made)? If so, it is more likely that the contract is primarily for her benefit.

d) Does the third party stand in such a ***relationship*** to the promisee that one could infer that the promisee wished to make an agreement for the third party's benefit? If so, it is more likely that the contract is primarily for her benefit.

d. Creditor or Donee Beneficiary
There are two basic categories of "intended" beneficiaries who may sue on the promise: creditor and donee beneficiaries. The distinction between the two is based on the promisee's purpose in extracting the commitment from the promisor.

1) Creditor Beneficiary
If the promisee's purpose in extracting the promise was to discharge an obligation owed to the third party, the third party is a creditor beneficiary.

2) Donee Beneficiary
If the promisee's purpose in extracting the promise was to confer a gift on the third party, the third party is a donee beneficiary.

2. When Do the Rights of the Beneficiary Vest?
An "intended" beneficiary can enforce a contract only after his rights have vested. This becomes important when the original parties to the contract take actions (e.g., rescission, modification, etc.) that affect the third-party beneficiary. The general rule for ***both*** creditor and donee beneficiaries is that their rights vest when the beneficiary:

(i) Manifests ***assent*** to the promise in a manner invited or requested by the parties;

(ii) Brings ***suit*** to enforce the promise; or

(iii) Materially ***changes position*** in justifiable reliance on the promise.

[Restatement (Second) of Contracts §311]

a. Significance of Vesting
Before the intended third-party beneficiary's rights vest, the promisor and promisee are free to modify their contract—including removing the third-party beneficiary altogether—without consulting the third party. Once the third-party beneficiary's rights have vested, the promisor and promisee cannot vary his rights without his consent.

3. What Are the Rights of the Third-Party Beneficiary and the Promisee?

a. Third-Party Beneficiary vs. Promisor
If the promisor fails to perform, the third-party beneficiary may sue the promisor on the contract, subject to defenses as follows:

1) Promisor's Defenses Against Promisee
Because the third-party beneficiary's rights are derivative, the promisor may raise any defense against the third-party beneficiary that he would have against the promisee, including: lack of assent, lack of consideration, illegality, impossibility, and failure of a condition.

2) Promisee's Defenses Against Third-Party Beneficiary If Promise Not Absolute
Whether the promisor can use any of the defenses that the promisee would have against the third-party beneficiary depends on whether the promisor made an absolute promise to pay (e.g., "I will pay T $500 in exchange for your services") or only a promise to pay what the promisee owes the beneficiary (e.g., "I will pay T whatever you owe him in exchange for your services"). In the former case, the promisor ***cannot*** assert the promisee's defenses; in the latter case, the promisor ***can*** assert the promisee's defenses.

b. Third-Party Beneficiary vs. Promisee
If the promisor fails to perform vis-à-vis the third-party beneficiary, whether the third-party beneficiary may sue the promisee depends on whether the third-party beneficiary is a donee beneficiary or a creditor beneficiary. A ***donee beneficiary*** generally may ***not*** sue the promisee because generally there is no right to sue for nondelivery of a gift. (*But see* exception below.) However, a ***creditor beneficiary*** can sue the promisee on the underlying obligation that the promisor's performance was meant to discharge.

Example: Suppose Alex offers to sell his car to Becky if Becky pays Cindy the $1,000 purchase price. Alex informs Cindy of the arrangement and she nods with approval, thus vesting her rights. Alex transfers his car to Becky, but Becky does not pay the $1,000 to Cindy. If Alex intended the $1,000 to be a gift to Cindy, she cannot sue Alex for Becky's failure to pay. But if Alex owed Cindy a debt and the $1,000 was meant to satisfy the debt, Cindy may sue Alex on the unsatisfied obligation that he owed her.

Note: The rights of a creditor beneficiary are cumulative. She need not elect between suing the promisor and suing her own debtor (i.e., the promisee). She may ***sue both***. Of course, she may obtain but ***one satisfaction***.

1) Exception—Detrimental Reliance
If the ***promisee tells*** the donee beneficiary of the contract and should ***foresee***

reliance by the beneficiary, and the beneficiary ***reasonably relies*** to her detriment, the beneficiary can sue the promisee directly under a promissory estoppel/detrimental reliance theory (*see* III.D., *supra*), even though the beneficiary cannot sue the promisee as a third-party beneficiary.

Example: Alex contracts to rent his house to Becky for one year, but the contract provides that Becky is to make the first three payments to Alex's cousin Cindy. Alex then calls Cindy and tells her that she will be able to buy the new furniture that she has wanted because Becky will be making his first three payments to Cindy. Cindy rushes out and buys new furniture. Alex decides not to rent the house to Becky. Cindy can sue Alex under a promissory estoppel/detrimental reliance theory but not as a third-party beneficiary under the contract.

c. Promisee vs. Promisor

1) Donee Beneficiary Situation

If the promisor fails to perform and the contract involves a donee beneficiary, it was once said that the promisee could not sue the promisor at law. The rationale was that because the donee beneficiary had no cause of action against the promisee, there was no damage suffered. Today, however, the ***majority view*** is that the ***promisee has a cause of action***. Because the promisee hardly ever suffers any actual damage, however, she will usually receive only nominal damages. Hence, most courts have resolved this problem by allowing ***specific performance*** in this situation.

2) Creditor Beneficiary Situation

If the promisor fails to perform as to a creditor beneficiary and a promisee has had to pay the beneficiary on the existing debt, the promisee ***may recover*** against the promisor. If the debt has not yet been paid by the promisee to the third party, the promisee can compel the promisor to pay in a ***specific performance*** action.

C. ASSIGNMENT OF RIGHTS AND DELEGATION OF DUTIES

The basic fact situation to be dealt with here is: X enters into a valid contract with Y. This contract does not contemplate performance to or by a third party. Subsequently, one of the parties seeks to transfer her rights and/or duties under the contract to a third party.

1. Assignment of Rights

A transfer of a right under a contract is called an "assignment." The main issues regarding assignments are:

(i) What rights may be assigned?

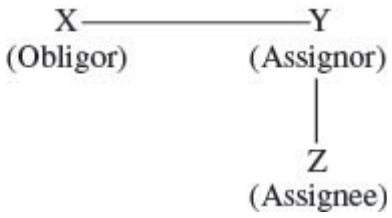
(ii) What is necessary for an effective assignment?

(iii) Is the assignment revocable or irrevocable?

(iv) What are the rights and liabilities of the various parties?

(v) What problems exist if there have been successive assignments of the same rights?

a. Terminology
X and Y have a contract. Y assigns her rights under the contract to Z. Y is the assignor, Z is the assignee, and X is the obligor.



b. What Rights May Be Assigned?

1) General Rule
Generally, ***all*** contractual rights may be assigned. However, several ***exceptions*** to this rule exist.

2) Exceptions

a) Assigned Rights Would Substantially Change Obligor's Duty
If an assignment of rights would substantially change the obligor's duty, the assignment will be barred.

(1) Personal Service Contracts
If the assignment of rights would result in the obligor having to perform personal services for someone other than the original obligee, the attempted assignment will be invalid. For the purposes of assignment, the test as to what constitutes personal services is whether the performance so involves the personality or personal characteristics of the obligor that it would be unfair to require the obligor to perform for a third person. Examples of personal services that cannot be assigned include those of a lawyer, physician, architect, and author. In contrast, repair and construction contracts usually are not considered to involve personal services, so a contractor may be required to render his performance to an assignee.

(2) Requirements and Output Contracts
Although at common law rights under requirements and output contracts were not assignable, under Article 2, they are assignable as long as the assignee does not disproportionately alter the contemplated quantity. Likewise, the buyer's duty to purchase goods under an output contract and the seller's duty to sell goods under a requirements contract can always be delegated, unless they fall within the general restrictions on delegation listed at 2.b., *infra,* because the other party's rights are not affected.

b) Rights Assigned Would Substantially Alter Obligor's Risk
When the obligor's risk would be substantially altered by any attempted assignment, the assignment will fail.

Example: Kwan owns a summer home that is insured by Acme Insurance Co. against loss due to fire. Kwan sells the building to Lincoln, who intends to convert it into a restaurant. Kwan may not, without the consent of Acme, assign his rights under the policy to Lincoln.

c) Assignment of Future Rights
The assignment of a ***right expected to arise*** under a contract of employment not then existing operates only as a promise to assign the right when it arises, i.e., when the expected future contract is in fact entered into.

Contrast this with ***future rights in existing contracts***, which are generally ***assignable*** even though the right might not yet have vested.

d) Assignment Prohibited by Law
A right may not be assigned if the assignment is prohibited by law. Such public policy against assignment may be embodied either in a statute or in case precedent. For example, many states have laws prohibiting, or at least limiting, wage assignments.

e) Express Contractual Provision Against Assignment

(1) Assignment of "the Contract"
Absent circumstances suggesting otherwise, a clause prohibiting the assignment of "the contract" will be construed as barring ***only the delegation*** of the assignor's ***duties***. [Restatement (Second) of Contracts §322; UCC §2-210(4)]

Example: Sam and Betty enter into a contract wherein Betty will purchase 100 books from Sam, a book collector, for $5,000. The contract provides that "this contract shall not be assigned." Subsequently, Sam assigns to Charlie his right to receive the $5,000 from the contract. Sam has not breached the contract because he merely assigned his right to receive payment; he did not delegate his duty to deliver the books.

(2) Assignment of Rights Under the Contract
A clause prohibiting the assignment of ***contractual rights*** generally does not bar assignment, but merely gives the obligor the right to sue for breach if an assignment is made. [Restatement (Second) of Contracts §322] In other words, the assignor has the ***power but not the right*** to assign.

(a) Factors that Make Assignment Ineffective
Notwithstanding the general rule, if the clause provides that any attempt to assign will be ***"void,"*** assignment will be ineffective (i.e., the assignor has neither the power nor the right to assign). Also, if the assignee has ***notice*** of the nonassignment clause, assignment will be ineffective.

c. Effect of Assignment—Real Party in Interest
The effect of an assignment is to establish privity of contract between the obligor and the assignee while extinguishing privity between the obligor and assignor. The assignee then replaces the assignor as the real party in interest, and she alone is entitled to performance under the contract.

d. What Is Necessary for an Effective Assignment?

1) Requirement of Writing
A writing is usually ***not required*** to have an effective assignment, so an oral assignment is generally effective. However, there are situations where an assignment ***must*** be in writing:

a) Wage assignments;

b) Assignments of an interest in land; and

c) Assignments intended as security interests under Article 9 of the UCC

2) Requirement of Adequate Description
The right being assigned must be adequately described.

3) Requirement of Present Words of Assignment
The assignor must also manifest an intent to transfer his rights under the contract ***completely and immediately*** to the assignee. Whether such intent is present will be determined by looking to the terms of the transfer itself, i.e., the test is objective, not subjective. It is not necessary to use the word "assign"; any generally accepted words of transfer will suffice (e.g., "convey," "sell," "transfer," etc.).

4) No Requirement of Consideration
Consideration is ***not required***; a gratuitous assignment is effective.

Note: It is important to remember, however, that even though neither a writing nor consideration is generally required, the lack thereof will affect revocability. (*See* f., *infra*.)

e. Partial Assignments
Contract rights may be transferred to one assignee or split up and transferred to two or more. Similarly, the assignor may transfer some rights under the contract and retain others.

f. Is the Assignment Revocable or Irrevocable?
When, if ever, do the rights of the assignee "vest" so that the assignment becomes irrevocable? Assignments are divided into two categories: assignments for value and gratuitous assignments.

1) Assignments for Value Are Irrevocable
An assignment is for value if it is: (i) done for ***consideration***, or (ii) taken as security for or payment of a ***preexisting debt***. Assignments for value cannot be revoked.

2) Gratuitous Assignments Are Revocable
An assignment not for value, i.e., a "gratuitous" assignment, is generally ***revocable***.

a) Exceptions to Rule of Revocability
In certain situations, however, a gratuitous assignment will be held irrevocable.

(1) Performance by Obligor
If the obligor has already performed, the assignment will be irrevocable.

(2) Delivery of Token Chose
If a token chose (tangible claim) involving the rights to be assigned (e.g., stock certificates, savings account passbook, etc.) has been delivered, the assignment will be irrevocable.

(3) Assignment of Simple Chose in Writing
If the assignment involves a simple chose, i.e., an intangible claim not embodied by any token (or the great majority of ordinary contract rights), setting it forth in a writing will make the assignment irrevocable.

(4) Estoppel
The theory of estoppel may prevent the assignor from revoking a gratuitous assignment if: (i) the assignor should reasonably foresee that the assignee will change her position in reliance on the assignment; and (ii) such detrimental reliance does in fact occur.

b) Methods of Revocation
A gratuitous revocable assignment may be terminated in a number of ways:

(1) ***Death*** of the assignor;

(2) ***Bankruptcy*** of the assignor;

(3) ***Notice*** of revocation communicated by the assignor to either the assignee or the obligor;

(4) The ***assignor takes performance*** directly from the obligor; or

(5) ***Subsequent assignment*** of the same right by the assignor to another.

c) Effect of Revocation
Once an assignment is revoked, the privity between the assignor and the obligor is restored, and the assignor is once again the real party in interest.

3) Effect of "Irrevocable" Assignment
One should note that the term "irrevocable" as applied to an assignment may be misleading. The effect of such irrevocability is to remove from the assignor the right to revoke or make a subsequent assignment of the same right to a third party. However, in many situations, even though the assignor no longer has this ***right***, he

still has the ***power*** to do so. He would, of course, be liable for a breach of contract. *Exception:* An exception exists for assignments accompanied by ***delivery of a token chose***. In this case, the assignor loses both the right ***and*** the power to revoke or further assign.

g. What Are the Rights and Liabilities of the Various Parties?

1) Assignee vs. Obligor

As the assignee is the real party in interest, she may enforce her rights against the obligor ***directly***.

a) What Defenses Does Obligor Have Against Assignee?

An assignee's rights against the obligor may be subject to any defenses that the obligor had against the assignor. This rule is similar to the rule discussed *supra* for promisors who are being sued by third-party beneficiaries.

Example: Opie, a mechanic, enters into a contract to purchase a car from Andy for $2,000, payment to be made in 30 days. Opie then performs some repair work for Andy and bills Andy $200. Andy tells Opie to subtract the $200 from the $2,000 that Opie owes Andy. The following week, Andy assigns his right to collect from Opie to his landlord, Lori. If Lori brings suit against Opie to collect the entire $2,000, Opie can raise the $200 setoff as a defense.

(1) Exception—Personal Defenses Arising After Assignment

If the obligor's defense is unrelated to the contract itself (i.e., it is a personal defense against the assignor, such as a setoff or counterclaim), the defense is not available against the assignee if it arose ***after*** the obligor had notice of the assignment.

Example: Same facts as in the example in a), above, but Opie performed the work for Andy after Andy asked Opie to pay the $2,000 due under the purchase agreement to Lori. Andy may ***not*** raise the setoff as a defense against Lori because it arose too late.

(a) Test

Is the defense ***inherent*** in the contract itself (e.g., failure of consideration) ***or*** is it a defense ***unrelated*** to the contract, the right of which has been assigned? As to defenses inherent in the contract itself, these defenses are always available against the assignee because they came into existence when the contract was made. As to setoffs, counterclaims, and the like, such defenses are good against the assignee only if they came into existence before the obligor had notice or knowledge of the assignment.

(2) Estoppel

The estoppel doctrine may operate to prevent the obligor from asserting a defense that might otherwise exist against the assignor.

Example: Jim and Harold entered into a contract. Subsequently, Harold sought to assign his rights under the contract to Zorba. Zorba inquired of Jim whether he had any defenses against Harold. Jim replied in the negative. Thereupon, Zorba paid Harold valuable consideration for the assigned rights. Jim may be estopped to raise any defenses existing at the time of his statement to Zorba.

b) Modification of the Contract
Suppose that after the obligor has received ***notice*** of the assignment, the obligor and assignor attempt to ***modify*** the contract. Will the modification affect the assignee's rights?

(1) No Effect on Rights of Assignee
Generally, such a modification of the contract will ***not*** affect the rights of the assignee. This is so even when the modification is undertaken in good faith.

(2) UCC Position
The UCC provides that such a modification of an assigned right to payment that ***has not yet been fully earned by performance*** is effective against the assignee if made in ***good faith***. However, the modification will cause a breach of an assignment contract that prohibits such modifications. [UCC §9-405]

c) Defenses of Assignor Not Available
The obligor will not be able to raise by way of defense any defenses that the assignor might have against the assignee.

2) Assignee vs. Assignor

a) Assignor's Warranties
In every assignment ***for value***, the assignor impliedly warrants that:

(i) He has the right to make the assignment; i.e., the assignor has made ***no prior assignment*** of the right;

(ii) The right exists and is ***not subject to limitations or defenses*** other than those stated or apparent at the time of the assignment; and

(iii) He will ***do nothing to defeat or impair*** the assigned right; e.g., he will not attempt a subsequent assignment.

[Restatement (Second) of Contracts §333] Breach of any of these warranties gives rise to a cause of action. For example, if the assignor wrongfully exercises his ***power*** to revoke the irrevocable assignment, the assignee may proceed against him. Also, the assignee may seek to recover against the assignor if the obligor successfully asserts a defense she had against the assignor in an action by the assignee, thereby defeating the assigned

right—provided the assignee had no notice of the defense at the time of the assignment.

b) Obligor Incapable of Performance
The assignor will ***not*** be liable to the assignee if the obligor is incapable of performing, e.g., is insolvent.

c) Rights of Sub-Assignees
Sub-assignees do not have any rights against the original assignor. The courts reason that there is no privity of contract. However, the assignee who "sub-assigns" becomes the assignor with respect to that assignment and can be held liable thereon.

3) Do Third Parties Have Any Equities Relating to Assignment?
If third parties have any equities in the subject matter of the assignment, the assignee will take subject to them if she has notice; she will not be subject to such equities if she is a bona fide purchaser without notice of the assigned interest.

h. What Problems Exist If There Have Been Successive Assignments of the Same Rights?
The problem: X assigns to Y a right to the payment of $500 owed him by Smith. Subsequently, X assigns this same right to Z. Who prevails—Y or Z?

1) Revocable Assignments
If the first assignment made is ***revocable***, a subsequent assignment will serve to ***revoke*** it (i.e., the subsequent assignee prevails).

2) Irrevocable Assignments

a) First Assignee Has Priority
The general rule is that if the assignor makes two assignments of the same right and the first assignment is ***irrevocable***, the ***first*** assignee has priority.

b) Exceptions
In certain situations, a second assignee who ***pays value*** and takes ***without notice*** of the earlier irrevocable assignment will prevail.

(1) Judgment Against Obligor
If the subsequent assignee gets the ***first judgment*** against the obligor, she will prevail.

(2) Payment of Claim
If the later assignee gets ***first payment*** from the obligor on the assigned claim, her rights will be superior.

(3) Delivery of Token Chose
If the subsequent assignee gets the ***first delivery of a token chose*** from the assignor, she will prevail.

(4) Novation
The second assignee will prevail if she obtains a novation that supersedes the obligation running to the assignor in favor of the new one running to her. This assumes that the obligor had ***no knowledge*** of the prior assignment at the time of the novation.

(5) Estoppel
If the subsequent assignee is able to set up an estoppel against the first assignee, she will have priority, e.g., the first assignee permits the assignor to retain a document that would indicate to a reasonable person that the assignor was sole owner of the right. (Estoppel could, of course, operate the other way as well. Thus, if the subsequent assignee has actual knowledge of the earlier assignment, she will be estopped to assert her claim as against the earlier assignee even though she would, under any of the other rules above, normally succeed.)

3) UCC Rules
Basically, the UCC has approached the successive assignments problem by imposing ***filing requirements***. [UCC §9-310] If the filing provision is applicable to the transaction, generally the assignee who is the first to file will prevail. [UCC §9-322]

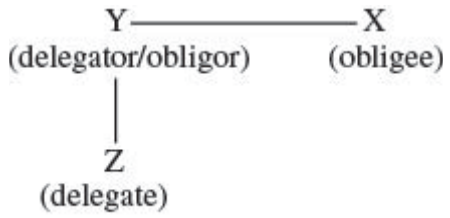
2. Delegation of Duties
A transfer of contractual duties is called a "delegation." The main issues regarding delegations are:

(i) What duties may be delegated?

(ii) How does one make a valid delegation?

(iii) What are the rights and liabilities of the various parties where there has been a valid delegation?

a. Terminology
X and Y have a contract. Y delegates duties thereunder to Z. Y is the ***obligor*** because Y is the one with the duty to perform the obligation. Y also is the ***delegator*** (sometimes called the delegant) because Y delegated the duty. Z is the ***delegate*** (sometimes called the delegatee) because Z is the one to whom the duty was delegated. X is called the ***obligee***, because X is the one for whom Y or Z is obligated to perform.



b. What Duties May Be Delegated?

1) General Rule
As a general rule, ***all contractual duties*** may be delegated to a third person.

2) Exceptions
There are several exceptions to the general rule.

a) Duties Involving Personal Judgment and Skill
If the duties involve personal judgment and skill, they may not be delegated.
Example: A talent agency cannot delegate its duty to select performers for a certain show to some other agency. It is immaterial that the other agency may have a better reputation and may have more performers under contract than the delegator. A court will not make such inquiries at all.

b) "Special Trust" in Delegator
Where a special trust has been reposed in the delegator, he may not delegate his duties (e.g., relationship of attorney and client, physician and patient, etc.).

c) Change of Obligee's Expectancy
If performance by the delegate will materially change the obligee's expectancy under the contract, the duty may not be delegated.

d) Contractual Restriction on Delegation
If a contract restricts either party's right to delegate duties, such a provision will usually be given ***strict effect***.

c. What Is Necessary for Effective Delegation?
In general, no special formalities are required to have a valid delegation. The delegation may be either ***written or oral***. However, the delegator must manifest a ***present intention*** to make the delegation. There is no need that the word "delegate" be used; any generally accepted words of transfer may be used.

d. What Are Rights and Liabilities of Parties?

1) Obligee
The obligee must accept performance from the delegate of all duties that may be delegated. She need not accept performance from the delegate of those duties that may not be delegated.

2) Delegator
The delegator will ***remain liable*** on his contract, even if the delegate expressly assumes the duties. However, as between the delegator and the delegate, the delegation places the primary responsibility to perform on the delegate. The delegator becomes secondarily liable, as a surety, for performance of the duty. Note that if an obligee expressly consents to the transfer of duties, it could be construed as an offer of novation (*see* below) rather than a delegation.

3) Delegate

The liability of a delegate turns largely on the question of whether there is a mere "delegation" or that plus an "assumption of duty."

a) Delegation

Delegation is the creation of a ***power*** in another to perform the delegator's contract duty. The nondelegating party to the contract (the obligee) cannot compel the delegate to perform, as the latter has not promised to perform.

b) Assumption

An assumption occurs when the delegate promises that she will perform the duty delegated and the ***promise*** is ***supported by consideration*** or its equivalent. This creates a third-party beneficiary situation in which the nondelegating party to the contract can compel performance or bring suit for nonperformance.

Example: Tom promises Becky that he will paint her fence for $100. Tom then asks Huck if he would paint the fence for $50 if Tom provides Huck with all of the paint and supplies needed. Huck agrees. Becky is a third-party beneficiary of the contract between Tom and Huck and may enforce Huck's promise to paint.

c) Result When Duties Delegated with Assignment of Rights

What happens if a delegation of duties is made in connection with an assignment of rights under the same contract out of which the duties arise, but the delegate has nonetheless not expressly assumed the duties? The majority of courts, the Restatement, and the UCC hold that unless a contrary intention appears, words assigning "the contract" or "all my rights under the contract" are to be construed as including an ***assumption*** of the duties; i.e., they imply a promise by the assignee to assume the duties of performance.

D. NOVATION DISTINGUISHED FROM OTHER THIRD-PARTY SITUATIONS

Note the difference between novation and the other third-party situations discussed above. Novation ***substitutes a new party*** for an original party to the contract. It requires the ***assent of all parties*** and ***completely releases*** the original party. The consent of the remaining party may be express or by implication of the acceptance of performance by the new party with knowledge that a novation is intended.

E. POWER OF PERSON OTHER THAN OWNER TO TRANSFER GOOD TITLE TO A PURCHASER

1. Entrusting

Entrusting goods to a merchant ***who deals in goods of that kind*** gives him the power (but not the right) to transfer all rights of the entruster to a ***buyer in the ordinary course of business***. [UCC §2-403] Entrusting includes both delivering goods to the merchant and leaving purchased goods with the merchant for later pickup or delivery. Buying in the ordinary course means buying in good faith from a person who deals in goods of the kind without knowledge that the sale is in violation of the ownership rights of third parties.

Examples: 1) Amy leaves her watch with Jeweler for repairs. Jeweler sells the watch to Zoe, who does not know that Jeweler has no right to sell. Zoe gets good title as against Amy. Amy's only remedy is to sue Jeweler for damages.

2) Amy leaves her watch with Jeweler for repairs. Jeweler borrows money from the bank, giving specific items of inventory, including Amy's watch, as pledged collateral. Amy can recover the watch from the bank. The bank is not a ***buyer***.

2. Voidable Title Concept

The UCC continues the pre-Code concept of voidable title. [*See* UCC §2-403] That is, if a sale is induced by fraud, the seller can rescind the sale and recover the goods from the fraudulent buyer. However, the defrauded seller may not recover the goods from a ***good faith purchaser for value*** who bought from the fraudulent buyer. The UCC specifies four particular situations in which the bona fide purchaser for value cuts off the rights of the true owner; in several of these instances the result under pre-Code law is changed.

Under the UCC, the ***good faith purchaser for value cuts off the defrauded seller's rights***, even though:

(i) The seller was deceived as to the identity of the buyer;

(ii) The delivery was in exchange for a check later dishonored;

(iii) The sale was a "cash sale"; or

(iv) The fraudulent conduct of the buyer is punishable as larceny.

The rights of a defrauded seller are cut off both by a buyer and by a person who takes a ***security interest*** in the goods.

3. Thief Generally Cannot Pass Title

If a thief steals goods from the true owner and then sells them to a buyer, the thief is ***unable*** to pass title to the buyer (because his title is ***void***). *Rationale:* A seller can transfer only the title he has or has power to transfer. Therefore, even a good faith purchaser for value generally cannot cut off the rights of the true owner if the seller's title was void. [UCC §2-403(1)]

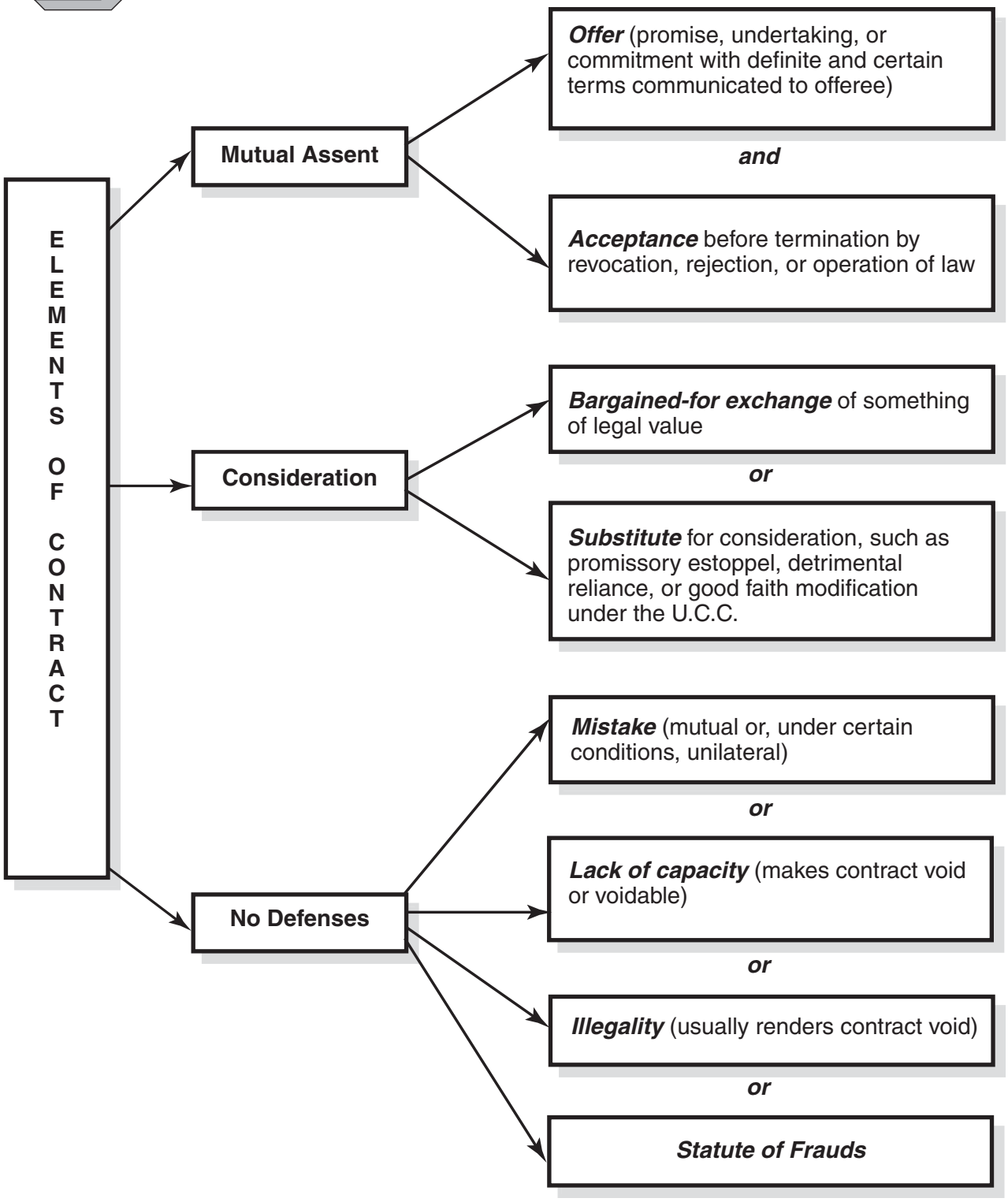
Example: Thief stole a painting from Owner and sold it to Buyer. Later, Owner discovered that Buyer had her painting. Owner may recover the painting from Buyer, even if Buyer purchased the painting in good faith and for value.

a. Exceptions

A thief may pass title in limited circumstances, such as where the buyer has made ***accessions*** (i.e., valuable improvements) to the goods or the true owner is estopped from asserting title (e.g., if the true owner expressly or impliedly represented that the thief had title).

CMR APPROACH CHART

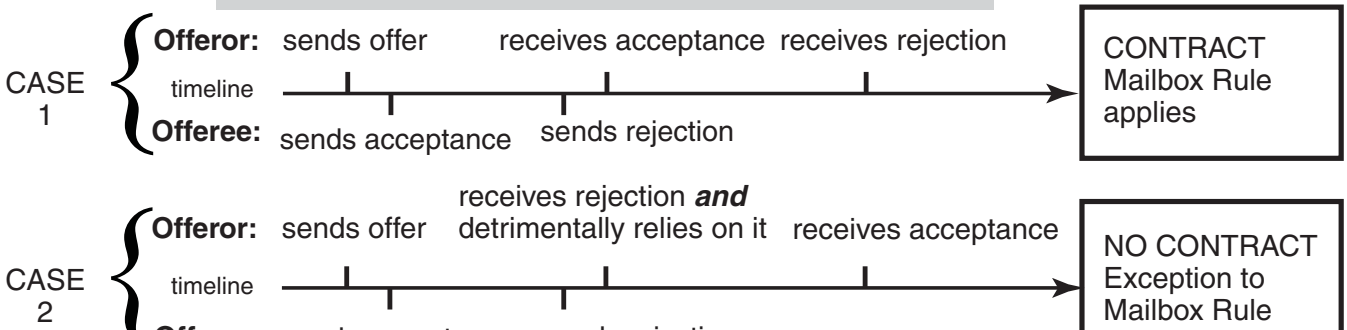
IS THERE AN ENFORCEABLE CONTRACT?



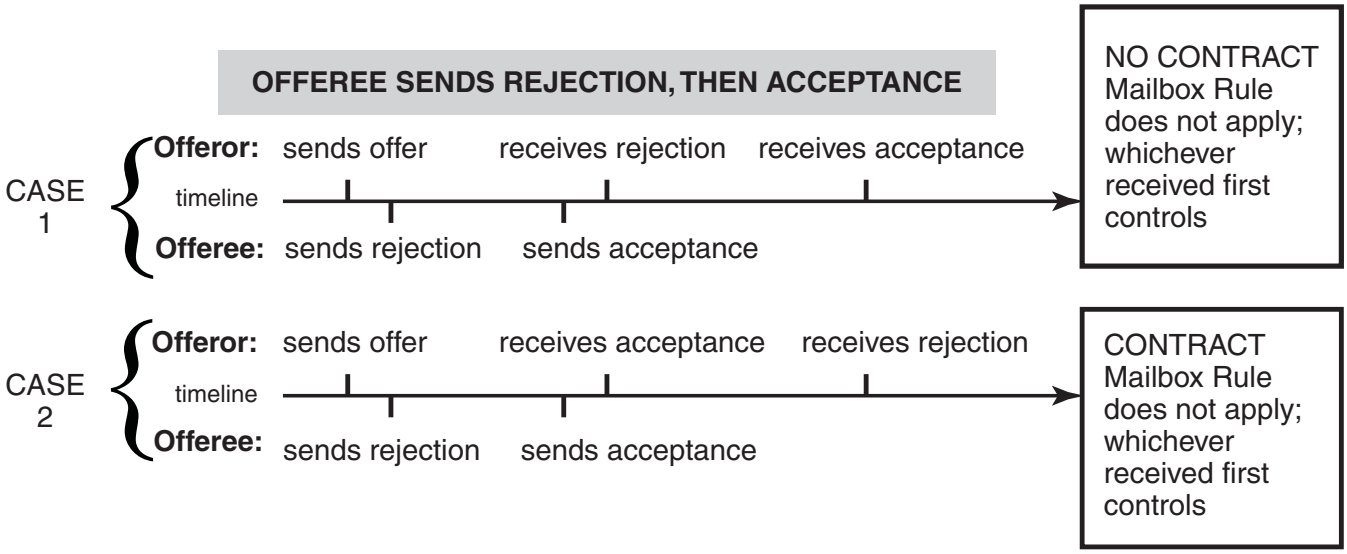
CMR EXAMPLE CHART

EFFECT OF REJECTION OR REVOCATION ON OFFER

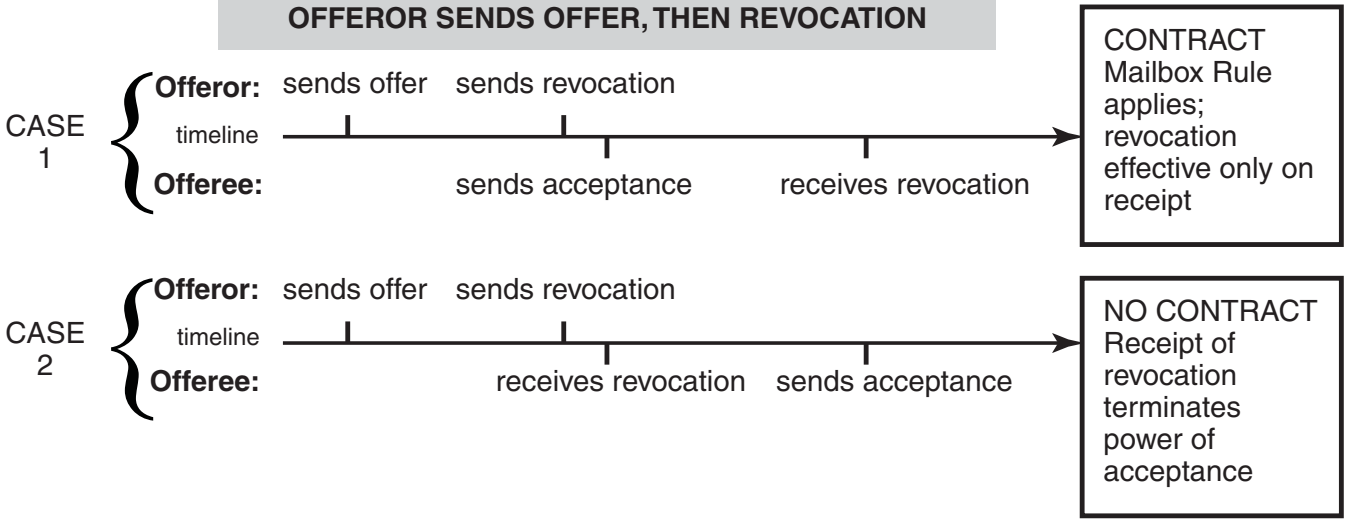
OFFEREE SENDS ACCEPTANCE, THEN REJECTION



OFFEREE SENDS REJECTION, THEN ACCEPTANCE

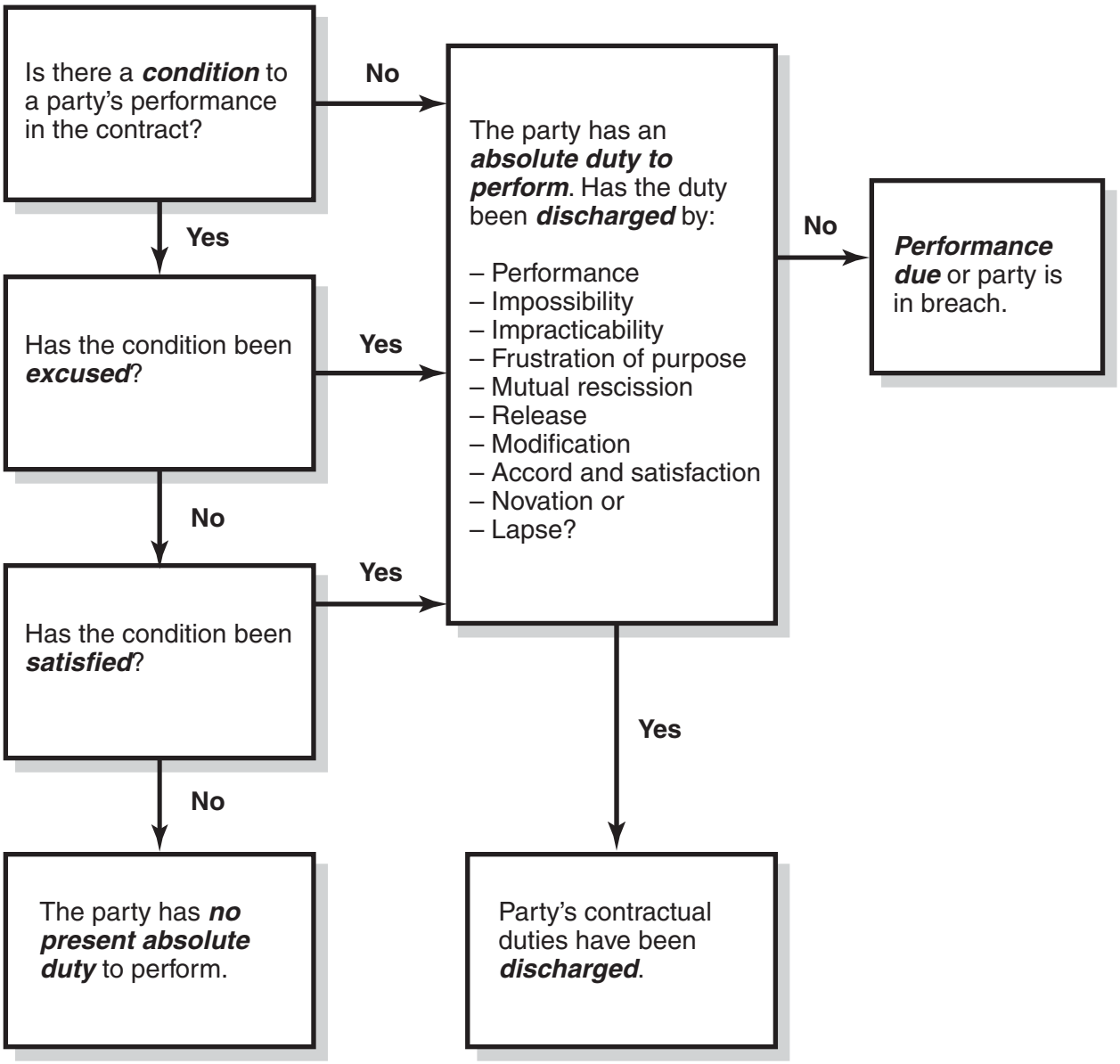


OFFEROR SENDS OFFER, THEN REVOCATION



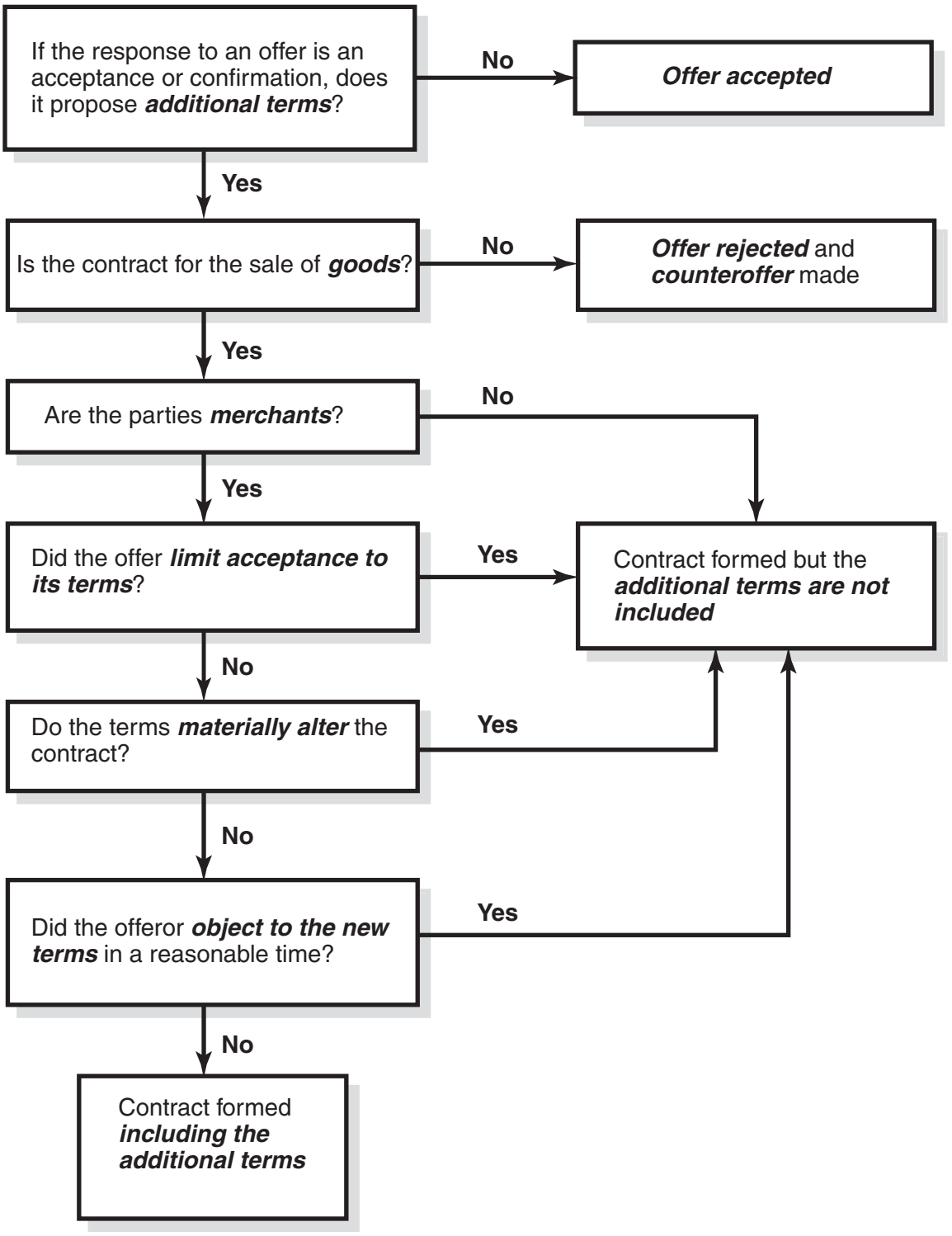
CMR APPROACH CHART

PERFORMANCE OF CONTRACT



CMR APPROACH CHART

ACCEPTANCE WITH ADDITIONAL TERMS



CONTRACTS AND SALES MULTIPLE CHOICE QUESTIONS

INTRODUCTORY NOTE
You can use the sample multiple choice questions below to review the law and practice your understanding of important concepts that you will likely see on your law school exam. To do more questions, access StudySmart Law School software from the BARBRI website.

Question 1

A jogger found a stray dog in the park. She took the dog home with her and placed an ad in the paper to try to find the dog's owner. Soon thereafter, the owner of the dog contacted the jogger. He came to the jogger's home and identified the dog as his. He offered to pay the jogger a $200 reward at the end of the week. The jogger thanked the dog owner but turned down the reward.

At the end of the week, however, the jogger changed her mind, so she called the dog owner and told him that she would like the reward after all. He refused to pay her, and she sues him for breach of contract.

What will the jogger recover?

(A) Nothing, because she rejected the dog owner's offer.

(B) Nothing, because there was no consideration to support a contract.

(C) $200, because the technical defense of the Statute of Frauds will be overcome by the dog owner's moral obligation to pay.

(D) $200, because the dog owner could not have revoked his offer until the end of the week, and he failed to do so before the jogger accepted.

Question 2

The owner of a custom jewelry supply shop placed an order with a manufacturer for 500 pairs of sterling silver "posts" of the type that are used to make pierced earrings. However, when the manufacturer started to fill the order, it had only 450 pairs of sterling silver posts available.

The manufacturer shipped the 450 pairs of sterling silver posts to the shop owner, plus 50 pairs of higher-priced 10-karat gold posts, without making any adjustment in price. The manufacturer enclosed a note with the order, explaining to the shop owner that it was sending the last of the sterling silver posts in stock, plus the 50 10-karat gold posts to accommodate the buyer.

Did the manufacturer's shipment constitute an acceptance of the shop owner's offer?

(A) Yes, and the shop owner may not reject the substituted goods because they are of comparable or greater value.

(B) Yes, although it is also a breach of the contract under the perfect tender doctrine.

(C) No, because it is a counteroffer that the shop owner is free to accept or reject.

(D) No, because it is a breach of the contract under the perfect tender doctrine.

Question 3

A homeowner offered to pay a roofer $500 to replace the bad shingles on his roof, provided the roofer could finish the job by October 1. The roofer told the homeowner he would get back to him after he had checked out prices at a local supply store. The next day, the roofer phoned the homeowner, who was not at home, and left a message on his answering machine that he could not do the work for less than $650. The roofer did not hear from the homeowner for several days. Because October 1 was still two weeks away, the roofer phoned the homeowner again and left another message on his answering machine stating that he would do the job for $500 and that he would do the work the next weekend unless that would be inconvenient for the homeowner. The homeowner replayed the second message just as he was leaving town on a business trip and did not contact the roofer. That weekend, unbeknownst to the homeowner, the roofer went to the homeowner's house and repaired the roof. When the homeowner returned home, the roofer presented him with a bill for $500, which represented the actual value of the work done. The homeowner refused to pay the bill.

If the roofer sues solely for breach of contract, who will likely prevail?

(A) The roofer, because he accepted the homeowner's offer before the latter materially changed his position in reliance on the first telephone message.

(B) The roofer, because the work he did was actually worth $500.

(C) The homeowner, because there was no writing signed by the homeowner.

(D) The homeowner, because he did not accept the roofer's offer to do the roof repair for $500.

Question 4

A father told his adult daughter that if she gave up smoking for the next 12 months, at the end of that time he would give her $10,000. She agreed to stop smoking, but later that day had doubts about whether her father would actually pay up if she complied. She contacted her stepmother, who told her to go ahead and quit smoking, and she would make good on the father's promise to pay her if he refused to do so. That very day, the daughter quit smoking and never smoked again. Eleven months after his conversation with his daughter, the father died.

One month later, the daughter sought payment of the $10,000 from her father's estate, which refused to pay. The daughter then asked her stepmother for the $10,000, but the stepmother also refused to pay. The daughter filed a claim against her stepmother for $10,000. She proves at trial that she has submitted a claim for $10,000 to the executor of her father's estate and has been refused payment.

What is the best argument for the court's rejecting this claim against her stepmother?

(A) The contract between the daughter and her stepmother was illusory.

(B) The daughter has not been damaged by any breach because the only effect—that she quit smoking—was salutary.

(C) The contract between the daughter and her stepmother was oral.

(D) No consideration flowed to the stepmother under the contract.

Question 5

A woman owed her auto mechanic $2,000. The debt remained unpaid until any claim for its repayment became barred by the statute of limitations. The woman then agreed in writing to pay the mechanic $1,500, but failed to pay him.

If the mechanic sues the woman for the $1,500, will the court rule in his favor?

(A) Yes, because the woman's promise to pay the $1,500 is in writing.

(B) Yes, because the woman had a preexisting legal duty to pay the mechanic.

(C) No, because the woman's promise to pay the $1,500 is not supported by consideration.

(D) No, because there has not been part performance.

Question 6

A merchant who sells raw silk and other natural fibers called a clothing manufacturer and offered to sell the manufacturer 20 bolts of silk at a cost of $50 per bolt, delivery in five weeks. The manufacturer immediately accepted the offer. After hanging up the phone, the silk merchant prepared a writing reciting the terms of the agreement, signed it, and mailed it to the manufacturer. The next day, the manufacturer received the letter, read it, and put it aside. Two days before the date of delivery, while the silk merchant was getting the silk ready for shipment, the manufacturer called the silk merchant to cancel the order, despite the silk merchant's protestations that they had a contract.

If the silk merchant sues the manufacturer for breach of contract, is the silk merchant likely to win?

(A) No, because the initial offer and acceptance that formed the basis of the agreement was oral.

(B) No, because the manufacturer did not sign the writing and he is the party to be charged.

(C) Yes, because the manufacturer did not object to the memorialization of their agreement.

(D) Yes, because the silk merchant was getting the goods ready for shipment.

Question 7

A large Midwestern wheat producer and a large food distributor located on the Pacific coast entered into a contract calling for the wheat producer to sell and the food distributor to buy 10,000 bushels of winter wheat for $5 per bushel. The contract stated that the wheat producer would deliver the wheat "F.O.B. St. Louis Railroad depot." The wheat producer hired a trucking company to transport the wheat from its silos to the St. Louis Railroad depot, where the wheat would be loaded onto railroad hopper cars bound west. En route to St. Louis, the trucks carrying the wheat were stopped, and the wheat was carried off by highway robbers. The wheat producer brings suit against the food distributor, which refused to pay for the wheat.

What will the wheat producer likely recover in damages?

(A) Nothing.

(B) The amount necessary to replace the stolen wheat.

(C) The full contract price.

(D) The profits it would have realized under the contract.

Question 8

In a state where gaming is legal, a professional gambler ran up a tab of $50,000 at his favorite casino. Pursuant to a longstanding agreement between the gambler and the casino, once the gambler's tab reached $50,000 he was required to repay the debt in five monthly installments of $10,000 before putting any additional charges on his tab. After making three repayments, the gambler approached the casino owner and offered an immediate payoff of $15,000 in cash as payment in full. The casino owner had a cash flow problem and needed the money, so he agreed. The gambler made the cash payment of $15,000 that same day. A few days later, the casino owner demanded $5,000 from the gambler.

Does the casino owner have a right to collect $5,000 from the gambler?

(A) Yes, because the gambler had a preexisting duty to pay the full $50,000.

(B) Yes, because the casino owner acted under duress when he accepted the immediate payoff of $15,000 in cash as payment in full for the gambler's debt.

(C) No, because there was a discharge by release.

(D) No, because there was an accord and satisfaction.

Question 9

A chef wanted to open his own restaurant, and a contractor offered to build the place for $160,000. Their written contract provided that the chef would pay the contractor $60,000 in cash when construction commenced, scheduled for April 15 after the spring thaw. On completion of the restaurant on September 30, the contractor would be paid the remaining $100,000. The region had a late spring, and on April 30 the contractor had not yet commenced construction of the restaurant.

Has the contractor breached the contract?

(A) No, and the chef need not make the initial $60,000 payment.

(B) No, but the chef must make the initial $60,000 payment.

(C) Yes, in a nonmaterial particular; thus, the chef need not make the initial $60,000 payment.

(D) Yes, in a material particular; thus, the chef may treat the contract as at an end and sue for damages.

Question 10

A builder entered into a contract with a landowner to build a warehouse for $500,000 by August 1. The agreement provided for five progress payments of $100,000 each at various stages of completion. On June 20, after the builder had spent $350,000 on performance and received $300,000 in progress payments, the builder notified the landowner that he was quitting the project. The landowner hired another contractor to complete the warehouse by August 1 for $250,000, which was a reasonable price given the short deadline.

Which of the following statements regarding the parties' remedies is correct?

(A) The builder can recover $50,000, the difference between the amount he expended on performance and the amount he was paid, to prevent the landowner's unjust enrichment.

(B) Neither party can recover anything, because the $50,000 extra that the landowner had to pay to complete the building is offset by the $50,000 difference between the builder's expenditures and the payments the landowner made to him.

(C) The landowner can recover $50,000, the difference between the contract price and the total amount he paid for completing the building.

(D) The landowner can recover $100,000, the difference between the contract price and the total amount spent constructing the building.

Question 11

On March 1, a widget manufacturer and a retailer entered into a written contract whereby the manufacturer agreed to sell and the retailer agreed to buy 10,000 widgets at a price of $10,000. Due to slow sales, the manufacturer was operating its factory at only 50% capacity and had ample inventory on hand. Delivery and payment was set for May 1. On April 1, the retailer told the manufacturer that he had no need for the widgets after all and would not accept delivery of them on May 1. After notice to the retailer, the manufacturer sold the widgets to another buyer a week later for $11,000, the market price at the time. On May 1, the market price of the widgets dropped to $8,000. The manufacturer's cost to produce and deliver the widgets was $7,000.

The manufacturer sued for breach of contract. At the time of the trial, the market price of widgets was $9,000. The court ruled in the manufacturer's favor, and found that its sale of the widgets to the subsequent buyer was done in good faith and in a commercially reasonable manner, and that there were no incidental damages or expenses saved as a result of the breach.

What amount of damages should the court award to the manufacturer?

(A) Nothing.

(B) $1,000.

(C) $2,000.

(D) $3,000.

Question 12

A large-scale bakery in the South entered into a written contract with a commercial apple orchard in the upper Midwest to purchase 200 bushels of apples at a cost of $8 per bushel. The contract provided that the apple orchard would deliver the apples "F.O.B. Louisville Railroad Depot," where the apples would be loaded onto a train headed south. The orchard assigned all of its rights under the contract to a large produce distributor which, in turn, hired a trucking company to deliver the apples to Louisville. En route to Louisville, the truck skidded off the road due to inclement weather and overturned, and the apples were destroyed. The bakery brought suit against the apple orchard for breach of contract.

What will be the probable outcome of the litigation?

(A) The bakery will lose.

(B) The bakery will recover the amount necessary to replace the destroyed apples, over the contract price.

(C) The bakery will recover the full contract price.

(D) The bakery will be able to compel specific performance of the contract.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

Answer to Question 1

(B) The jogger will recover nothing because her finding the lost dog occurred prior to the dog owner's promise to pay the $200. An enforceable contract must be supported by consideration. Consideration consists of: (i) a bargained-for exchange between the parties; and (ii) an element of legal value to that which is bargained for. Legal value is present if the promisee has incurred a detriment (*i.e.,* has done something she is under no legal obligation to do or has refrained from doing something that she has a legal right to do). To have a "bargained-for exchange," the promise must induce the detriment, and the detriment must induce the promise. If something has already been given or performed before the promise is made, it will not satisfy the bargain requirement, because it was not given in exchange for the promise. Here, the jogger was under no legal obligation to return the dog to its owner. Thus, in doing so, she incurred a detriment. However, the jogger was not induced to so act by the dog owner's promise to pay $200. Because the jogger's actions regarding the dog were performed before the dog owner's promise, those actions were not given in exchange for the promise when made. Thus, the "bargain" element is absent. (A) is incorrect because for a communication to constitute an offer, the acceptance of which results in a contract, it must express a promise to enter into a contract on the basis of terms that are certain and definite. Here, the dog owner simply offered to pay $200 in gratitude for an act already performed by the jogger. This was not an expression of a commitment to enter into a contract. Thus, there was no "offer" that was capable of either acceptance or rejection. In addition, as detailed above, consideration was not present. Even if the jogger had not declined the dog owner's promise, she could not have enforced its performance. (C) is incorrect for two reasons: First, the technical defense bar, to which it apparently refers, is inapplicable to these facts. If a past obligation (*e.g.,* a promise to pay money) would be enforceable but for the existence of a technical defense (*e.g.,* statute of limitations, discharge in bankruptcy), a new promise is enforceable if it is written or has been partially performed. Here, the dog owner owed no past obligation to the jogger. Second, the Statute of Frauds is inapplicable here. The Statute of Frauds provides that certain agreements must be evidenced by a writing signed by the party sought to be charged. These agreements are: (i) a promise by an executor or administrator to pay the estate's debts out of his own funds; (ii) a promise to answer for the debt of another; (iii) a promise made in consideration of marriage; (iv) a promise creating an interest in land; (v) a promise that cannot be performed within one year; and (vi) a promise for the sale of goods for $500 or more. None of these types of promises is at issue here. Therefore, the Statute of Frauds does not come into play. (D) is also incorrect for two reasons: First, as explained previously, consideration is not present on these facts. Consequently, the jogger cannot enforce the promise to pay $200, regardless of any right of the dog owner to revoke his offer. Second, it is not true that the dog owner could not have revoked the offer until the end of the week. An offer not supported by consideration or detrimental reliance can be revoked at will by the offeror if revocation is communicated to the offeree prior to acceptance. Here, the jogger gave no consideration, nor did she detrimentally rely, so the dog owner could have revoked his offer at any time.

Answer to Question 2

(C) The shipment did not constitute an acceptance. The manufacturer's shipment of both conforming and nonconforming goods along with a note explaining that the nonconforming goods were being offered as an accommodation to the buyer constitutes a counteroffer, which the shop owner is free to accept or reject. If the counteroffer is accepted, a contract is thereby created. Under U.C.C. section 2-206(1)(b), a shipment of nonconforming goods by a seller is not an acceptance of the

buyer's offer if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer. If the seller had merely shipped the nonconforming goods without the explanatory note, the shipment would have been both an acceptance of the buyer's offer, creating a bilateral contract, and a breach of the contract. In that case, (B) would have been the correct answer. Under the perfect tender rule, if goods or their tender of delivery do not conform to the sales contract ***in any respect,*** the buyer may reject the whole, accept the whole, or accept any commercial unit or units and reject the rest, subject to the seller's right to cure. (A) is incorrect for that same reason: The perfect tender rule, and not the concept of comparable worth, applies to contracts for the sale of goods. (D) is incorrect because there first must be an acceptance before there is a contract to breach. The perfect tender doctrine does not relate to acceptance.

Answer to Question 3

(D) The homeowner will likely prevail on the contract claim because he did not enter into a contract with the roofer. To form a contract, there must be a valid offer and acceptance. The homeowner made an offer, but the roofer rejected the offer the next day with his first phone call. Once an offer is rejected, the offeree's power of acceptance is destroyed. Thus, the roofer's second call was not an acceptance, but rather an offer. The homeowner did nothing to accept the roofer's offer, and this is not the type of case where silence will be deemed to be an acceptance (*e.g.,* where the parties have so agreed or where that has been their course of dealing). The homeowner had no reason to know the services were being rendered. Thus, there was no acceptance and no contract. Therefore, (D) is correct and (A) is incorrect. (B) is incorrect because it suggests a restitutionary remedy in a quasi-contract action (which allows a party to recover the value of his services under some circumstances even if a contract cannot be established), and the question specifically states that the roofer's action is limited to a breach of contract claim. (C) is incorrect because if there were a contract here, it would not be within the Statute of Frauds (*i.e.,* it is a contract for services that can be completed within one year).

Answer to Question 4

(C) The stepmother's best defense is that the contract was oral. Generally, contracts need not be in writing to be enforceable; however, under the Statute of Frauds, certain contracts must be evidenced by a writing signed by the party to be charged to be enforceable. One such contract is to pay the debt of another, such as the stepmother's promise here to pay the father's debt if he does not pay. Therefore, (C) is correct. (A) is incorrect because the promise was not illusory. A promise is illusory when there is not consideration on both sides of the contract. Here, the daughter will receive $10,000 if she performs, and the stepmother will receive the daughter's detriment of not doing something that she has a right to do, which is valid consideration (the benefit to the promisor need not have economic value). The daughter's performance is valid consideration even though she has already promised her father to refrain from smoking (*i.e.,* it is not a preexisting duty), because she was not bound by her promise to her father. The offer was for a unilateral contract (*i.e.,* one seeking performance rather than a promise to perform), and so could be accepted only by performance. The daughter had not yet performed when her stepmother made her own promise to her, so she had not yet accepted her father's contract and was not bound by her promise to refrain from smoking. Therefore, she was not under a preexisting duty, and the stepmother's promise served as additional consideration for her performance. Note also that a surety such as the stepmother will be bound by her promise to pay another's debt as long as she makes her promise before the creditor (the daughter) performs or promises to perform; the surety need not receive any separate consideration. (B) is incorrect because the

daughter's giving up what she had a legal right to do—even if harmful—is sufficient consideration to support a contract, so the stepmother could be bound to pay even though the contract was beneficial to the daughter. (D) is incorrect because the daughter's quitting smoking was the consideration that the stepmother received. Moreover, as explained above, a surety need not receive consideration separate from the consideration of the person whose debt she is backstopping.

Answer to Question 5

(A) The court should award the mechanic the $1,500, because the woman's promise to pay him that amount is in writing. A promise to pay a legal obligation barred by law, in this case, by the statute of limitations, is enforceable. If a past obligation, such as a debt, would be enforceable except for the fact that a technical defense to enforcement stands in the way (*e.g.,* statute of limitations), the courts will enforce a new promise if it is in writing ***or*** there has been part performance. Here, the promise is in writing, so it can be enforced. (B) is incorrect because the woman's preexisting legal duty to pay the mechanic terminated when the statute of limitations ran out. (C) is incorrect because the mechanic can enforce this agreement without further consideration on the woman's part. (D) is incorrect because, as stated above, the promise can be enforced because it is in writing, even though there has been no part performance.

Answer to Question 6

(C) The silk merchant is likely to prevail because a written confirmation between merchants satisfies the Statute of Frauds even if it is not signed by the party to be charged. Generally, the Statute of Frauds requires that a contract for the sale of goods priced at $500 or more be evidenced by a writing signed by the party to be charged. However, between merchants, if one party sends to the other party a written confirmation of their oral agreement that is sufficient to bind the sender, it will also bind the recipient if he has reason to know of its contents and does not object within 10 days of receipt. Here, there was a contract for the sale of goods valued at a total of $1,000, which would have to be evidenced by a writing under the Statute of Frauds. The silk merchant mailed a signed writing to the manufacturer memorializing the terms of their contract. The manufacturer received the letter, read it, and did not object to its contents at all, let alone within 10 days. Therefore, the writing is sufficient to satisfy the Statute of Frauds as to the manufacturer. (A) is incorrect because, although the initial offer and acceptance that formed the basis of the contract were indeed oral, the written confirmation between merchants satisfies the Statute of Frauds as discussed above. (B) is incorrect because the manufacturer's signing was not required under the provision for written confirmation between merchants. The Statute of Frauds requires that a contract for the sale of goods priced at $500 or more be evidenced by a writing signed by the party to be charged, and here, the manufacturer (*i.e.,* the party to be charged) did not sign the writing. However, under the merchants' confirmatory memo rule, if both parties are merchants, the party to be charged need only know of the contents of the writing signed by the other party and not object to it within the 10-day period. It is not necessary that the party to be charged sign the writing. (D) is incorrect because the contract is enforceable regardless of whether the silk merchant has begun his performance. While courts may apply promissory estoppel to remove a contract from the Statute of Frauds when the defendant's conduct foreseeably induces a plaintiff to change his position in reliance on the oral agreement, the silk merchant does not need to show detrimental reliance here. The contract satisfies the Statute of Frauds by virtue of the merchants' confirmatory memo, as discussed above.

Answer to Question 7

(A) The wheat producer will lose and recover nothing, because the wheat producer had the risk of loss at the time the wheat was stolen. Because crops such as wheat are goods, this contract will be governed by the Uniform Commercial Code (U.C.C.). The U.C.C. modifies the common law rule that destruction of the subject matter without fault of either party discharges both parties of their obligations under the contract. Under the U.C.C., the risk of loss falls on the buyer or seller according to the terms of their contract. Here, the contract called for the wheat producer to deliver the wheat "F.O.B." (free on board) St. Louis. When a contract has an F.O.B. delivery term, the seller is obligated to get the goods to the destination indicated and make a reasonable contract for freight if the destination indicated is not the buyer's place of business. The seller has the risk of loss until the goods make it to the F.O.B. destination, and thereafter the buyer has the risk. Here, the theft occurred before the seller got the goods to the F.O.B. destination (St. Louis); so the risk of loss was on the seller (the wheat producer), who is in breach for nondelivery. Thus, the wheat producer will lose and recover nothing. (B) would be incorrect even if the wheat producer did not have the risk of loss. A seller's remedy if the goods are lost or destroyed when the risk of loss is on the buyer would be the contract price. If the seller were given the value of the stolen goods, he might recover more or less than the contract price (depending on the price agreed upon by the parties), whereas the aim of the U.C.C. is to put a nonbreaching party in as good a position as he would have been in had there not been a breach. (C) would be correct if the wheat producer did not have the risk of loss—as indicated above, the nonbreaching seller's remedy for stolen goods is the contract price. Note that section 2-613, which allows a seller to avoid the contract if the goods are lost or destroyed before the risk of loss passes to the buyer, does not apply. That section applies only if the specific goods are identified at the time the contract was made. This was merely a contract for unspecified wheat. (D) would be incorrect even if the wheat producer did not have the risk of loss, because merely awarding a nonbreaching seller the profits on a contract where the goods are lost or destroyed rather than the full contract price will cause him a loss, because he had to pay for the manufacture or purchase of the goods and would not be recovering those costs.

Answer to Question 8

(D) The casino owner cannot collect from the gambler. There was a valid accord and satisfaction, discharging the gambler's obligations under the contract. An accord is the agreement under which one party agrees to accept some other, different performance from the other party than he would have received under the existing contract. An accord, like other contracts, must be supported by consideration. The casino owner's willingness to take a ***lesser amount*** in exchange for an ***earlier repayment*** of a mutually agreed-upon amount is sufficient as mutual consideration. Payment of a smaller sum than due is sufficient consideration for a promise by a creditor to discharge a debt because the consideration was ***different*** (*e.g.,* immediate payment before the last payment was due). Thus, there was consideration supporting the accord. The satisfaction of the accord occurred on the payment of the $15,000 in cash. Satisfaction discharges both the accord and the original contract. (A) is incorrect because, while it is true that the gambler had a preexisting legal duty to pay $50,000, the slight change in the consideration is an exception to the rule that a preexisting legal duty cannot constitute valid consideration. (B) is incorrect because the casino owner's decision to take less than the full amount of the debt because of a cash flow problem does not rise to the level of duress. Duress is typically not found where one party merely takes economic advantage of the other's pressing need to enter into a contract. (C) is incorrect because a discharge by release is an agreement to release a party from liability; in other words, it is a contract not to sue. Here the parties were seeking to

change the terms of their agreement. They were not attempting to release either party from the contract or agreeing not to sue.

Answer to Question 9

(A) The contractor has not breached the contract, and the chef need not make the first payment until the contractor begins work. The contractor promised to build the restaurant by September 30. He did not promise to begin on April 15. The contractual term as to the contractor's beginning construction is a condition precedent to making the first payment. It is a condition relating to the chef's performance, not the contractor's performance. Nothing in the facts indicates that the contractor promised to begin on April 15. Contracts are construed as a whole and words are given their ordinary meaning. The purpose of the contract is to build a restaurant by September 30. Construction cannot commence before the spring thaw. Thus, the best interpretation is that the language regarding commencement of construction was merely a condition of the chef's first payment, inserted to insure that the contractor was motivated to begin and that the chef would not be out of pocket if the contractor failed to begin. Thus, the term regarding the beginning of construction of the restaurant on April 15 merely fixes a tentative time of the start of performance and does not involve an absolute promise by the contractor to commence performance on April 15. Because the contractor was under no absolute duty to commence construction on April 15, his failure to do so does not constitute a breach of the contract. (B) is incorrect because, with the failure to satisfy the condition, the chef is not yet contractually obligated to make the initial payment. (C) and (D) are incorrect because the contractor's failure to commence construction on April 15 is not a breach. As explained above, there can be no breach until there is an absolute duty to perform, and the contractor had not absolutely promised to commence construction on April 15. An additional note: (C) states that, if the contractor has breached the contract in a nonmaterial manner, then the chef need not make the initial payment. Actually, the usual effect of a minor breach would be simply to provide a remedy to the aggrieved party; the aggrieved party would not be relieved of her duty of performance under the contract. Only if the promise that is breached is also a condition for the aggrieved party's performance would a minor breach relieve the party's duty to perform. Hence, even if the contractor's failure to begin on time were a minor breach, that fact alone would not have allowed the chef to suspend his performance.

Answer to Question 10

(C) The landowner can recover $50,000, which is the amount above the contract price that it will cost to get the building completed. In construction contracts, the standard measure of damages when the builder breaches will depend on when the breach occurred. If the builder breaches after partially performing, the owner is entitled to the cost of completion plus reasonable compensation for any delay in performance (unless completion would involve undue economic waste). Here, the cost of completion (the amount above the contract price that it will cost to get the building completed) is $50,000, which was a reasonable price considering the deadline. Hence, that is what the landowner can recover. Most courts will allow the builder to offset or recover for work performed to date if necessary to avoid the unjust enrichment of the owner. (A) and (B) are incorrect because the landowner is not being unjustly enriched by the additional amount that the builder expended in performance over the progress payments that it received. Thus, the builder is not entitled to recover the $50,000 he spent above the amount he was paid. The landowner still had to pay $50,000 more than the contract amount for completion of the warehouse because of the builder's breach; thus, that is the landowner's recovery. (On the other hand, if the cost of completing the building to specifications were only $150,000 after the

builder's breach, the builder could recover $50,000 in restitution from the landowner in a quasi-contract action because the landowner would have been unjustly enriched from the builder's breach.) (D) is incorrect because the cost of completion is determined from the perspective of the landowner, *i.e.,* how much additional he has to pay to have the building completed. The landowner would be unjustly enriched if he could recover $50,000 more than the damages he incurred.

Answer to Question 11

(D) The court should award the manufacturer $3,000 as lost profits. When a buyer anticipatorily breaches a contract for the sale of goods, the seller's basic damages are either the difference between the contract price and the market price as of the time for performance or the difference between the contract price and resale price. If neither of these measures puts the seller in as good a position as performance would have, and the seller is a lost volume seller, the seller may recover lost profits plus incidental damages. Here, the manufacturer, by virtue of the fact that it can manufacture as many widgets as it can sell and has ample inventory on hand, is a lost volume seller. The difference between the contract price and the market price on May 1 (the time for performance) was $2,000. The difference between the contract price and the resale price is $0 because it sold them for more than the contract price. Neither of those measures puts the manufacturer in as good a position as it would have been in had the retailer performed under the contract. In that case, the manufacturer would have had $3,000 profit from the sale to the retailer, as well as a $4,000 profit from the sale to the subsequent buyer. The facts state that there are no incidental damages. Thus, the manufacturer should be awarded the $3,000 in lost profit as damages. (A) is incorrect because it is based on the difference between the contract price and the resale price. Because the manufacturer sold the widgets for more than the contract price, its damages would be zero under this calculation. The manufacturer, however, is a lost volume seller and this measure of damages does not put the manufacturer in as good a position as it would have been in had the retailer performed. Thus, the manufacturer is entitled to lost profits. (B) is incorrect because it represents the difference between the market price at trial and the contract price. That is not the correct measure of damages in any case unless the trial date precedes the date for performance. That is not the case here and would not be the correct answer even if it were, because the manufacturer is entitled to lost profits. (C) is incorrect. This figure represents the difference between the market price and the contract price at the time for performance, but, like the resale price measure, does not put the manufacturer in as good a position as it would have been in had the retailer performed. In any case, that measure would not apply because the manufacturer had already resold the widgets. Alternatively, $2,000 represents the difference between the manufacturer's lost profit of $3,000 and the extra profit of $1,000 that it made on resale of the widgets because of the higher market price. Again, however, because the manufacturer is a lost volume seller and could have made that sale anyway, the extra profit will not be deducted from its lost profits damages.

Answer to Question 12

(B) If the bakery brings an action against the apple orchard, the bakery will be able to recover the costs of replacing the destroyed apples because the apple orchard remained liable on the assigned contract and it had the risk of loss. Although most contractual duties may be assigned—unless they are personal—and the obligee must accept performance from the delegate, the delegating party (delegator) remains liable on his obligation. Thus, an assignment of a contract that includes a delegation of duties does not relieve the assignor from its duty to perform. Here, the bakery did not receive the performance that was due (the apples), so it could sue the apple orchard to recover

for the breach. When a nonbreaching buyer does not receive the contracted goods, it has several options: it can cancel the contract and recover any incidental damages, or it can purchase replacement goods and sue for the cost of replacement—"cover." Damages under the latter option are measured by the difference between the contract price and the amount the buyer actually has to pay for the replacement goods. Thus, (B) is correct, and (A) is incorrect. Note that (A) would have been correct if U.C.C. section 2-613 were applicable, because it provides for avoidance of the contract when goods are lost without fault of either party before risk of loss passes to the buyer. However, that section applies only when particular goods are identified to the contract ***when the contract was made***; here, there is no designation of specific bushels of apples until shipment. (C) is not a proper measure of damages unless the bakery had already paid for the apples and wished to cancel (and the facts do not indicate this to be the case), because the contract price may not be enough to purchase replacement goods if the price of apples has risen, and would be too much if the price has dropped. (D) is incorrect because specific performance is usually not available for goods unless the circumstances call for it—for example, if replacement goods could not be obtained or the goods are unique. Here, the goods are not unique and there is no indication that replacement apples are not available.

APPROACH TO EXAMS

CONTRACTS AND SALES

IN A NUTSHELL: A contract is a promise that the law will enforce. The law will enforce a promise that was offered to a particular person or class of people who accepted the offer if the promise was supported by consideration and unless a defense is available. Enforcement may be through awarding damages or ordering the party to perform. Rights and duties under a contract may be granted to people beyond the contracting parties (i.e., third-party beneficiaries, delegates, and assignees).

I. WHAT LAW APPLIES?

A. UCC Article 2

1. The UCC governs all contracts for the sale of ***goods***
2. Special rules govern transactions between merchants

B. Common Law

Any contracts not governed by the UCC are governed by the common law

II. IS THERE A VALID CONTRACT?

A. Offer

1. Is there a valid offer?
   a. Manifestation of a present intent to contract demonstrated by a promise, undertaking, or commitment;
   b. Communicated to an identified offeree; and
   c. Definite and certain terms
2. Has the offer been terminated?
   a. Lapse of time—must accept within specified time period or, if none, within reasonable time
   b. Revocation—words or conduct of the offeror terminating the offer
      1) Revocation is effective when received by offeree
      2) Irrevocable offer:
         a) Merchant's firm offer under UCC
         b) Option contract—offeree gave consideration to hold open offer
         c) Detrimental reliance
   c. Rejection—words or conduct of the offeree rejecting the offer
      1) Rejection effective when received by offeror
      2) Counteroffer acts as rejection
   d. Termination by operation of law when:
      1) Destruction of subject matter of the contract
      2) Supervening illegality of subject matter of contract
      3) Death or insanity of either party

B. Acceptance

1. Unequivocal acceptance
   a. Common law—acceptance of each and every term of the offer (***mirror image rule***)
   b. UCC—an acceptance that adds terms to the offer is valid

1) Between merchants, the additional terms become part of the contract unless they materially alter the contract, the offeror objects, or the offer is limited to its terms (***"battle of the forms"***)

2. Methods of acceptance
   a. UCC—reasonable means
   b. Unilateral contract—performance
   c. Bilateral contract—promise or performance
3. Acceptance effective upon dispatch (***mailbox rule***)
   a. Limitation—offeror opts out; rejection sent first

C. Consideration

1. Bargained-for exchange (not a gift), and
2. Detriment to promisee or legal benefit to promisor (courts focus on detriment)
   a. Adequacy generally irrelevant
   b. Past consideration generally invalid (***preexisting duty rule***)
      1) Exceptions:
         a) Written promise to pay time-barred debt
         b) New or different consideration promised
         c) Promise ratifying a voidable obligation (e.g., minor ratifying upon reaching age of majority)
         d) Compromise of honest dispute
         e) Unforeseen circumstances make modification fair and equitable (modern rule) or rise to the level of impracticability (majority view)
         f) Good faith modification under Article 2
3. Substitutes for consideration—***promissory estoppel*** and ***detrimental reliance***

D. Must Be No Defenses to Formation or Enforcement

1. Mistake
   a. Unilateral mistake—contract is voidable if nonmistaken party knew or should have known of mistake
   b. Mutual mistake—contract is voidable by adversely affected party if:
      1) Mistake concerns basic assumption on which contract was made;
      2) Mistake has material effect, and
      3) Party seeking avoidance did not assume risk
   c. Ambiguous terms—neither party or one party aware of ambiguity = contract; both parties aware of ambiguity = no contract
2. Fraud and misrepresentation (includes concealment and nondisclosure)
3. Illegality of consideration or subject matter
4. Incapacity—infancy, mental incapacity, intoxication, duress, and undue influence
5. Statute of Frauds—certain contracts must be in writing, signed by the party to be charged (***"MY LEGS"***)
   a. ***M***arriage—when marriage is consideration for promise (e.g., "If you marry my son, I will buy you a car")
   b. ***Y***ear—promises that cannot be performed within one year
   c. ***L***and—promises creating interests in land (e.g., leases, easements, fixtures, mineral rights, mortgages)
   d. ***E***xecutors and administrators—promises to pay estate debts from own funds
   e. ***G***oods—contracts for sale of goods for a price of $500 or more

1) Exceptions—specially manufactured goods, goods accepted or paid for
f. ***S***uretyship—promise to answer for debt of another

6. Unconscionability—court may refuse to enforce to avoid unfair terms (e.g., contracts of adhesion)

III. WHAT ARE THE TERMS OF THE CONTRACT?

A. Rules of Contract Construction

General rules: contracts are construed as a whole, words are generally given their ordinary meaning, written or typed terms prevail over printed, custom and usage in business and locale is considered, court will try to find contract valid, and ambiguities are construed against the contract's preparer

B. Parol Evidence Rule

When parties intend that a writing is the final expression of their bargain, no prior (oral or written) or contemporaneous (oral) expressions are admissible to vary the terms of the writing

1. Integration—final and complete expression
   a. If incomplete (partial integration), evidence admitted to supplement
   b. Merger clause (states agreement is complete on its face) is evidence of full integration
2. Evidence outside scope of the rule may be admitted:
   a. Evidence concerning validity (e.g., formation defects, conditions precedent)
   b. Evidence used to interpret (words used are uncertain or ambiguous)
   c. Evidence showing true consideration paid
   d. Evidence in action for reformation

C. Article 2 Provisions

1. "Gap-fillers"—if missing, Article 2 provides: price (reasonable at time of delivery), place of delivery (seller's business), time of shipment (reasonable), time for payment (receipt of goods), and assortment (buyer's option)
2. Delivery Terms and Risk of Loss
   a. Noncarrier cases
      1) Merchant seller—risk passes to buyer upon taking physical possession
      2) Nonmerchant seller—risk passes upon tender of delivery
   b. Carrier cases
      1) Shipment—risk passes on delivery to carrier
      2) Destination—risk passes on tender at destination
      3) F.O.B.—risk passes on delivery to F.O.B. location
3. Warranties in sales of goods
   a. Types—title, against infringement, merchantability, fitness, express
      1) Implied warranty of merchantability (goods are fit for ordinary purpose) implied in every contract by merchant of goods of kind sold
      2) Implied warranty of fitness for particular purpose implied whenever any seller has reason to know particular purpose for which goods to be used and that buyer is relying on seller's skill and judgment to select goods, and buyer does in fact rely
   b. Disclaimers
      1) Title—specific language or circumstances putting buyer on notice that seller is not claiming title
      2) Merchantability

a) Specific disclaimer must mention "merchantability" and, if in writing, must be conspicuous
b) Also can be disclaimed by "as is," refusal to examine, or course of dealing

3) Fitness for a particular purpose—only by conspicuous writing or general disclaimer ("as is," refusal to examine, course of dealing)
4) Express—disclaimer usually not given effect

c. Damages—difference between goods tendered and as warranted

D. Modification of Terms

1. Common law
   a. Under general contract law, additional consideration needed
   b. Modern view permits modification without consideration if due to circumstances that were unanticipated by the parties when the contract was made and it is fair and equitable
   c. Written contract can be modified orally even if contrary provision
2. UCC Article 2
   a. No consideration needed so long as in good faith
   b. Must be in writing if, as modified, contract is for $500 or more
   c. Gives effect to provisions prohibiting oral modification

IV. HAS PERFORMANCE BEEN EXCUSED OR DISCHARGED?

A. Has the Condition (Precedent, Concurrent, or Subsequent) Been Excused?

1. Hindrance or failure to cooperate
2. Breach of contract
3. Anticipatory repudiation—party unequivocally indicates he will not perform before time of performance
4. Prospective inability or unwillingness to perform—doubts as to party's performance
5. Substantial performance
6. Divisibility of contract
7. Waiver or estoppel

B. Has the Absolute Duty Been Discharged?

1. Performance or tender of performance
2. Occurrence of condition subsequent
3. Illegality of subject matter after contract was made
4. Impossibility, impracticability, or frustration of purpose
5. Rescission of contract
6. Modification of contract
7. Novation (replacing parties) or substituted contract (replacing contract)
8. Accord and satisfaction

V. HAVE THE TERMS OF THE CONTRACT BEEN BREACHED?

A. Material or Minor Breach (Common Law)

1. Minor breach—obligee gains the substantial benefit of bargain so aggrieved party must perform, but right to damages
2. Material breach—obligee does not gain substantial benefit of bargain so no duty to perform, immediate right to damages and other remedies

B. Perfect Tender Rule (UCC Article 2)—if goods or delivery fail to conform to contract in any way, buyer generally may reject all, accept all, or accept any commercial units and reject rest

VI. WHAT REMEDIES ARE AVAILABLE IF THE CONTRACT HAS BEEN BREACHED?

A. Specific Performance
If legal remedy (damages) is inadequate, court may order breaching party to perform (land and rare or unique goods)

B. Damages
1. Compensatory
   a. Expectation damages ("benefit of the bargain")
   b. Consequential damages available only if reasonably foreseeable, could not have been avoided through reasonable efforts, and can be proved with reasonable certainty
2. Liquidated damages if:
   a. Actual damages difficult to calculate at the time of contracting
   b. Amount is a reasonable forecast of the likely damages (not punitive)
3. Sale of goods contracts (Article 2)
   a. Buyer's damages
      1) Cover (difference between contract price and cost of replacement goods)
      2) Difference between contract price and market price
      3) Warranty damages (if accepted nonconforming goods)
      4) Consequential damages (if seller knew of buyer's needs)
   b. Seller's damages
      1) Difference between contract price and resale price
      2) Difference between contract price and market price
      3) Lost profits (lost volume seller)
4. Land sale contracts—difference between the contract price and fair market value
5. Employment contracts
   a. Employer breach—full contract price
   b. Employee breach—cost to replace employee
6. Construction contracts
   a. Breach by owner
      1) Before construction—builder's prospective profits
      2) During construction—contract price minus the cost of completion
      3) After completion—full contract price plus interest
   b. Breach by builder
      1) Before or during construction—cost of completion plus compensation for delay
      2) Late completion—value of lost use
7. Avoidable damages—nonbreaching party has duty to mitigate

C. Restitution
Prevents unjust enrichment; measure is value of benefit conferred

D. Rescission and Reformation
1. Rescission—contract voidable/rescinded if mutual mistake of material fact, unilateral mistake that other party knew or should have known or extreme hardship, misrepresentation of material factor, or duress, undue influence, illegality, incapacity, or failure of consideration

2. Reformation—writing changed to conform to parties' original intent if mutual mistake, unilateral mistake and party knows of it and does not disclose, or misrepresentation

VII. DO ANY THIRD PARTIES HAVE RIGHTS OR RESPONSIBILITIES UNDER THE CONTRACT?

A. Third-Party Beneficiaries

1. Only intended beneficiaries have rights under contract
2. Vesting of third party's rights (no modification without third party's consent after vesting)—third party's rights are vested if he:
   a. Manifested assent,
   b. Brought suit to enforce the promise, or
   c. Materially changed position in justifiable reliance
3. Promisor can raise against the third party any defenses he could raise against promisee
4. Third-party beneficiary v. promisee (if promisor fails to perform):
   a. Donee beneficiary—may not sue promisee unless detrimental reliance
   b. Creditor beneficiary—may sue promisee on underlying obligation
5. Third-party beneficiary may sue both the promisor and promisee but may obtain only one satisfaction

B. Assignment of Rights—Transfer of Rights Under Contract

1. All contract rights are assignable unless assignment materially alters the obligor's duty or risk or it is prohibited by law
   a. Contract provision prohibiting assignment bars only delegation of duties
2. Revocability—assignments for value are irrevocable (includes preexisting debt)
3. Assignor's warranty liability to assignee—assignor impliedly warrants:
   a. He has made no prior assignment of the right
   b. The right is not subject to limitations or defenses other than those disclosed or apparent
   c. He will do nothing to defeat or impair the right
4. Successive assignments of same right
   a. Revocable assignments—subsequent assignee prevails
   b. Irrevocable assignment—first assignee has priority

C. Delegation of Duties—Transfer of Contractual Duties

1. Duties that cannot be delegated:
   a. Those involving personal judgment or skill
   b. Those involving special trust in delegator (e.g., doctor, lawyer)
   c. Those restricted by contract
   d. Those the performance of which by a delegate materially changes the obligee's expectancy
2. Liability of parties:
   a. Delegator remains liable
   b. Delegate liable if he assumes the duty
   c. Assignment of "contract" or "rights under the contract" construed to include delegation and assumption of duties

ESSAY EXAM QUESTIONS

INTRODUCTORY NOTE

The essay questions that follow have been selected to provide you with an opportunity to experience how the substantive law you have been reviewing may be tested in the hypothetical essay examination question context. These sample essay questions are a valuable self-diagnostic tool designed to enable you to enhance your issue-spotting ability and practice your exam writing skills.

It is suggested that you approach each question as though under actual examination conditions. The time allowed for each question is 60 minutes. You should spend 15 to 20 minutes spotting issues, underlining key facts and phrases, jotting notes in the margins, and outlining your answer. ***If*** you organize your thoughts well, 40 minutes will be more than adequate for writing them down. Should you prefer to forgo the actual writing involved on these questions, be sure to give yourself no more time for issue-spotting than you would on the actual examination.

The BARBRI technique for writing a well-organized essay answer is to (i) spot the issues in a question and then (ii) analyze and discuss each issue using the "CIRAC" method:

C — State your ***conclusion*** first. (In other words, you must think through your answer ***before*** you start writing.)
I — State the ***issue*** involved.
R — Give the ***rule(s)*** of law involved.
A — ***Apply*** the rule(s) of law to the facts.
C — Finally, restate your ***conclusion***.

After completing (or outlining) your own analysis of each question, compare it with the BARBRI model answer provided herein. A passing answer does ***not*** have to match the model one, but it should cover most of the issues presented and the law discussed and should ***apply the law to the facts*** of the question. Use of the CIRAC method results in the best answer you can write.

EXAM QUESTION NO. 1

On Thursday, May 14, Tenant received the following letter from Shore: "Dear Tenant, I will let you have my 'Shore House' for this June through August season, same terms under which you occupied it last year. Please reply in a week." Tenant noticed Shore's letter was postmarked May 11.

Earlier in May, Tenant had made inquiry at "The Cliffs," a mountain resort owned by Cliff. In Cliff's absence, Joe, one of Cliff's caretakers, had shown Tenant two available houses, "Hi-Vu" and "Lo-Vu," which Joe stated were listed for rent at $6,000 and $3,000, respectively, for one season.

On May 15, Tenant received a letter from Cliff which read, "This confirms statements by Joe. You may have Hi-Vu at $6,000, or Lo-Vu at $3,000, for the season June through August, all services included, payable in equal monthly installments."

On May 17, Tenant wrote to Cliff as follows, "I think your prices are high. Will you take $5,000 for Hi-Vu? If not, then I'll have to settle for Lo-Vu, and I agree to pay the $3,000 you ask, only I hope you may be willing to consider some concession if I pay the whole $3,000 in advance."

On May 17, Tenant learned that Shore had sold Shore House to Jones for Jones's immediate occupancy.

On May 18, Cliff received Tenant's letter and Cliff immediately telegraphed Tenant, "No change in prices. See my letter of the 16th." Tenant received Cliff's telegram the same day, May 18. Later that day Tenant also received Cliff's letter of May 16, which read, "Our deal is off." Tenant immediately wrote Shore, "I'll take Shore House per your letter of the 11th."

The normal course of post between Tenant and Shore and Tenant and Cliff was one day.

You may assume that all requirements of the Statute of Frauds have been satisfied. What rights, if any, does Tenant have against Shore and against Cliff? Discuss.

EXAM QUESTION NO. 2

Buyer, who was in the market for a car, heard that Seller wanted to sell his car for $5,000. On June 1, Buyer visited Seller and saw the car. Buyer asked Seller about the car's condition. In response, Seller said, "The car is in tip-top shape—the brakes and clutch were replaced in the last six months. It's in beautiful shape for a vehicle of this age. Good for another 100,000 miles easy."

Seller agreed to sell the car to Buyer for $5,000. They both signed the following document: "Seller agrees to sell, and Buyer agrees to buy, Seller's car for the price of $5,000. Buyer will pick up the car at Seller's home on June 2 and pay Seller $5,000 in cash at that time."

On June 2, Buyer came to Seller's home. Before handing the payment to Seller, Buyer said, "I'd like my mechanic to look at the car to make sure that it is as you represented it." Seller responded, "Don't waste money on a mechanic. The car is exactly as I described it." Even though Buyer, while at Seller's home, had no way to tell if the brakes and clutch were as represented, Buyer thought that it would be a waste of time and money to visit a mechanic and thus decided to proceed with the transaction. Accordingly, after briefly inspecting the car, Buyer gave Seller $5,000 in cash. Seller handed Buyer the keys to the car, and Buyer left with the car.

On June 10, the car broke down and Buyer had it towed to a mechanic's shop. After looking at the car, the mechanic accurately told Buyer that the clutch had failed because it was old and needed to be replaced. The mechanic also warned Buyer that the brakes were unsafe and that the engine needed a complete overhaul or it would not last another 10,000 miles. The mechanic told Buyer that if the car had been as represented by Seller, it would have had a market value of $5,000, but in its current condition the car was worth only about $500—its value as salvage for parts.

On June 11, Buyer hand-delivered a letter to Seller. The letter informed Seller that Buyer was revoking his acceptance of the car and that Seller could recover his car at the mechanic's shop.

What rights, if any, does Buyer have against Seller? Explain.

EXAM QUESTION NO. 3

On April 1, Ann Star, a young television personality, signs a contract with Bland Television Network to perform May 1 in a one-hour "live" TV show from 8 to 9 p.m. Bland agrees to pay Star $1,000 for this performance. The contract also provides that if for any reason Star does not appear as scheduled, she will "forfeit the sum of $25,000 to Bland as liquidated damages."

On April 10, Star informs Bland that she is suffering from acute fatigue and that her physician probably will not allow her to appear as scheduled. Bland immediately urges her in writing to fulfill her contractual obligations.

On April 15, Star tells Bland that she has miraculously recovered and will appear as scheduled on the May 1 show.

On April 23, Bland informs Star that, due to her unpredictability, it has hired actress Prima Donna as of that date and will not require Star's services.

On April 28, Prima Donna breaks her leg in an accident. Bland immediately wires Star that it has reconsidered the whole matter and will hold her to the original contract to perform on May 1.

On the evening of May 1, Star appears at the studio ready to perform, but Bland, acting under orders from the Federal Communications Commission, cancels the show in order to broadcast a special address by the President of the United States.

Discuss the legal implications of the foregoing events.

EXAM QUESTION NO. 4

P and D, who were casual acquaintances, resided in communities 100 miles apart. On February 1, P wrote D as follows:

> I have decided to give up my farm, Blackacre, and move to town. I thought you might consider buying it from me because you have often said that you were going to move to a farm after retirement. I will sell you Blackacre for $100,000. I'll let you have 10 days to think about it and to talk it over with your wife. In other words, I'll keep the offer open and will not withdraw it during this time.
>
> Sincerely yours,
>
> /s/P
> February 1, 2010

As a result of a delay in the mails, P's letter did not arrive in the normal course on February 2, but was received on February 4. On February 8, P deposited in the mail a letter addressed to D in which he said, among other things, "Blackacre deal off." This letter was not received by D until February 12, a few hours after D had posted an acceptance of the offer. The letter of acceptance was received in due course on February 13. In the correspondence that followed, P denied that any contract resulted, and D did not tender any money to P. On February 20, D delivered to A a writing that stated, "I hereby transfer to A my right to Blackacre under my contract with P for $100, receipt of which is hereby acknowledged. /s/D." On February 25, D gave a similar instrument to B, who immediately presented it to P. The next day A presented his claim to P.

What are the rights and liabilities of all the parties? Discuss.

ANSWERS TO EXAM QUESTIONS

ANSWER TO EXAM QUESTION NO. 1

Tenant v. Shore

Tenant has no rights against Shore. Tenant's rights versus Shore depend on whether a valid contract was formed. At issue is whether Shore's offer was accepted prior to its termination.

To have a valid contract there must be an offer, acceptance, and consideration. Consideration is a bargained-for exchange of legal value. Consideration is not an issue here because, if a valid contract were formed, it would be a promise of possession of Shore House for the season in exchange for a promise to pay the same rent as the year before (presumably it was not free the year before).

For a communication to be an offer, it must create a reasonable expectation in the offeree that the offeror is willing to enter into a contract on the basis of the offered terms. Generally, there must be a promise, undertaking, or commitment to enter into a contract, with certain and definite essential terms communicated to the offeree. Here, Shore's letter offering the Shore House for June through August under the same terms as last year is a commitment to enter into a contract communicated to the offeree. Although the terms are not spelled out, they are sufficiently definite because the offer provides a reference to the specific terms that a court could use to enforce a contract. Thus, Shore's letter creates a reasonable expectation in Tenant that he could create a contract by accepting Shore's terms.

The power of acceptance ends when the offer is terminated. A revocation is a retraction of an offer and terminates the power of acceptance. In addition to a traditional revocation, an offer may be revoked by indirect communication; i.e., the offeree receives correct information from a reliable source of the offeror's acts that would indicate to a reasonable person that the offeror no longer wishes to make the offer. Here, Tenant learned that Shore had sold the house for the buyer's immediate occupancy. Assuming Tenant learned this from a reliable source, this information would indicate to a reasonable person that Shore no longer wished to make the rental offer to Tenant. Thus, when Tenant learned of the sale, the offer was revoked. Therefore, Tenant no longer had the power to accept the offer when he sent Shore his acceptance on May 18. Thus, there was no contract, and Tenant has no rights against Shore.

Note that Shore's power to revoke the offer was not limited by his request that Tenant reply within one week. Offers can be revoked at will by the offeror, even if he has promised not to revoke for a certain period—unless the offeree gives consideration for the promise not to revoke (which creates an option contract). Here, Shore did not promise to hold the offer open, and in any case, Tenant did not provide any consideration to Shore to keep the offer open. Therefore, Shore was free to revoke the offer at any time.

Tenant v. Cliff

Tenant may enforce his contract rights against Cliff because there is a contract between Tenant and Cliff for the seasonal rental of Lo-Vu for $3,000. At issue is whether Tenant accepted Cliff's offer before it was revoked.

As noted above, a valid contract requires an offer, acceptance, and consideration. Again, consideration is not an issue because the bargain involves the exchange of promises for the possession of property for a rental period in exchange for a specified amount of money.

Cliff's letter of May 15 was a specific offer to enter into a contract with Tenant for the rental of either Hi-Vu or Lo-Vu at the rents specified. An offer that allows the offeree to choose among alternatives is still sufficiently definite to constitute a valid offer. At issue is whether Cliff effectively revoked its offer before Tenant accepted it.

For an acceptance to be effective, it must be unequivocal. Under the mirror image of rule of the common law, any different or additional terms change the response from an acceptance to a rejection

and counteroffer. An acceptance coupled with a request or inquiry, however, does not amount to a rejection. Here, Tenant's letter to Cliff states that if Cliff will not take the offer for Hi-Vu, Tenant will settle for Lo-Vu at the offered price. That is an acceptance. The additional language asking whether Cliff would be willing to consider concession if the price is paid in advance would likely be considered a request or separate inquiry.

The next issue is whether Cliff terminated Tenant's power of acceptance by revoking the offer before Tenant's acceptance was effective. Under the mailbox rule, acceptance by mail creates a contract at the moment of dispatch, but a revocation is effective only upon receipt. Here, Tenant mailed his acceptance on May 17. Although Cliff mailed its revocation on May 16, it was not effective until it was received on May 18. Thus, the offer was still viable when Tenant accepted by mail on May 17, and a contract for Lo-Vu was created on that date.

If Cliff refuses to honor the contract, it will be in breach and Tenant can pursue a suit for damages or specific performance.

ANSWER TO EXAM QUESTION NO. 2

This case involves a contract for the sale of goods; thus, Article 2 of the UCC applies. There was an offer, acceptance, and consideration. The terms of the bargain were set out in writing. Under the UCC, Buyer may keep the car and sue Seller for breach of warranty, revoke his acceptance of the car and sue for damages, or void the contract on the ground of misrepresentation.

Breach of Warranty

At issue is whether Seller breached any express or implied warranties. Implied warranties, such as the implied warranty of merchantability, apply only to contracts by merchants who deal in goods of the kind sold. Since Seller appears to be selling his personal automobile from his home, it seems safe to assume that he is not a merchant. Seller did, however, make statements that could be construed as express warranties. Any affirmation or promise made by the seller to the buyer or any description of the goods creates an express warranty if it is part of the basis of the bargain. To be a part of the basis of the bargain, the statement need only come at such a time that the buyer could have relied on it when he entered into the contract. Here, Seller could argue that his statements that the car was "in tip-top shape" and "good for another 100,000 miles" were merely his opinion and could not be the basis for an express warranty. However, Seller's statement that the brakes and clutch were replaced in the last six months was not a statement of opinion and certainly was made at such a time that Buyer could have relied on it.

Buyer's biggest hurdle in his express warranty suit is the parol evidence rule. Under the parol evidence rule, if the parties to a contract intend a writing to be the full and final expression of their bargain (i.e., it is an integration), any other expressions—written or oral—made prior to or contemporaneous with the writing are inadmissible to vary its terms. If the writing contains a merger clause reciting that the agreement is complete, the presumption that it is a complete integration is strengthened. Seller will argue that evidence of his statements is barred by the parol evidence rule, and the written agreement makes no warranties. Buyer in turn can argue that the written agreement does not contain a merger clause and was not intended to be the complete and exclusive expression of the parties' agreement. Buyer's position is further bolstered by the Article 2 parol evidence rule, which provides that a party may add consistent additional terms unless there is a merger clause or the court finds from all of the circumstances that the writing was intended as a complete and exclusive statement of the agreement. In this case, the writing does not contain a merger clause or any disclaimer or mention of warranties. Thus, the express warranty would be a consistent additional term.

Since the Article 2 presumption of partial integration is not overcome, Buyer will be permitted to introduce evidence of the express warranty. Warranty damages are appropriate when the buyer keeps the nonconforming goods. Therefore, Buyer's damages for breach of that warranty would be the difference between the value of the car as accepted and the value of the car if it were as warranted. In this case the car is worth $500, but would have been worth $5,000 if it had been as warranted. Thus, Buyer would be entitled to $4,500 in warranty damages, plus incidental and consequential damages, if any. To recover damages, the buyer must, within a reasonable time after discovering the defect, notify the seller of the defect. If Buyer does not notify Seller within a reasonable time, he loses his right to sue on the warranty.

Revocation of Acceptance

At issue is whether Buyer may revoke the acceptance of the car more than a week after accepting it. Under Article 2, if goods fail to conform to the contract in any way, the buyer may reject them. Once goods are accepted, the buyer's power to reject them is generally terminated, and the buyer is obligated to pay the price less any damages from the seller's breach. However, a buyer may revoke an acceptance if the goods have a defect that substantially impairs their value to him and he accepted them because of the difficulty of discovering the defects or because of the seller's assurance that the goods conformed to the contract. To effectuate this revocation, the buyer must notify the seller of it within a reasonable time after discovering the defect and before any substantial change in the goods occurs that is not caused by the defect. Here, Buyer accepted the car. He drove it for a week. The car is, however, nonconforming. It was represented to have a new clutch and brakes, and it does not. Even if Seller argues that Buyer had an opportunity to inspect the car and decided not to do so, he will likely lose because Seller assured Buyer that the car was exactly as Seller had described it. Given that the value of the car was substantially impaired and that Seller gave that false assurance, Buyer will likely be able to revoke his acceptance. Buyer notified Seller of the revocation one day after discovering the defect and no change has occurred in the car that was not caused by the defect. Once the acceptance has been revoked, Buyer will be entitled to recover the purchase price plus either the difference between the contract price and market price or difference between the contract price and the cost of buying a replacement (cover), plus incidental and consequential damages. If he chooses the first, he will likely be limited to incidental and consequential damages, because the mechanic stated the market price is the same as the contract price. If he chooses to cover, he must make a reasonable contract for a substitute car in good faith and without unreasonable delay.

Misrepresentation

At issue is whether Seller fraudulently induced Buyer to enter the agreement. If a party induces another to enter into a contract by using fraudulent misrepresentation (by asserting information he knows is untrue), the contract is voidable by the innocent party if he justifiably relied on the misrepresentation. Here, Buyer has a strong case for fraud in the inducement. While it would be difficult to prove that Seller knew the general statements about the condition of the car were false, he clearly knew that the clutch and brakes were not replaced within the last six months. It seems likely that Buyer justifiably relied on that statement in entering into the contract. Thus, Buyer may avoid the contract if he so chooses. If he does so, under the UCC he would be entitled to damages for breach in addition to restitution of the purchase price.

ANSWER TO EXAM QUESTION NO. 3

The major issues raised by this question are whether either Bland or Star can be held in breach of the contract and whether the purported "liquidated damages clause" would be enforceable against Star.

Formation of Contract

There appear to be no problems as to the formation of an executory bilateral contract between Star and Bland on April 1. There was a writing stating the essential terms signed by the parties, and the promise to perform in return for the promise to pay $1,000 represents legally sufficient consideration on both sides of the agreement.

Effect of April 10 Communication

Star's notice to Bland on April 10 that she probably would not be able to appear as scheduled raises the issue of ***breach by anticipatory repudiation.*** Where in advance of the time set for performance either party to an executory bilateral contract manifests an unconditional, unequivocal refusal to perform as promised, there is a present material breach, giving the other party the right to bring immediate suit. Here, however, Star's letter falls short of an express repudiation. The fact that she "probably" would not be able to perform is not an unconditional, unequivocal notice that she ***will not*** or ***cannot*** perform. Her expression of mere doubt is not enough to constitute the requisite repudiation, and hence, at this juncture, the contract remained intact as to both parties.

Effect of April 15 Communication

Even if it were held that Star's notice amounted to an anticipatory breach, Star's communication to Bland on April 15 would constitute a valid ***retraction*** and "revive" the contract. According to the general view, the repudiator can withdraw a repudiation any time before the other party has changed position in reliance thereon. Because Bland neither commenced suit nor otherwise suffered any detriment in the interim, any threatened breach at this point has been cured.

Effect of April 23 and April 28 Communications

When Bland informed Star that it would not be requiring her services, this amounted to an express repudiation. Having couched its intent in unequivocal language, Bland could have been held liable for anticipatory breach. However, Star did not bring suit, and the facts in no way indicate that she changed her position (e.g., by procuring another job). Thus, the subsequent wire from Bland deciding to hold Star to the original contract was a communication of its firm intention to abide by the agreement and, hence, was a valid retraction of the repudiation. The agreement, therefore, remained in force.

Defenses of Discharge by Impossibility of Performance and Frustration of Purpose

The occurrence of an unanticipated event may make contractual duties impossible to perform or frustrate the purpose of the contract. If the nonoccurrence of the event was a basic assumption of the parties in making the contract and neither party has expressly or impliedly assumed the risk of the event, contractual duties may be discharged. Because the promisor's duty to perform is a condition precedent to the other party's duty to perform, if one party's duties are discharged by impossibility or frustration, the other party's duties are also discharged.

In this case, Star's duties may be discharged by impossibility, which would also discharge Bland's duties. Similarly, Bland's duties may be discharged by frustration of purpose, thereby discharging Star's duties as well. It has become impossible for Star to perform in a one-hour live television show from 8-9 p.m. on May 1, because the show will not be on television. The show has been preempted by the F.C.C. to broadcast a presidential address. Thus, Star's duty to perform likely would be discharged for impossibility. Likewise, Bland's purpose in entering into the contract with Star has been frustrated by the preemption. To establish frustration of purpose, Bland must show that there is a supervening act that the parties did not reasonably foresee when they entered into the contract and that the purpose of the contract has been destroyed by this event. Here, Bland hired Star to perform on a live television program. The presidential address is a supervening act that neither party could foresee. The preemption of the live program destroys the purpose of Bland's hiring of Star. It no longer needs her to perform. Thus, Bland's duty to pay Star is discharged by frustration of purpose. Either defense of impossibility

or frustration of purpose would serve to discharge both parties from their duties. Therefore, Star is no longer obligated to perform and Bland is no longer obligated to pay Star.

Status of Liquidated Damages Clause

Because neither party can be held in breach, the status of the damages clause in the contract is really a moot question. Briefly, however, its enforceability would depend on whether it is found to be a valid liquidated damages clause or void as an attempted penalty. Two conditions must be met for the clause to be upheld: (i) at the time of contracting, both parties must have recognized that actual damages in the event of breach would be extremely difficult to ascertain; and (ii) the amount adopted must be a reasonable forecast of actual damages. Here, it is likely that the first condition was met, because there are so many variables in the television industry that could affect the consequences to Bland should Star not perform. Whether $25,000 is a reasonable estimate of actual loss would be a jury question (although use of the word "forfeit" is suspect terminology).

ANSWER TO EXAM QUESTION NO. 4

This question raises major formation and assignment issues, both of which will be discussed in the context of the various possible suits between the parties.

D v. P

A suit by D against P for breach of the alleged contract is foreclosed on the ground that D no longer has any ***standing to sue***. Although he was an original party to the contract, as will be discussed below, an operable assignment transpired prior to any tender by D, which extinguished both his right to receive performance from P and his right to pursue a cause of action on the contract.

A v. P

Standing to Sue: A is the proper party to bring suit. At issue is the effect of D's assignment of rights to A. Because A was not a party to the alleged contract, his rights to sue, if any, are as an assignee pursuant to an operable assignment. This requires a showing of a present transfer of an ***assignable right***. Although the right to purchase land is often held too "personal" to assign, this is generally true only with credit transactions (because the obligor should not be subject to variation in risk that he will be paid). Apparently, however, a sale of Blackacre on credit was not contemplated here. Moreover, P in no way indicated in his letter that any attempted assignment would be void. Hence, at this point, A has succeeded to D's rights by way of an operable assignment.

However, the facts state that D subsequently made a similar assignment to B. This poses the problem of whether A thereby lost his standing to sue by virtue of the law of ***successive assignments.*** Under the majority rule, where, as in this case, the equities are equal between the parties (i.e., both A and B paid consideration for delivery of a written assignment), the ***first assignee in time*** prevails. The rationale is that thereafter the assignor had nothing left to transfer. Hence, in most jurisdictions A is now the proper party to bring suit.

Formation of Contract: The issue here is whether the offer ***terminated*** either by its own terms or by notice of revocation prior to the dispatch of a timely acceptance by D.

Termination by Lapse of Time? P's promise to keep the offer open for 10 days could arguably be construed as restricting D's power to accept it within 10 days after the letter (a) was dated, (b) normally would have been received, or (c) actually was received. Moreover, it is also plausible that P meant that he had to be aware of D's acceptance within 10 days. Nevertheless, where, as here, it is not clear what P intended, the interpretation turns on what a reasonable offeree would understand P's statement to mean (objective theory of contracts). According to the facts, D was given 10 days to think over the

offer. Because it obviously takes time for mail to travel, P probably intended the offer to remain open for 10 days after receipt in the normal course of post (one day). Thus, because as a reasonable person D would be expected to have read the date on the letter (February 1), thereby realizing it was delayed in transit, he would have only until February 12 to accept the offer. The facts state that D did post an acceptance on February 12 when the offer had not yet terminated by lapse of time.

Termination by Revocation? Although P promised to hold his offer open for 10 days, this commitment was not binding because it was not supported by consideration. P therefore retained the power to revoke and in fact attempted to do so in his February 8 letter, received by D on February 12, but after D had dispatched his acceptance. According to the weight of authority, a revocation is not effective until ***received,*** and an acceptance is effective upon ***dispatch*** through an authorized mode of communication. Because the offeree is impliedly authorized to use any means of transmission comparable to that used by the offeror (here, mail), D's acceptance became effective when posted (as discussed above, the offer had not yet terminated). Therefore, being that the revocation was not received until a few hours later, in most jurisdictions a ***valid contract was formed*** for the conveyance of Blackacre. Consequently, P is obligated to follow through with his promise to sell.

B v. D

As indicated above, in most jurisdictions, assignee A is the sole party in possession of the contract right against P. However, B (the losing assignee), having paid consideration for the assignment, can sue D for ***breach of implied warranty*** that the assigned right exists (i.e., that it was not previously transferred). Under the minority rule, where B would prevail over A, A could pursue an action against D for breach of implied warranty that he would not make a subsequent assignment.