



Contract Doctrine, Theory and Practice

Volume One

J.H. VERKERKE



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About the Author

Before he received his law degree in 1990, J. H. (Rip) Verkerke earned a master's of philosophy in economics. Verkerke joined the Law School faculty in 1991 and teaches employment law, employment discrimination law, contracts and a seminar on law and economics.

While at Yale, Verkerke was articles editor and articles administrator for the *Yale Law Journal* and held a number of fellowships, including the John M. Olin Fellowship in Law, Economics, and Public Policy. After graduation, he clerked for Judge Ralph K. Winter Jr. of the U.S. Court of Appeals for the Second Circuit.

In June 1996 Verkerke received a three-year grant from the University's Academic Enhancement Program to establish the Program for Employment and Labor Law Studies at the Law School. He served as visiting professor of law at the University of Texas at Austin in the fall of 1997. Verkerke also participated in an ABA project to draft a new labor code for the transitional government of Afghanistan. In 2007, Verkerke received an All-University Teaching Award from UVA, and in 2011, he was selected as an inaugural member of the University Academy of Teaching.

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Preface

These teaching materials are a work-in-progress. Our reading assignments this semester will include all of the elements that make up a conventional casebook. You will read judicial opinions, statutory provisions, academic essays, and hypotheticals. You will puzzle over common law doctrines and carefully parse statutes. We will try to develop theories that can predict and justify the patterns of judicial decisions we observe.

Unlike a conventional casebook, however, I have selected each element of the readings myself. We will start at the beginning of these materials, read each assignment in order, and finish at the end. All of the reading assignments are also self-contained. When I ask you to read a statutory section or a portion of the Restatement, it will appear in the text at the point where you should read it. In addition, we will cover the entire set of materials. You will not spend the semester hauling around hundreds of extra pages that we have no time to read or discuss. At the end of each section, you will find discussion questions that track very closely the questions that I will ask during our class time together. Finally, the pages themselves are formatted to make reading easier and to give you plenty of space to take notes and mark up the text.

Our class also will use an online collaboration site to enrich and extend class discussions. This site will provide links to additional legal sources as well as questions for class discussion, practice problems, explanatory notes, and a discussion forum. The site will develop and evolve in response to your needs and interests. If you have any suggestions for changes or additions to these materials, I invite you to talk with me or post your ideas to our collaboration site.

Why study contract law?

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

Why collaborative teaching materials?

The ultimate goal of this project is to involve many professors in producing a library of materials for teaching contracts (and other subjects). For the moment, I will be solely responsible for collecting public domain content and generating problems and explanatory essays. These embryonic reading materials will grow and evolve as I use and expand them and as other professors join in producing additional content. I gratefully acknowledge the extraordinary work of my talented research assistants who have been instrumental in helping me to put these materials together. Thanks to Sarah Bryan, Mario Lorello, Elizabeth Young, Vishal Phalgoo, Valerie Barker and Jim Sherwood.

I believe that it is equally important to involve students in the ongoing process of refining and improving how we teach legal subjects. Our collaboration site will provide a platform for student-generated content and lively dialogue. With your enthusiastic engagement, we will finish the semester with an excellent understanding of contracts and a useful collection of reference materials. I invite each of you to join us for what will be a challenging, sometimes frustrating, but ultimately rewarding, intellectual journey.

I. Introduction to the Legal Significance of Promise Making

The goal of this chapter is to introduce you to some of the fundamental questions that organize our study of contract law and theory. At least initially, we will focus exclusively on the judge-made rules of the “common law.” Prior judicial decisions—often referred to as “precedents”—comprise the only legally authoritative source of the common law. However, the American Law Institute (ALI), a prestigious organization of judges, professors and practicing lawyers, has promulgated “Restatements” for many core areas of the law, including contracts. We will study various sources of contract law in more detail soon, but for the moment, bear in mind that the Restatement (Second) of Contracts (1981), [hereinafter Restatement (Second)], quoted repeatedly in these reading materials is a highly influential formulation of the law of contracts.

1. What is a Promise?

We begin by considering what it means to make a promise. Let’s forget for just a moment about the law and think instead what normal people mean when they talk about a promise. Suppose that your professor tells you on the first day of class: “I promise that you’ll enjoy Contracts this semester.” Consider how we should understand this “promise.” Does the fact that the statement is oral rather than in writing make any difference? Is there anything about the circumstances in which this statement is made that undermines your confidence that the professor intends for this “promise” to be binding?

Now read the following sections of the Restatement (Second), and think about how the legal use of the term “promise” relates to our common sense understanding of the word.

Restatement (Second) of Contracts

§ 1. Contract Defined

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

§ 2. Promise; Promisor; Promisee; Beneficiary

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

(2) The person manifesting the intention is the promisor.

(3) The person to whom the manifestation is addressed is the promisee.

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

§ 3. Agreement Defined; Bargain Defined

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

§ 4. How a Promise May Be Made

A promise may be stated in words either oral or written, or may be inferred wholly or partly from conduct.

1.0.1 Discussion of Promise

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

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

1.1 Principal Case – *Bailey v. West*

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

Bailey v. West

Supreme Court of Rhode Island
105 R.I. 61, 249 A.2d 414 (1969)

PAOLINO, Justice.

[1] This is a civil action wherein the plaintiff [Bailey] alleges that the defendant [West] is indebted to him for the reasonable value of his services rendered in connection with the feeding, care and maintenance of a certain race horse named “Bascom's Folly” from May 3, 1962 through July 3, 1966. The case was tried before a justice of the superior court sitting without a jury, and resulted in a decision for the plaintiff for his cost of boarding the horse for the five months immediately subsequent to May 3, 1962, and for certain expenses incurred by him in trimming its hoofs. The cause is now before us on the plaintiff's appeal and defendant's cross appeal from the judgment entered pursuant to such decision.

[2] The facts material to a resolution of the precise issues raised herein are as follows. In late April 1962, defendant, accompanied by his horse trainer, went to Belmont Park in New York to buy race horses. On April 27, 1962, defendant purchased Bascom's Folly from a Dr. Strauss and arranged to have the horse shipped to Suffolk Downs in East Boston, Massachusetts. Upon its arrival defendant's trainer discovered that the horse was lame, and so notified defendant, who ordered him to reship the horse by van to the seller at Belmont Park. The seller refused to accept delivery at

Belmont on May 3, 1962, and thereupon, the van driver, one Kelly, called defendant's trainer and asked for further instructions. Although the trial testimony is in conflict as to what the trainer told him, it is not disputed that on the same day Kelly brought Bascom's Folly to plaintiff's farm where the horse remained until July 3, 1966, when it was sold by plaintiff to a third party.

[3] While Bascom's Folly was residing at his horse farm, plaintiff sent bills for its feed and board to defendant at regular intervals. According to testimony elicited from defendant at the trial, the first such bill was received by him some two or three months after Bascom's Folly was placed on plaintiff's farm. He also stated that he immediately returned the bill to plaintiff with the notation that he was not the owner of the horse nor was it sent to plaintiff's farm at his request. The plaintiff testified that he sent bills monthly to defendant and that the first notice he received from him disclaiming ownership was "maybe after a month or two or so" subsequent to the time when the horse was left in plaintiff's care.

[4] In his decision the trial judge found that defendant's trainer had informed Kelly during their telephone conversation of May 3, 1962, that "he would have to do whatever he wanted to do with the horse, that he wouldn't be on any farm at the defendant's expense." He also found, however, that when Bascom's Folly was brought to his farm, plaintiff was not aware of the telephone conversation between Kelly and defendant's trainer, and hence, even though he knew there was a controversy surrounding the ownership of the horse, he was entitled to assume that "there is an implication here that, 'I am to take care of this horse.'" Continuing his decision, the trial justice stated that in view of the result reached by this court in a recent opinion¹ wherein we held that the instant defendant was liable to the original

¹ See *Strauss v. West*, 100 R.I. 388, 216 A.2d 366.

seller, Dr. Strauss, for the purchase price of this horse, there was a contract “implied in fact” between the plaintiff and defendant to board Bascom's Folly and that this contract continued until plaintiff received notification from defendant that he would not be responsible for the horse's board. The trial justice further stated that “I think there was notice given at least at the end of the four months, and I think we must add another month on there for a reasonable disposition of his property.”

[5] In view of the conclusion we reach with respect to defendant's first two contentions, we shall confine ourselves solely to a discussion and resolution of the issues necessarily implicit therein, and shall not examine other subsidiary arguments advanced by plaintiff and defendant.

I

[6] The defendant alleges in his brief and oral argument that the trial judge erred in finding a contract implied in fact between the parties. We agree.

[7] The following quotation from 17 C.J.S. Contracts § 4 at pp. 557-560, illustrates the elements necessary to the establishment of a contract implied in fact:

A “contract implied in fact,” ... or an implied contract in the proper sense, arises where the intention of the parties is not expressed, but an agreement in fact, creating an obligation, is implied or presumed from their acts, or, as it has been otherwise stated, where there are circumstances which, according to the ordinary course of dealing and the common understanding of men, show a mutual intent to contract.

It has been said that a contract implied in fact must contain all the elements of an express contract. So, such a contract is dependent on mutual agreement or consent, and on the intention of the parties: and a meeting of the

minds is required. A contract implied in fact is to every intent and purpose an agreement between the parties, and it cannot be found to exist unless a contract status is shown. Such a contract does not arise out of an implied legal duty or obligation, but out of facts from which consent may be inferred; there must be a manifestation of assent arising wholly or in part from acts other than words, and a contract cannot be implied in fact where the facts are inconsistent with its existence.

[8] Therefore, essential elements of contracts implied in fact are mutual agreement, and intent to promise, but the agreement and the promise have not been made in words and are implied from the facts. *Power-Matics, Inc. v. Ligotti*, 191 A.2d 483 (N.J. Super. 1963); *St. Paul Fire & M. Ins. Co. v. Indemnity Ins. Co. of No. America*, 158 A.2d 825 (N.J. 1960); *St. John's First Lutheran Church v. Storsteen*, 84 N.W.2d 725 (S.D. 1957).²

[9] In the instant case, plaintiff sued on the theory of a contract “implied in law.” There was no evidence introduced by him to support the establishment of a contract implied in fact, and he cannot now argue solely on the basis of the trial justice's decision for such a result.

[10] The source of the obligation in a contract implied in fact, as in express contracts, is in the intention of the parties. We hold that there was no mutual agreement and intent to promise between the plaintiff and defendant so as to establish a contract implied in fact for defendant to pay plaintiff for the maintenance of this horse. From the time Kelly delivered the horse to him plaintiff knew there was a dispute as to its ownership, and his subsequent actions indicated he did not know with whom, if anyone, he had a contract. After he had

² Compare *Arden Engineering Co. v. E. Turgeon Constr. Co.*, 97 R.I. 342, 347, 197 A.2d 743, 746, and *George Spalt & Sons, Inc. v. Maiello*, 48 R.I. 223, 226, 136 A. 882, 883.

accepted the horse, he made inquiries as to its ownership and, initially, and for some time thereafter, sent his bills to both defendant and Dr. Strauss, the original seller.

[11] There is also uncontroverted testimony in the record that prior to the assertion of the claim which is the subject of this suit neither defendant nor his trainer had ever had any business transactions with plaintiff, and had never used his farm to board horses. Additionally, there is uncontradicted evidence that this horse, when found to be lame, was shipped by defendant's trainer not to plaintiff's farm, but back to the seller at Belmont Park. What is most important, the trial justice expressly stated that he believed the testimony of defendant's trainer that he had instructed Kelly that defendant would not be responsible for boarding the horse on any farm.

[12] From our examination of the record we are constrained to conclude that the trial justice overlooked and misconceived material evidence which establishes beyond question that there never existed between the parties an element essential to the formulation of any true contract, namely, an intent to contract. Compare *Morrissey v. Piette*, R.I., 241 A.2d 302, 303.

II

[13] The defendant's second contention is that, even assuming the trial justice was in essence predicating defendant's liability upon a quasi-contractual theory, his decision is still unsupported by competent evidence and is clearly erroneous.

[14] The following discussion of quasi-contracts appears in 12 Am.Jur., Contracts, § 6 (1938) at pp. 503 to 504:

A quasi-contract has no reference to the intentions or expressions of the parties. The obligation is imposed despite, and frequently in frustration of, their intention. For a quasi contract neither promise nor privity, real or imagined, is necessary. In quasi contracts the

obligation arises, not from consent of the parties, as in the case of contracts, express or implied in fact, but from the law of natural immutable justice and equity. The act, or acts, from which the law implies the contract must, however, be voluntary. Where a case shows that it is the duty of the defendant to pay, the law imputes to him a promise to fulfil that obligation. The duty, which thus forms the foundation of a quasi-contractual obligation, is frequently based on the doctrine of unjust enrichment..... The law will not imply a promise against the express declaration of the party to be charged, made at the time of the supposed undertaking, unless such party is under legal obligation paramount to his will to perform some duty, and he is not under such legal obligation unless there is a demand in equity and good conscience that he should perform the duty.

[15]Therefore, the essential elements of a quasi-contract are a benefit conferred upon defendant by plaintiff, appreciation by defendant of such benefit, and acceptance and retention by defendant of such benefit under such circumstances that it would be inequitable to retain the benefit without payment of the value thereof. *Home Savings Bank v. General Finance Corp.*, 10 Wis.2d 417, 103 N.W.2d 117, 81 A.L.R.2d 580.

[16]The key question raised by this appeal with respect to the establishment of a quasi-contract is whether or not plaintiff was acting as a “volunteer” at the time he accepted the horse for boarding at his farm. There is a long line of authority which has clearly enunciated the general rule that “if a performance is rendered by one person without any request by another, it is very unlikely that this person will be under a legal duty to pay compensation.” 1 A Corbin, *Contracts* § 234.

[17]The Restatement of Restitution, § 2 (1937) provides: “A person who officiously confers a benefit upon another is not entitled to restitution therefor.” Comment a in the above-mentioned section states in part as follows:

Policy ordinarily requires that a person who has conferred a benefit...by way of giving another services...should not be permitted to require the other to pay therefor, unless the one conferring the benefit had a valid reason for so doing. A person is not required to deal with another unless he so desires and, ordinarily, a person should not be required to become an obligor unless he so desires.

[18]Applying those principles to the facts in the case at bar it is clear that plaintiff cannot recover. The plaintiff's testimony on cross-examination is the only evidence in the record relating to what transpired between Kelly and him at the time the horse was accepted for boarding. The defendant's attorney asked plaintiff if he had any conversation with Kelly at that time, and plaintiff answered in substance that he had noticed that the horse was very lame and that Kelly had told him: “That's why they wouldn't accept him at Belmont Track.” The plaintiff also testified that he had inquired of Kelly as to the ownership of Bascom's Folly, and had been told that “Dr. Strauss made a deal and that's all I know.” It further appears from the record that plaintiff acknowledged receipt of the horse by signing a uniform livestock bill of lading, which clearly indicated on its face that the horse in question had been consigned by defendant's trainer not to plaintiff, but to Dr. Strauss's trainer at Belmont Park. Knowing at the time he accepted the horse for boarding that a controversy surrounded its ownership, plaintiff could not reasonably expect remuneration from defendant, nor can it be said that defendant acquiesced in the conferment of a benefit upon him. The undisputed testimony was that defendant, upon receipt of plaintiff's first bill, immediately notified him

that he was not the owner of Bascom's Folly and would not be responsible for its keep.

[19]It is our judgment that the plaintiff was a mere volunteer who boarded and maintained Bascom's Folly at his own risk and with full knowledge that he might not be reimbursed for expenses he incurred incident thereto.

[20]The plaintiff's appeal is denied and dismissed, the defendant's cross appeal is sustained, and the cause is remanded to the superior court for entry of judgment for the defendant.

1.1.1 Discussion of implied contract claim in *Bailey v. West*

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

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

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

1.1.2 The Law of Agency

Although the court sometimes talks about Bailey and West as though they were dealing directly with one another, the *Bailey* case is also full of potential "agents." A complex body of law determines who is an

agent and what that agent is authorized to do on behalf of his or her “principal.” Here are a few sections of the Restatement (Third) of Agency (2006), [hereinafter Restatement (Third)], that explain the basic legal rules governing when someone has the legal authority to make a contract for another person.

Restatement (Third) of Agency

§ 1.03 Manifestation

A person manifests assent or intention through written or spoken words or other conduct.

§ 2.01 Actual Authority

An agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal's manifestations to the agent, that the principal wishes the agent so to act.

§ 2.03 Apparent Authority

Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations.

§ 3.03 Creation of Apparent Authority

Apparent authority, as defined in § 2.03, is created by a person's manifestation that another has authority to act with legal consequences for the person who makes the manifestation, when a third party reasonably believes the actor to be authorized and the belief is traceable to the manifestation.

§ 3.11 Termination of Apparent Authority

(1) The termination of actual authority does not by itself end any apparent authority held by an agent.

(2) Apparent authority ends when it is no longer reasonable for the third party with whom an agent deals to believe that the agent continues to act with actual authority.

1.1.3 Hypo on Agency

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

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

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

1.1.4 Discussion of Agency

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

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

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

1.1.5 Problem on Agency

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

1.1.6 The Law of Restitution

After rejecting Bailey's implied contract claim, the *Bailey* court also considers whether West should be bound to pay Bailey for boarding services under "a quasi-contractual theory." Modern commentary has largely abandoned the term "quasi-contract" and instead analyzes such claims under the law of restitution. Courts ordinarily refuse to provide compensation without evidence of a bargain. They often characterize the unsuccessful claimant as a "mere volunteer" or even perhaps an "officious intermeddler." In very limited circumstances, however, courts may be willing to impose liability on someone who receives a benefit for which he or she has not bargained. An oft-quoted example is the following hypothetical from a judicial opinion:

If a person saw day after day a laborer at work in his field doing services which must of necessity enure to his benefit, knowing that the laborer expected pay for his work, when it was perfectly easy to notify him his services

were not wanted, even if a request were not expressly proved, such a request, either previous or contemporaneous with the performance of the services might fairly be inferred. But if the fact was merely brought to his attention upon a single occasion and casually, if he had little opportunity to notify the other that he did not desire the work and should not pay for it, or could only do so at the expense of much time and trouble, the same inference might not be made.

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

1.1.7 Hypo on Restitution

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

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

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

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

1.1.8 Discussion of Restitution

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

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

Does Bailey have any argument for restitutionary recovery from West?

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

1.2 Principal Case – *Lucy v. Zehmer*

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

Lucy v. Zehmer
Supreme Court of Virginia
196 Va. 493, 84 S.E.2d 516 (1954)

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

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

brother of W. O. Lucy, to whom W. O. Lucy transferred a half interest in his alleged purchase.

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

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

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

[5] W. O. Lucy, a lumberman and farmer, thus testified in substance: He had known Zehmer for fifteen or twenty years and had been familiar with the Ferguson farm for ten years. Seven or eight years ago he had offered Zehmer \$20,000 for the farm which Zehmer had accepted, but the agreement was verbal and Zehmer backed out. On the night of December 20, 1952, around eight o'clock, he took an employee to McKenney, where Zehmer lived and operated a restaurant, filling station and motor court. While there he decided to see Zehmer and again try to buy the Ferguson farm. He entered

the restaurant and talked to Mrs. Zehmer until Zehmer came in. He asked Zehmer if he had sold the Ferguson farm. Zehmer replied that he had not. Lucy said, "I bet you wouldn't take \$50,000.00 for that place." Zehmer replied, "Yes, I would too; you wouldn't give fifty." Lucy said he would and told Zehmer to write up an agreement to that effect. Zehmer took a restaurant check and wrote on the back of it, "I do hereby agree to sell to W. O. Lucy the Ferguson Farm for \$50,000 complete." Lucy told him he had better change it to "We" because Mrs. Zehmer would have to sign it too. Zehmer then tore up what he had written, wrote the agreement quoted above and asked Mrs. Zehmer, who was at the other end of the counter ten or twelve feet away, to sign it. Mrs. Zehmer said she would for \$50,000 and signed it. Zehmer brought it back and gave it to Lucy, who offered him \$5 which Zehmer refused, saying, "You don't need to give me any money, you got the agreement there signed by both of us."

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

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

[8] December 20 was on Saturday. Next day Lucy telephoned to J. C. Lucy and arranged with the latter to take a half interest in the purchase and pay half of the consideration. On Monday he engaged an attorney to examine the title. The attorney reported favorably on December 31 and on January

2 Lucy wrote Zehmer stating that the title was satisfactory, that he was ready to pay the purchase price in cash and asking when Zehmer would be ready to close the deal. Zehmer replied by letter, mailed on January 13, asserting that he had never agreed or intended to sell.

[9] Mr. and Mrs. Zehmer were called by the complainants as adverse witnesses. Zehmer testified in substance as follows:

[10]He bought this farm more than ten years ago for \$11,000. He had had twenty-five offers, more or less, to buy it, including several from Lucy, who had never offered any specific sum of money. He had given them all the same answer, that he was not interested in selling it. On this Saturday night before Christmas it looked like everybody and his brother came by there to have a drink. He took a good many drinks during the afternoon and had a pint of his own. When he entered the restaurant around eight-thirty Lucy was there and he could see that he was "pretty high." He said to Lucy, "Boy, you got some good liquor, drinking, ain't you?" Lucy then offered him a drink. "I was already high as a Georgia pine, and didn't have any more better sense than to pour another great big slug out and gulp it down, and he took one too."

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

[12]Finally, said Zehmer, Lucy told him if he didn't believe he had \$50,000, "you sign that piece of paper here and say you will take \$50,000.00 for the farm." He, Zehmer, "just grabbed the back off of a guest check there" and wrote on the back of

it. At that point in his testimony Zehmer asked to see what he had written to “see if I recognize my own handwriting.” He examined the paper and exclaimed, “Great balls of fire, I got 'Firgerson' for Ferguson. I have got satisfactory spelled wrong. I don't recognize that writing if I would see it, wouldn't know it was mine.”

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

[14]Mrs. Zehmer testified that when Lucy came into the restaurant he looked as if he had had a drink. When Zehmer came in he took a drink out of a bottle that Lucy handed him. She went back to help the waitress who was getting things ready for next day. Lucy and Zehmer were talking but she did not pay too much attention to what they were saying. She heard Lucy ask Zehmer if he had sold the Ferguson farm, and Zehmer replied that he had not and did not want to sell it. Lucy said, “I bet you wouldn't take \$50,000 cash for that farm,” and Zehmer replied, “You haven't got \$50,000 cash.” Lucy said, “I can get it.” Zehmer said he might form a company and get it, “but you haven't got \$50,000.00 cash to pay me tonight.” Lucy asked him if he would put it in writing that he would sell him this farm. Zehmer then wrote on the back of a pad, “I agree to sell the Ferguson Place to W. O. Lucy for \$50,000.00 cash.” Lucy said, “All right, get your wife

to sign it.” Zehmer came back to where she was standing and said, “You want to put your name to this?” She said “No,” but he said in an undertone, “It is nothing but a joke,” and she signed it.

[15]She said that only one paper was written and it said: “I hereby agree to sell,” but the “I” had been changed to “We”. However, she said she read what she signed and was then asked, “When you read ‘We hereby agree to sell to W. O. Lucy,’ what did you interpret that to mean, that particular phrase?” She said she thought that was a cash sale that night; but she also said that when she read that part about “title satisfactory to buyer” she understood that if the title was good Lucy would pay \$50,000 but if the title was bad he would have a right to reject it, and that that was her understanding at the time she signed her name.

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

[17]The waitress referred to by Mrs. Zehmer testified that when Lucy first came in “he was mouthy.” When Zehmer came in they were laughing and joking and she thought they took a drink or two. She was sweeping and cleaning up for next day. She said she heard Lucy tell Zehmer, “I will give you so much for the farm,” and Zehmer said, “You haven't got that much.” Lucy answered, “Oh, yes, I will give you that

much.” Then “they jotted down something on paper ... and Mr. Lucy reached over and took it, said let me see it.” He looked at it, put it in his pocket and in about a minute he left. She was asked whether she saw Lucy offer Zehmer any money and replied, “He had five dollars laying up there, they didn't take it.” She said Zehmer told Lucy he didn't want his money “because he didn't have enough money to pay for his property, and wasn't going to sell his farm.” Both of them appeared to be drinking right much, she said.

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

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

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

[21]In his testimony Zehmer claimed that he “was high as a Georgia pine,” and that the transaction “was just a bunch of two doggoned drunks bluffing to see who could talk the biggest and say the most.” That claim is inconsistent with his attempt to testify in great detail as to what was said and what was done. It is contradicted by other evidence as to the condition of both parties, and rendered of no weight by the

testimony of his wife that when Lucy left the restaurant she suggested that Zehmer drive him home. The record is convincing that Zehmer was not intoxicated to the extent of being unable to comprehend the nature and consequences of the instrument he executed, and hence that instrument is not to be invalidated on that ground. 17 C.J.S., Contracts, § 133 b., p. 483; *Taliaferro v. Emery*, 124 Va. 674, 98 S.E. 627. It was in fact conceded by defendants' counsel in oral argument that under the evidence Zehmer was not too drunk to make a valid contract.

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

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

[24]On Sunday, the day after the instrument was signed on Saturday night, there was a social gathering in a home in the town of McKenney at which there were general comments that the sale had been made. Mrs. Zehmer testified that on

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

[25]If it be assumed, contrary to what we think the evidence shows, that Zehmer was jesting about selling his farm to Lucy and that the transaction was intended by him to be a joke, nevertheless the evidence shows that Lucy did not so understand it but considered it to be a serious business transaction and the contract to be binding on the Zehmers as well as on himself. The very next day he arranged with his brother to put up half the money and take a half interest in the land. The day after that he employed an attorney to examine the title. The next night, Tuesday, he was back at Zehmer's place and there Zehmer told him for the first time, Lucy said, that he wasn't going to sell and he told Zehmer, "You know you sold that place fair and square." After receiving the report from his attorney that the title was good he wrote to Zehmer that he was ready to close the deal.

[26]Not only did Lucy actually believe, but the evidence shows he was warranted in believing, that the contract

represented a serious business transaction and a good faith sale and purchase of the farm.

[27]In the field of contracts, as generally elsewhere, “We must look to the outward expression of a person as manifesting his intention rather than to his secret and unexpressed intention. “The law imputes to a person an intention corresponding to the reasonable meaning of his words and acts.” *First Nat. Bank v. Roanoke Oil Co.*, 169 Va. 99, 114, 192 S.E. 764, 770.

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

[29]The mental assent of the parties is not requisite for the formation of a contract. If the words or other acts of one of the parties have but one reasonable meaning, his undisclosed intention is immaterial except when an unreasonable meaning which he attaches to his manifestations is known to the other party. Restatement of the Law of Contracts, Vol. I, § 71, p. 74.

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

Clark on Contracts, 4 ed., § 3, p. 4.

[30]An agreement or mutual assent is of course essential to a valid contract but the law imputes to a person an intention corresponding to the reasonable meaning of his words and acts. If his words and acts, judged by a reasonable standard, manifest an intention to agree, it is immaterial what may be the real but unexpressed state of his mind. 17 C.J.S., Contracts, § 32, p. 361; 12 Am. Jur., Contracts, § 19, p. 515.

[31]So a person cannot set up that he was merely jesting when his conduct and words would warrant a reasonable person in believing that he intended a real agreement, 17 C.J.S., Contracts, § 47, p. 390; Clark on Contracts, 4 ed., § 27, at p. 54.

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

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

[34]Specific performance, it is true, is not a matter of absolute or arbitrary right, but is addressed to the reasonable and sound discretion of the court. *First Nat. Bank v. Roanoke Oil Co.*, *supra*, 169 Va. at p. 116, 192 S.E. at p. 771. But it is likewise true that the discretion which may be exercised is not an arbitrary or capricious one, but one which is controlled by the established doctrines and settled principles of equity; and, generally, where a contract is in its nature and circumstances unobjectionable, it is as much a matter of course for courts of equity to decree a specific performance of it as it is for a court of law to give damages for a breach of it. *Bond v. Crawford*, 193 Va. 437, 444, 69 S.E.2d 470, 475.

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

Reversed and remanded.

1.2.1 Capacity to Contract

In *Lucy*, the court discusses at some length the possibility that Zehmer might be excused from contractual liability because he was intoxicated. The law concerning intoxication is simply one manifestation of a more general principle that we refer to as “capacity to contract.” Here is what the Restatement (Second) has to say on the subject:

Restatement (Second) of Contracts

§ 12. Capacity To Contract

(1) No one can be bound by contract who has not legal capacity to incur at least voidable contractual duties. Capacity to contract may be partial and its existence in respect of a particular transaction may depend upon the nature of the transaction or upon other circumstances.

(2) A natural person who manifests assent to a transaction has full legal capacity to incur contractual duties thereby unless he is

- (a) under guardianship, or
- (b) an infant, or
- (c) mentally ill or defective, or
- (d) intoxicated.

§ 16. Intoxicated Persons

A person incurs only voidable contractual duties by entering into a transaction if the other party has reason to know that by reason of intoxication

- (a) he is unable to understand in a reasonable manner the nature and consequences of the transaction, or
- (b) he is unable to act in a reasonable manner in relation to the transaction.

1.2.2 Discussion of *Lucy v. Zehmer*

What leads the court to reject Zehmer's intoxication defense?

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

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

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

1.2.3 Leonard v. Pepsico

Sometimes a purported promise is merely a joke. In the celebrated case of *Leonard v. Pepsico*, 88 F. Supp. 116 (S.D.N.Y. 1997), the court considered Leonard's claim that a "Pepsi Stuff" commercial constituted a promise to redeem 7,000,000 Pepsi Points for a Harrier Jet. Leonard submitted an order form, fifteen Pepsi Points, and a check for \$700,008.50 to purchase the remaining points. Although the order form offered additional points at 10 cents each, it did not list the jet as an available premium. Leonard wrote in "1 Harrier Jet"

in the “Item” column and “7,000,000” in the “Total Points” column. Pepsico returned Leonard’s submission and explained that the company had included the images of the Harrier Jet for its comic effect. The court similarly rejected plaintiff’s claim and opined that:

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

Id. at 137.

2. Which Promises Are Enforced?

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

2.1 Why Enforce Promises?

2.1.1 Alternative Methods of Enforcement

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

moment that litigation costs will prevent retailers from suing you for breach.

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

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

2.1.2 Hypo on Instant Retraction

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

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

2.1.3 Discussion of Instant Retraction

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

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

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

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

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

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

2.1.4 Gap Filling

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

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

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

2.1.5 Hypo on Gap Filling

My colleague Paul Mahoney and I agree that I will lease his car for a year while he is on leave to establish a new law office in Russia. We explicitly agree on a rental rate of \$100/month and a lease term of one year. Suppose that the car’s clutch fails six months into the lease. How would you expect a court to respond to my claim that Mahoney is obligated to pay for the necessary repairs?

2.1.6 Discussion of Gap Filling

We can array various approaches to gap filling along a continuum. At one extreme are simple majoritarian default rules, a one-size-fits-all solution. At the opposite extreme is a highly tailored default term that

tries to capture what these particular parties would have agreed to if they had bargained over the issue.

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

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

Which approach to gap filling do you favor? Why?

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

2.2 Introduction to Indefiniteness Doctrine

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

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

The second argument for refusing to enforce indefinite agreements proceeds on the assumption that the parties intended to form an enforceable contract. Courts taking this approach focus on concerns about judicial capacity and the parties' *lack of care in drafting*. For example, in *Walker v. Keith*, 382 S.W.2d 198 (Ky. Ct. App. 1964), the court explained that:

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

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

2.3 Principal Case – *Varney v. Ditmars*

Varney v. Ditmars

Court of Appeals of New York
217 N.Y. 223, 111 N.E. 822 (1916)

CHASE, Judge

[1] This is an action brought for an alleged wrongful discharge of an employee. The defendant is an architect employing engineers, draftsmen and other assistants. The plaintiff is an architect and draftsman. In October, 1910, he applied to the defendant for employment and when asked what wages he wanted, replied that he would start for \$40 per week. He was employed at \$35 per week. A short time thereafter he informed the defendant that he had another position offered to him and the defendant said that if he would remain with him and help him through the work in his

office he thought he could offer him a better future than anybody else. He continued in the employ of the defendant and became acquainted with a designer in the office and said designer and the plaintiff from time to time prior to the 1st of February, 1911, talked with the defendant about the work in his office. On that day by arrangement the two remained with the defendant after the regular office hours and the defendant said: "I am going to give you \$5 more a week; if you boys will go on and continue the way you have been and get me out of this trouble and get these jobs started that were in the office three years, on the first of next January I will close my books and give you a fair share of my profits. That was the result of the conversation. That was all of that conversation." The plaintiff was given charge of the drafting. Thereafter suggestions were made by the plaintiff and said designer about discharging many of the defendant's employees and employing new men and such suggestions were carried out and the two worked in the defendant's office over time and many Sundays and holidays. At least one piece of work that the defendant said had been in his office for three years was completed. The plaintiff on his cross-examination told the story of the employment of himself and said designer as follows: "And he says at that time 'I am going to give you \$5 more a week starting this week.' This was about Thursday. He says 'You boys go on and continue the work you are doing and the first of January next year I will close my books and give you a fair share of my profits.' Those were his exact words."

[2] Thereafter the plaintiff was paid \$40 a week. On November 6, 1911, the night before the general election in this state, the defendant requested that all of his employees that could do so, should work on election day. The plaintiff told the defendant that he wanted to remain at home to attend an election in the village where he lived. About four o'clock in the afternoon of election day he was taken ill and remained at his house ill until a time that as nearly as can be

stated from the evidence was subsequent to December 1, 1911. On Saturday, November 11, the defendant caused to be delivered to the plaintiff a letter in which he said: "I am sending you herewith your pay for one day's work of seven hours, performed on Monday, the 6th inst. On Monday night, I made it my special duty to inform you that the office would be open all day Election Day and that I expected you and all the men to report for work. Much to my surprise and indignation, on Tuesday you made no appearance and all the men remained away, in obedience of your instructions to them of the previous evening. An act of this kind I consider one of extreme disloyalty and insubordination and I therefore am obliged to dispense with your services."

[3] After the plaintiff had recovered from his illness and was able to do so he went to the defendant's office (the date does not appear) and told him that he was ready, willing and able to continue his services under the agreement. The defendant denied that he had any agreement with him and refused to permit him to continue in his service. Thereafter and prior to January 1, 1912, the plaintiff received for special work about \$50.

[4] The plaintiff seeks to recover in this action for services from November 7, 1911, to December 31, 1911, inclusive, at \$40 per week and for a fair and reasonable percentage of the net profits of the defendant's business from February 1, 1911, to January 1, 1912, and demands judgment for \$1,680.

[5] At the trial he was the only witness sworn as to the alleged contract and at the close of his case the complaint was dismissed.

[6] The statement alleged to have been made by the defendant about giving the plaintiff and said designer a fair share of his profits is vague, indefinite and uncertain and the amount cannot be computed from anything that was said by the parties or by reference to any document, paper or other transaction. The minds of the parties never met upon any

particular share of the defendant's profits to be given the employees or upon any plan by which such share could be computed or determined. The contract so far as it related to the special promise or inducement was never consummated. It was left subject to the will of the defendant or for further negotiation. It is urged that the defendant by the use of the word "fair" in referring to a share of his profits, was as certain and definite as people are in the purchase and sale of a chattel when the price is not expressly agreed upon, and that if the agreement in question is declared to be too indefinite and uncertain to be enforced a similar conclusion must be reached in every case where a chattel is sold without expressly fixing the price therefor.

[7] The question whether the words "fair" and "reasonable" have a definite and enforceable meaning when used in business transactions is dependent upon the intention of the parties in the use of such words and upon the subject-matter to which they refer. In cases of merchandising and in the purchase and sale of chattels the parties may use the words "fair and reasonable value" as synonymous with "market value." A promise to pay the fair market value of goods may be inferred from what is expressly agreed by the parties. The fair, reasonable or market value of goods can be shown by direct testimony of those competent to give such testimony. The competency to speak grows out of experience and knowledge. The testimony of such witnesses does not rest upon conjecture. The opinion of this court in *United Press v. N. Y. Press Co.* (164 N. Y. 406) was not intended to assert that a contract of sale is unenforceable unless the price is expressly mentioned and determined.

[8] In the case of a contract for the sale of goods or for hire without a fixed price or consideration being named it will be presumed that a reasonable price or consideration is intended and the person who enters into such a contract for goods or service is liable therefor as on an implied contract. Such contracts are common, and when there is nothing therein to

limit or prevent an implication as to the price, they are, so far as the terms of the contract are concerned, binding obligations.

[9] The contract in question, so far as it relates to a share of the defendant's profits, is not only uncertain but it is necessarily affected by so many other facts that are in themselves indefinite and uncertain that the intention of the parties is pure conjecture. A fair share of the defendant's profits may be any amount from a nominal sum to a material part according to the particular views of the person whose guess is considered. Such an executory contract must rest for performance upon the honor and good faith of the parties making it. The courts cannot aid parties in such a case when they are unable or unwilling to agree upon the terms of their own proposed contract.

[10] It is elementary in the law that, for the validity of a contract, the promise, or the agreement, of the parties to it must be certain and explicit and that their full intention may be ascertained to a reasonable degree of certainty. Their agreement must be neither vague nor indefinite, and, if thus defective, parol proof cannot be resorted to. (*United Press v. N. Y. Press Co.*, *supra*, and cases cited; *Ruling Case Law*, vol. 6, 644.)

[11] The courts in this state, in reliance upon and approval of the rule as stated in the *United Press* case, have decided many cases involving the same rule. Thus, in *Mackintosh v. Thompson* (58 App. Div. 25) and again in *Mackintosh v. Kimball* (101 App. Div. 494) the plaintiff sought to recover compensation in addition to a stated salary which he had received and which additional amount rested upon a claim by him that while he was employed by the defendants he informed them that he intended to leave their employ unless he was given an increase in salary, and that one of the defendants said to him that they would make it worth his while if he would stay on, and would increase his salary, and that his idea was to give him an interest in the profits on certain buildings that they

were then erecting. The plaintiff further alleges that he asked what would be the amount of the increase and was told, "You can depend upon me; I will see that you get a satisfactory amount." The court held that the arrangement was too indefinite to form the basis of any obligation on the part of the defendants.

[12]In *Bluemmer v. Garvin* (120 App. Div. 29) the plaintiff and defendant were architects, and the plaintiff alleged that he drew plans for a public building in accordance with a contract held by the defendant and pursuant to a special agreement that if the plans were accepted the defendant would give him a fair share of the commissions to be received by him. The court held that a good cause of action was stated on *quantum meruit*, but that the contract was too vague and indefinite to be enforced.

[13]A similar rule has been adopted in many other states. I mention a few of them. In *Fairplay School Township v. O'Neal* (127 Ind. 95) a verbal contract between a school trustee and a teacher, in which the latter undertook to teach school for a term in the district, and the trustee promised to pay her "good wages," it was held that the alleged contract was void for uncertainty as to compensation, and that the school township was not liable for its breach.

[14]In *Dayton v. Stone* (111 Mich. 196) the plaintiff had sold to the defendant her stock of goods and fixtures, and by the contract of sale the undamaged goods were to be inventoried and taken at cost price, and the damaged goods at prices to be agreed upon. In an action for breach of contract it was held that the contract was an entire one, and that so far as it left the price of the damaged goods to be fixed and determined it was uncertain and incomplete, and not one which could be enforced against the defendant.

[15]In *Wittkowsky v. Wasson* (71 N. C. 451) it was held that where the price of certain property was to be fixed by agreement between the parties after the time of the

agreement and they did not agree upon the price that the title to the property did not pass.

[16]In *Adams v. Adams* (26 Ala. 272) a promise by a defendant for a valuable consideration to give his daughter a "full share of his property" which then and there was worth \$ 25,000 was held to be too indefinite and uncertain to support an action.

[17]In *Van Slyke v. Broadway Ins. Co.* (115 Cal. 644) a contract between an insurance agent and the insurance company for a contingent commission of 5% which did not give the facts upon which the contingency depended nor state the sum on which the 5% was to be computed was held unenforceable and also that it could not be aided by parol.

[18]In *Marvel v. Standard Oil Co.* (169 Mass. 553) a contract by which the defendant agreed to sell the plaintiff its oil on such reasonable terms as to enable him to compete successfully with other parties selling in the same territory was held to be too indefinite and too general to be enforceable as a contract.

[19]In *Burks v. Stam* (65 Mo. App. 455) a contract for the sale of two race horses for a specified sum and providing for a further payment of a fixed sum by the purchaser if he did well and had no bad luck with the horses was held too vague to admit of enforcement.

[20]In *Butler v. Kemmerer* (218 Pa. St. 242) the plaintiff was in the employ of the defendant at a regular salary and the defendant promised him that if there were any profits in the business he would divide them with the plaintiff "upon a very liberal basis." The action was brought to recover a part of the profits of the business and the court held that the contract was never made complete and that there was no standard by which to measure the degree of liberality with which the defendant should regard the plaintiff.

[21]The only cases called to our attention that tend to sustain the appellant's position are *Noble v. Joseph Burnett Co.* (208

Mass. 75) and *Silver v. Graves* (210 Mass. 26). The first at least of such cases is distinguishable from the case under consideration, but in any event the decisions therein should not be held sufficient to sustain the plaintiff's contention in view of the authorities in this state.

[22]The rule stated from the *United Press* case does not prevent a recovery upon *quantum meruit* in case one party to an alleged contract has performed in reliance upon the terms thereof, vague, indefinite and uncertain though they are. In such case the law will presume a promise to pay the reasonable value of the services. Judge Gray, who wrote the opinion in the *United Press* case, said therein: "I entertain no doubt that, where work has been done, or articles have been furnished, a recovery may be based upon *quantum meruit*, or *quantum valebat*; but, where a contract is of an executory character and requires performance over a future period of time, as here, and it is silent as to the price which is to be paid to the plaintiff during its term, I do not think that it possesses binding force. As the parties had omitted to make the price a subject of covenant, in the nature of things, it would have to be the subject of future agreement, or stipulation." (p. 412.)

[23]In *Petze v. Morse Dry Dock & Repair Co.* (125 N.Y. App. Div. 267, 270) the court say: "There is no contract so long as any essential element is open to negotiation." In that case a contract was made by which an employee in addition to certain specified compensation was to receive 5% of the net distributable profits of a business and it was further provided that "the method of accounting to determine the net distributable profits is to be agreed upon later when the company's accounts have developed for a better understanding." The parties never agreed as to the method of determining the net profits and the plaintiff was discharged before the expiration of the term. The court in the opinion say that "the plaintiff could recover for what he had done on a *quantum meruit*, and the employment must be deemed to have commenced with a full understanding on the part of

both parties that that was the situation." The judgment of the Appellate Division was unanimously affirmed without opinion in this court. (195 N. Y. 584.)

[24]So, this case, while I do not think that the plaintiff can recover anything as extra work, yet if the work actually performed as stated was worth more than \$40 per week, he having performed until November 7, 1910, could, on a proper complaint, recover its value less the amount received. (See *Bluemner v. Garvin, supra; S. C.*, 124 App. Div. 491; *King v. Broadhurst*, 164 App. Div. 689.)

[25]The plaintiff claims that he at least should have been allowed to go to the jury on the question as to whether he was entitled to recover at the rate of \$40 per week from November 7, 1911, to December 31, 1911, inclusive. He did not perform any services for the defendant from November 6 until some time after December 1st, by reason of his illness. He has not shown just when he offered to return. It appears that between the time when he offered to return and January 1st he received \$50 for other services.

[26]The amount that the plaintiff could recover, therefore, if any, based upon the agreement to pay \$40 per week would be very small, and he did not present to the court facts from which it could be computed. His employment by the defendant was conditional upon his continuing the way he had been working, getting the defendant out of his trouble and getting certain unenumerated jobs that were in the office three years, started. There was nothing in the contract specifying the length of service except as stated. It was not an unqualified agreement to continue the plaintiff in his service until the first of January, and it does not appear whether or not the special conditions upon which the contract was made had been performed. Even apart from the question whether the plaintiff's absence from the defendant's office by reason of his illness would permit the defendant to refuse to take him back into his employ, I do not think that on the testimony as it appears before us it was error to refuse to

leave to the jury the question whether the plaintiff was entitled to recover anything [at] the rate of \$40 per week.

[27]The judgment should be affirmed, with costs.

CARDOZO, Judge ([concurring in the judgment in part and] dissenting [in part]).

[28]I do not think it is true that a promise to pay an employee a fair share of the profits in addition to his salary is always and of necessity too vague to be enforced (*Noble v. Joseph Burnett Co.*, 208 Mass. 75; *Silver v. Graves*, 210 Mass. 26; *Brennan v. Employers Liability Assurance Corp., Ltd.*, 213 Mass. 365; *Joy v. St. Louis*, 138 U.S. 1, 43). The promise must, of course, appear to have been made with contractual intent (*Henderson Bridge Co. v. McGrath*, 134 U.S. 260, 275). But if that intent is present, it cannot be said from the mere form of the promise that the estimate of the reward is inherently impossible. The data essential to measurement may be lacking in the particular instance, and yet they may conceivably be supplied. It is possible, for example, that in some occupations an employee would be able to prove a percentage regulated by custom. The difficulty in this case is not so much in the contract as in the evidence. Even if the data required for computation might conceivably have been supplied, the plaintiff did not supply them. He would not have supplied them if all the evidence which he offered, and which the court excluded, had been received. He has not failed because the nature of the contract is such that damages are of necessity incapable of proof. He has failed because he did not prove them.

[29]There is nothing inconsistent with this view in *United Press v. N. Y. Press Co.* (164 N. Y. 406). The case is often cited as authority for the proposition that an agreement to buy merchandise at a fair and reasonable price is so indefinite that an action may not be maintained for its breach in so far as it is still executory. Nothing of the kind was decided, or with reason could have been. What the court did was to construe a

particular agreement, and to hold that the parties intended to reserve the price for future adjustment. If instead of reserving the price for future adjustment, they had manifested an intent on the one hand to pay and on the other to accept a fair price, the case is far from holding that a jury could not determine what such a price would be and assess the damages accordingly. Such an intent, moreover, might be manifested not only through express words, but also through reasonable implication. It was because there was neither an express statement nor a reasonable implication of such an intent that the court held the agreement void to the extent that it had not been executed.

[30]On the ground that the plaintiff failed to supply the data essential to computation, I concur in the conclusion that profits were not to be included as an element of damage. I do not concur, however, in the conclusion that he failed to make out a case of damage to the extent of his loss of salary. The amount may be small, but none the less it belongs to him. The hiring was not at will (*Watson v. Gugino*, 204 N. Y. 535; *Martin v. N. Y. Life Ins. Co.*, 148 N. Y. 117). The plain implication was that it should continue until the end of the year when the books were to be closed. The evidence would permit the jury to find that the plaintiff was discharged without cause, and he is entitled to damages measured by his salary for the unexpired term.

[31]The judgment should be reversed and a new trial granted, with costs to abide the event.

2.3.1 Discussion of *Varney v. Ditmars*

What terms in Varney's employment agreement are uncertain?

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

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

Is there any hint of the drafting concern?

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

2.3.2 Cortbell v. Summit Thread Co.

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

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

Id. at 99.

2.3.3 Reconciling *Varney* and *Corthell*

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

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

2.4 Sources of Contract Law

Our discussion to this point has focused on what is known as the common law of contracts. Originating in judge-made English common law, the U.S. common law has developed and in some respects diverged from the English model in the two centuries since independence. The only fully authoritative statement of common law rules are the judicial decisions applying those rules. However, the American Law Institute (ALI) – a prestigious organization of prominent attorneys, judges and academics – has periodically published a Restatement of the Law of Contracts and of other subjects such as torts, agency law, etc. The most recent edition for contracts, the Restatement (Second), was completed in 1981. Though formally non-binding, the Restatement (Second) exerts a powerful influence on judges throughout the country and provides attorneys with an invaluable compendium of prevailing legal doctrines.

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

The driving force and principal architect of the Code was Professor Karl Llewellyn. He sought to modernize and update the law by encouraging courts to discover the commercial norms that he thought were imminent in each transaction and industry. As a result, UCC provisions often make legal rules depend on determining what is “reasonable” in the circumstances. Thus, we have provisions that

refer to a “reasonable price,” to a “reasonable time for delivery,” and to “reasonable limitations of damages.” One challenge for students and practitioners is to give content to these apparently amorphous concepts.

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

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

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

"Goods" means all things that are movable at the time of identification to a contract for sale. The term includes future goods, specially manufactured goods, the unborn young of animals, growing crops, and other identified things attached to realty as described in Section 2-107. The term does not include information, the money in which the price is to be paid, investment securities under Article 8, the subject matter of foreign exchange transactions, or choses in action.

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

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

an interest in land is effective only as a contract to sell.

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

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

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

2.5 Principal Case – D.R. Curtis Co. v. Mathews

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

D.R. Curtis, Company v. Matthews

Court of Appeals of Idaho

103 Idaho 776; 653 P.2d 1188 (1982)

WALTERS, C.J.

[1] This case involves the enforceability of a contract for the sale of goods where the parties left a factor in the price term to be agreed upon and failed to subsequently agree on the factor left open. Grant Mathews, a grain farmer, appeals a judgment holding him in breach of a contract for the sale of hard red spring wheat, and ordering him to pay \$12,450 damages to D.R. Curtis Company. We affirm the judgment.

[2] The respondent, D.R. Curtis Company, is a brokerage firm in the farm commodity market. As a "middleman" between producers and exporters of farm commodities, Curtis Company buys crops directly from a farmer and then sells the crop to the exporter. Thus, for each contract to purchase grain from a producer, Curtis Company makes an interrelated, but independent, agreement to sell the grain to a grain exporter. When the company deals with hard red spring wheat for export, the grain is generally sold to large export companies in the Portland, Oregon ("North Coast"), exchange. Grain sold in this exchange is delivered to and shipped from Portland.

[3] In April, 1978, Raleigh Curtis, a grain broker for Curtis Company, contacted Mathews by telephone to discuss the purchase of Mathews' hard red spring wheat crop. Mathews had never before sold his grain to Curtis Company, although he had sold other crops to the company. Nor had he ever before dealt in the Portland grain export market. His experience was limited to the procedures in the domestic grain market at Ogden, Utah. Raleigh Curtis informed Mathews that the then current price of hard red spring wheat at the Portland grain terminal was \$3.58 per bushel. That price was attractive, so Mathews orally agreed to sell 30,000 bushels to Curtis Company.

[4] Both Mathews and Curtis Company, from prior dealings in the hard red spring wheat market, realized that although an express price per bushel is agreed upon, the price actually to be paid for the grain is not fixed until the grain is delivered to market. The actual price is determined, with respect to the expressed contract price term, by three factors: the protein content of the grain, the protein "basis" figure, and the protein "scale." The protein content, i.e., the actual percentage of protein in the grain, is commonly determined in the grain market at the time of delivery. The protein "basis" is a figure ordinarily agreed upon between the broker and the exporter, at the time they contract, in advance of delivery. The protein "scale" is commonly determined by the grain exporter on the day the wheat is delivered to the grain terminal.

[5] Protein "basis" is a standard against which the actual protein content is compared. If the protein content coincides with the fixed protein "basis" figure, then the price paid per bushel coincides with the price expressed in the contract. When protein content and protein "basis" do not coincide, the actual price paid for the grain is determined on the protein "scale," which runs up and down from the protein "basis." The "scale" is expressed as cents-per-bushel for each one-quarter-percent by which the protein content exceeds, or falls short of, the protein "basis" figure.

[6] Mathews testified that he expected the "basis" figure in his agreement with Curtis Company to be established by mutual agreement with Curtis Company. Because Curtis was unable to ascertain a protein "basis" figure while negotiating with Mathews, and because protein "scale" was commonly set by the grain export company on the day the grain was delivered, protein "basis" and protein "scale" were left open, to be established later.

[7] On the day after their oral agreement, Raleigh Curtis signed and mailed a written memorandum to Mathews. It stated the terms of the agreement as follows: "\$3.58 per

bushel. Delivered Rail North Coast... . Hard Red Spring Wheat -- Protein scale to be established." No reference to a protein "basis" term or to a means of establishing the term was made. Mathews later testified that because protein "basis" was not mentioned he understood the written terms of the contract to mean that a protein "basis" figure was either not required or was still mutually to be agreed upon. He signed and returned the memorandum. Curtis Company sold the quantity of grain commensurate with this purchase to exporters within twenty-four hours of the purchase.

[8] In September, at harvest time, Curtis Company informed Mathews that fourteen percent was the protein "basis" figure for the grain contract. The company had known that a "basis" of fourteen was required at the time they sold the grain to the grain export companies. It is not clear why Curtis Company waited until September to inform Mathews of the fourteen percent protein "basis" figure. Mathews replied he could not meet that figure, and he disavowed any contract. Thereafter, the parties continued to communicate, with Curtis Company trying to assure itself that Mathews had arranged to deliver the grain to Portland.

[9] Curtis Company employees went to Mathews' farm in November to test the protein content of his hard red spring wheat and to check his progress in arranging to deliver the grain. When they arrived, Mathews informed them that he had already sold his grain through the Ogden domestic market. Curtis Company then filed this suit for breach of contract.

[10]The trial court determined that the parties had entered into the oral agreement and had executed the written memorandum with the intent to enter into a binding contract. Because Mathews failed to deliver the grain as required by the contract, the court concluded that Mathews breached the contract. Curtis Company was awarded \$12,450 as the cost of "cover."

[11]On appeal, Mathews contends that the trial court erred in determining how price was to be determined under the contract. He further argues that the contract should fail because it is ambiguous and indefinite. Mathews asserts that Finding of Fact No. 11 is not supported by substantial and competent evidence. He alleges the error stems from a failure to distinguish between protein scale and protein basis. Assuming that no agreement was reached regarding protein basis, he urges that the contract is unenforceable because it is ambiguous and indefinite. He also asserts that the trial court applied an incorrect measure of damages.

[12]We first address the alleged error in Finding of Fact No. 11. It appears undisputed that both Mathews and Curtis Company, from prior dealings in the grain market, knew that protein "scale" was established by the export purchaser on the date of delivery and at the place of delivery. It is not disputed that the parties expressly agreed that protein scale was to be established in this manner. On the other hand, the record does not show that Mathews and Curtis Company agreed to accept the "basis" figure fixed in the market. Consequently, we do not find substantial evidence in the record to support that part of Finding No. 11 which states "[that] the contract provided ... [for] basis to be established on the date of delivery which is prevailing in the market at the place of delivery." We do not conclude, however, that this error materially affects the ultimate holding of the trial court.

[13]The trial court found that the parties had the requisite intent to form a binding contract for sale at the time they entered into the contract. This finding is supported by competent and substantial evidence and we will not disturb it on appeal. I.R.C.P. 52(a); *Nesbitt v. Wolfkiel*, 100 Idaho 396, 598 P.2d 1046 (1979). Parties to a contract for the sale of goods may make a binding contract for sale even though the price is not settled, so long as they intend to enter into a binding contract. I.C. §§ 28-2-305, 28-2-204(3). That is, in the sale of goods, a contract will not fail on the grounds of

indefiniteness when the price term is left open, *see* I.C. § 28-2-305, comment 1, so long as the agreement is entered with the mutual intent of the parties to make a binding contract.

[14]If the price in such a binding contract is left open by the parties to be established by later agreement and they fail to reach later agreement, the parties are still bound to perform under the contract for the sale of goods. In such a case, the price is a reasonable price at the time for delivery. I.C. § 28-2-305(1)(b).

[15]Here, the protein "basis" was a component of price; and, therefore it was an essential term of the contract for sale of the wheat. The term was left open to be established by the parties at a later date. The fact that this term was left open to be established, and the parties failed to reach an agreement on the figure, does not make the contract ambiguous or void for indefiniteness. It simply means that a reasonable figure remained to be determined. The record discloses no proof that a fourteen percent "basis" figure was unreasonable in the "North Coast" market. We hold that the trial court correctly determined that Mathews breached the contract for sale of grain.

[16]In regard to the damages question, the trial court correctly determined that the proper standard for damages for nondelivery of the grain was the difference between the market price at the time the buyer learned of the breach and the contract price. I.C. § 28-2-713. The trial court found that Curtis Company learned of the breach on November 6 when Mathews refused to deliver the grain. The Portland market price for hard red spring wheat on this date was \$3.99½ per bushel. This was \$0.41½ more than the contract price of \$ 3.58 per bushel. Thus, \$0.41½ (damages per bushel) multiplied by 30,000 bushels gives a figure of \$12,450, which the trial court awarded as damages.

[17]Mathews argues that Curtis Company first learned that the grain would not be delivered in September when he stated

that he was not going to deliver his grain subject to a fourteen percent "basis" requirement. Thus, he argues, the trial court erred by using the November 6 market price instead of September market prices in the computation of damages. Determination of the date when the buyer learned of the breach is a question of fact. Conflicting evidence exists in the record concerning the date when Curtis Company first learned that Mathews did not intend to deliver his grain pursuant to the contract. Mathews did inform Curtis Company in September that he would not agree to the fourteen percent figure. However, after that time he continued to communicate by telephone with Curtis Company employees, and he was still apparently willing to load his grain on Curtis Company trucks. The trial court made no mention of the September date in its findings of fact. The finding of the trial court that the breach occurred on November 6 is supported by substantial and competent evidence. Although conflicting evidence does exist, we will not disturb this finding. *J.E.T. Development v. Dorsey Const. Co.*, 102 Idaho 863, 642 P.2d 954 (Ct.App.1982).

[18]Finally, Curtis Company requests that it be allowed recovery of a reasonable attorney fee for defense of this appeal. The request is made pursuant to I.C. § 12-120(2), which provides that in any action to recover on a contract relating to the purchase or sale of goods, the prevailing party shall be allowed a reasonable attorney fee to be set by the court, to be taxed and collected as costs. Curtis Company is the prevailing party both at trial and on this appeal. The action involves recovery for breach of a contract for the sale of goods. The request is therefore proper and is granted, subject to I.A.R. 41. *McKee Bros., Ltd. v. Mesa Equipment, Inc.*, 102 Idaho 202, 628 P.2d 1036 (1981).

[19]The judgment is affirmed; costs and attorney fees to respondent, Curtis Company. BURNETT and SWANSTROM, JJ., concur.

2.5.1 Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher

In *Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher*, 52 N.Y.2d 105 (1981), the parties executed a real estate lease containing an option to renew at a price to be agreed upon. The renewal clause provided that the “Tenant may renew this lease for an additional period of five years at annual rentals to be agreed upon; Tenant shall give Landlord thirty (30) days written notice, to be mailed certified mail, return receipt requested, of the intention to exercise such right.” The tenant sought to exercise this option but the landlord demanded a rental rate for renewal of \$900 per month, far in excess of the \$650 rate provided for the final year of the original lease. The tenant sued to compel the landlord to extend the lease at a “reasonable rate” or “fair market value.” Although a lower court granted the tenant specific performance at a “fair” rent, the appellate court reversed. The court invoked a widely applied rule that a mere “agreement to agree, in which a material term is left for future negotiations, is unenforceable.” In the court’s view, it takes at least some evidence of an agreement on all material terms before a court can step in to resolve any contractual ambiguity. An agreement to agree demonstrates to the contrary that the parties were unable to reach an agreement on that term.

2.5.2 Discussion of *D.R. Curtis* and *Schumacher*

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

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

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

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

§ 2-204. Formation in General.

- (1) A contract for sale of goods may be made in any manner sufficient to show agreement,

including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

§ 2-305. Open Price Term.

(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

- (a) nothing is said as to price; or
- (b) the price is left to be agreed by the parties and they fail to agree; or
- (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time

of delivery and the seller must return any portion of the price paid on account.

2.5.3 Problem: Price vs. Quantity Under the UCC

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

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

II. The Consideration Requirement and Alternatives

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

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

1. Consideration Doctrine

Begin by reading the following Restatement (Second) provisions concerning consideration doctrine:

Restatement (Second) of Contracts

§ 17. Requirement of a Bargain

- (1) Except as stated in Subsection (2), the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.
- (2) Whether or not there is a bargain, a contract may be formed under special rules applicable to formal contracts or under the rules stated in §§ 82-94.

§ 71. Requirement of Exchange; Types of Exchange

- (1) To constitute consideration, a performance or a return promise must be bargained for.
- (2) A performance or return promise is bargained for if it is sought by the promisor in exchange for

his promise and is given by the promisee in exchange for that promise.

- (3) The performance may consist of
 - (a) an act other than a promise, or
 - (b) a forbearance, or
 - (c) the creation, modification, or destruction of a legal relation.
- (4) The performance or return promise may be given to the promisor or to some other person. It may be given by the promisee or by some other person.

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

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

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

1.1 Principal Case – *Hamer v. Sidway*

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

Hamer v. Sidway

Court of Appeals of New York
124 N.Y. 538, 27 N.E. 256 (1891)

- [1] APPEAL from order of the General Term of the Supreme Court in the fourth judicial department, made July 1, 1890, which reversed a judgment in favor of plaintiff entered upon a decision of the court on trial at Special Term and granted a new trial.
- [2] This action was brought upon an alleged contract.
- [3] The plaintiff presented a claim to the executor of William E. Story, Sr., for \$5,000 and interest from the 6th day of February, 1875. She acquired it through several mesne assignments from William E. Story, 2d. The claim being rejected by the executor, this action was brought. It appears that William E. Story, Sr., was the uncle of William E. Story, 2d; that at the celebration of the golden wedding [anniversary] of Samuel Story and wife, father and mother of William E. Story, Sr., on the 20th day of March, 1869, in the presence of the family and invited guests he promised his nephew that if he would refrain from drinking, using tobacco, swearing and playing cards or billiards for money until he became twenty-one years of age he would pay him a sum of \$5,000. The nephew assented thereto and fully performed the conditions inducing the promise. When the nephew arrived at the age of twenty-one years and on the 31st day of January, 1875, he wrote to his uncle informing him that he had performed his part of the agreement and had thereby become entitled to the sum of \$5,000. The uncle received the letter and a few days later and on the sixth of February, he wrote and mailed to his nephew the following letter:

BUFFALO, Feb. 6, 1875.

W. E. STORY, Jr.:

DEAR NEPHEW--Your letter of the 31st ult. came to hand all right, saying that you had lived up to the promise made to me several years ago. I have no doubt but you have, for which you shall have five thousand dollars as I promised you. I had the money in the bank the day you was 21 years old that I intend for you, and you shall have the money certain. Now, Willie I do not intend to interfere with this money in any way till I think you are capable of taking care of it and the sooner that time comes the better it will please me. I would hate very much to have you start out in some adventure that you thought all right and lose this money in one year. The first five thousand dollars that I got together cost me a heap of hard work. You would hardly believe me when I tell you that to obtain this I shoved a jackplane many a day, butchered three or four years, then came to this city, and after three months' perseverance I obtained a situation in a grocery store. I opened this store early, closed late, slept in the fourth story of the building in a room 30 by 40 feet and not a human being in the building but myself. All this I done to live as cheap as I could to save something. I don't want you to take up with this kind of fare. I was here in the cholera season '49 and '52 and the deaths averaged 80 to 125 daily and plenty of small-pox. I wanted to go home, but Mr. Fisk, the gentleman I was working for, told me if I left then, after it got healthy he probably would not want me. I stayed. All the money I have saved I know just how I got it. It did not come to me in any mysterious way, and the reason I speak of this is that money got in this way stops longer

with a fellow that gets it with hard knocks than it does when he finds it. Willie, you are 21 and you have many a thing to learn yet. This money you have earned much easier than I did besides acquiring good habits at the same time and you are quite welcome to the money; hope you will make good use of it. I was ten long years getting this together after I was your age. Now, hoping this will be satisfactory, I stop. One thing more. Twenty-one years ago I bought you 15 sheep. These sheep were put out to double every four years. I kept track of them the first eight years; I have not heard much about them since. Your father and grandfather promised me that they would look after them till you were of age. Have they done so? I hope they have. By this time you have between five and six hundred sheep, worth a nice little income this spring. Willie, I have said much more than I expected to; hope you can make out what I have written. To-day is the seventeenth day that I have not been out of my room, and have had the doctor as many days. Am a little better to-day; think I will get out next week. You need not mention to father, as he always worries about small matters.

Truly Yours,

W. E. STORY.

P. S.--You can consider this money on interest.

- [4] The nephew received the letter and thereafter consented that the money should remain with his uncle in accordance with the terms and conditions of the letters. The uncle died on the 29th day of January, 1887, without having paid over to his nephew any portion of the said \$5,000 and interest.

PARKER, J.

- [5] The question which provoked the most discussion by counsel on this appeal, and which lies at the foundation of plaintiff's asserted right of recovery, is whether by virtue of a contract defendant's testator William E. Story became indebted to his nephew William E. Story, 2d, on his twenty-first birthday in the sum of five thousand dollars. The trial court found as a fact that "on the 20th day of March, 1869, ...William E. Story agreed to and with William E. Story, 2d, that if he would refrain from drinking liquor, using tobacco, swearing, and playing cards or billiards for money until he should become 21 years of age then he, the said William E. Story, would at that time pay him, the said William E. Story, 2d, the sum of \$5,000 for such refraining, to which the said William E. Story, 2d, agreed," and that he "in all things fully performed his part of said agreement."
- [6] The defendant contends that the contract was without consideration to support it, and, therefore, invalid. He asserts that the promisee by refraining from the use of liquor and tobacco was not harmed but benefited; that that which he did was best for him to do independently of his uncle's promise, and insists that it follows that unless the promisor was benefited, the contract was without consideration. A contention, which if well founded, would seem to leave open for controversy in many cases whether that which the promisee did or omitted to do was, in fact, of such benefit to him as to leave no consideration to support the enforcement of the promisor's agreement. Such a rule could not be tolerated, and is without foundation in the law. The Exchequer Chamber, in 1875, defined consideration as follows: "A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." Courts "will not ask whether the thing which forms the consideration does in fact benefit the promisee or a third

party, or is of any substantial value to anyone. It is enough that something is promised, done, forborne or suffered by the party to whom the promise is made as consideration for the promise made to him.” (Anson's Prin. of Con. 63.)

- [7] “In general a waiver of any legal right at the request of another party is a sufficient consideration for a promise.” (Parsons on Contracts, 444.)
- [8] “Any damage, or suspension, or forbearance of a right will be sufficient to sustain a promise.” (Kent, vol. 2, 465, 12th ed.)
- [9] Pollock, in his work on contracts, page 166, after citing the definition given by the Exchequer Chamber already quoted, says: “The second branch of this judicial description is really the most important one. Consideration means not so much that one party is profiting as that the other abandons some legal right in the present or limits his legal freedom of action in the future as an inducement for the promise of the first.”
- [10] Now, applying this rule to the facts before us, the promisee used tobacco, occasionally drank liquor, and he had a legal right to do so. That right he abandoned for a period of years upon the strength of the promise of the testator that for such forbearance he would give him \$5,000. We need not speculate on the effort which may have been required to give up the use of those stimulants. It is sufficient that he restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle's agreement, and now having fully performed the conditions imposed, it is of no moment whether such performance actually proved a benefit to the promisor, and the court will not inquire into it, but were it a proper subject of inquiry, we see nothing in this record that would permit a determination that the uncle was not benefited in a legal sense. Few cases have been found which may be said to be precisely in point, but such as have been support the position we have taken.
- [11] In *Shadwell v. Shadwell* (9 C. B. [N. S.] 159), an uncle wrote to his nephew as follows:

MY DEAR LANCEY

I am so glad to hear of your intended marriage with Ellen Nicholl, and as I promised to assist you at starting, I am happy to tell you that I will pay to you 150 pounds yearly during my life and until your annual income derived from your profession of a chancery barrister shall amount to 600 guineas, of which your own admission will be the only evidence that I shall require.

Your affectionate uncle,

CHARLES SHADWELL.

It was held that the promise was binding and made upon good consideration.

- [12] In *Lakota v. Newton*, an unreported case in the Superior Court of Worcester, Mass., the complaint averred defendant's promise that "if you (meaning plaintiff) will leave off drinking for a year I will give you \$100," plaintiff's assent thereto, performance of the condition by him, and demanded judgment therefor. Defendant demurred on the ground, among others, that the plaintiff's declaration did not allege a valid and sufficient consideration for the agreement of the defendant. The demurrer was overruled.
- [13] In *Talbott v. Stemmons*, 12 S. W. Rep. 297, (a Kentucky case not yet reported), the step-grandmother of the plaintiff made with him the following agreement: "I do promise and bind myself to give my grandson, Albert R. Talbott, \$500 at my death, if he will never take another chew of tobacco or smoke another cigar during my life from this date up to my death, and if he breaks this pledge he is to refund double the amount to his mother." The executor of Mrs. Stemmons demurred to the complaint on the ground that the agreement was not based on a sufficient consideration. The demurrer was sustained and an appeal taken therefrom to the Court of Appeals, where the decision of the court below was reversed.

In the opinion of the court it is said that “the right to use and enjoy the use of tobacco was a right that belonged to the plaintiff and not forbidden by law. The abandonment of its use may have saved him money or contributed to his health, nevertheless, the surrender of that right caused the promise, and having the right to contract with reference to the subject-matter, the abandonment of the use was a sufficient consideration to uphold the promise.” Abstinence from the use of intoxicating liquors was held to furnish a good consideration for a promissory note in *Lindell v. Rokes* (60 Mo. 249)....

- [14] The order appealed from should be reversed and the judgment of the Special Term affirmed, with costs payable out of the estate.

1.1.1 The Benefit-Detriment Test

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

The words “benefit” and “detriment” in contract cases involving consideration have technical meanings. “Detriment” as used in determining the sufficiency of consideration to support a contract means “legal detriment” as distinguished from detriment in fact. It means giving up something which immediately prior thereto the promisee was privileged to retain, or doing or refraining from doing something which he was then privileged not to do, or not to refrain from doing.” (*Hamilton Bancshares, Inc. v. Leroy* (1985), 131 Ill. App. 3d 907, 913, quoting 1 Willison, *Contracts* § 102A, at 380-382 (3d ed. 1957).) For example, a promise to give up smoking is also a legal detriment and sufficient consideration to support a contract.

Davies v. Martel Laboratory Services, Inc., 189 Ill. App. 3d 694, 545 N.E.2d 475, 477 (1989).

1.1.2 Consideration and Motive

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

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

1.1.3 Discussion of *Hamer v. Sidway*

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

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

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

1.2 Principal Case – St. Peter v. Pioneer Theatre

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

St. Peter v. Pioneer Theatre Corp.

Supreme Court of Iowa

227 Iowa 1391, 291 N.W. 164 (1940)

MILLER, Justice.

- [1] This controversy involves a drawing at a theatre under an arrangement designated as "bank night", not identical with, but substantially similar to the arrangement involved in the controversy heretofore presented to this court by the case of *State v. Hundling*, 220 Iowa 1369, 264 N.W. 608, 103 A.L.R. 861. In that case, we held that the arrangement was not a lottery in violation of the provisions of Section 13218 of the Code, 1931, and that the proprietor of the theatre was not subject to criminal prosecution. In this case, we are confronted with the question whether the arrangement is such that one, to whom the prize is awarded, has a cause of action to enforce the payment thereof.
- [2] Plaintiff's petition alleges that the Pioneer Theatre Corporation operates a theatre at Jefferson, Iowa, known as the Iowa Theatre, and that the defendant Parkinson was at all times material herein manager of such theatre. The bank night drawing by defendants was conducted on Wednesday evening, at about 9 p.m. On December 21, 1938, the prize or purse was advertised by defendants in the amount of \$275. At about 9 p.m., plaintiff and her husband were outside the theatre when an agent of the defendants announced that plaintiff's name had been called. Plaintiff immediately went into the theatre and made demand upon the manager, who refused to pay her the prize or purse, although plaintiff made demand therefor within the three minutes allowed by

defendants. Plaintiff demanded judgment for the \$275 and costs.

- [3] In count II of the plaintiff's petition, plaintiff alleged that her husband's name was drawn, he presented himself within three minutes, demanded the \$275 and payment was refused, if he was not within the allotted time it was due to acts of defendants, her husband assigned his claim to plaintiff and plaintiff demanded judgment as such assignee.
- [4] Defendants' answer admitted that the Pioneer Theatre Corporation is operating the Iowa Theatre at Jefferson, Iowa, and that the defendant Parkinson is and has been for more than five years manager of said Iowa Theatre for the corporate defendant. The answer denied all other allegations of both counts of the petition.
- [5] The only witnesses to testify at the trial were the plaintiff and her husband. Their testimony is not in conflict. Accordingly, no disputed question of fact is presented, only questions of law.
- [6] They testified that each had signed the bank night register, plaintiff's number was 6396, her husband's number 212. The husband signed the register at the express invitation and request of Parkinson. Plaintiff signed the register later at the theatre in the presence of an usher. Plaintiff attended every bank night, often accompanied by her husband. Sometimes they attended as patrons of the theatre. Other times they stood on the sidewalk outside. On the occasions when they remained on the sidewalk outside the theatre, one Alice Kafer habitually announced the name that had been drawn inside the theatre. The only other person seen by them to make such announcement was Parkinson.
- [7] On the evening of December 21, 1938, plaintiff and her husband were on the sidewalk in front of the theatre. They observed a sign reading "Bank Night \$275". About 9 o'clock Alice Kafer came out and said to plaintiff, "Hurry up Mrs. St. Peter, your name is called." Plaintiff entered the theatre and

called to Parkinson. He came back and said, "I am sorry, but it was your husband's name that was called, where is your husband?" She said, "He is right behind me," turned around and motioned to him and said, "It's your name that was called." As he started toward them, the lights went out and in the darkness they lost track of Parkinson. They sent an usher to look for him. When Parkinson came out and approached them he said to plaintiff's husband, "You are too late, just one second too late." Mr. St. Peter said, "You have a pretty good watch." Parkinson replied, "One second is just as good as a week." Mr. St. Peter said, "Why don't you call the name outside like you do inside?" Parkinson replied, "I have a lady hired to call the name out." When asked who she was, he said, "It's none of your business." When told that Mr. St. Peter intended to see a lawyer, Parkinson stated, "That is what we want you to do; the law is backing us up on our side." Plaintiff and her husband then left the theatre. Plaintiff's husband testified that he assigned his claim to the plaintiff before the action was commenced.

- [8] At the close of plaintiff's evidence, which consisted solely of her testimony, that of her husband, and defendants' bank night register, defendants made a motion for a directed verdict on seven grounds, to wit: (1) there was no adequate or legal consideration for the claimed promise to give the alleged purse, (2) there was no evidence that Alice Kafer was employed by or in any manner authorized by defendants to announce the winner of the drawing, and defendants were not bound by her statements, (3) the most that could be claimed for plaintiff's alleged cause of action was a mere executory agreement to make a gift upon the happening of certain events without legal or adequate consideration, and no recovery could be had, (4) if a verdict were returned for plaintiff under the evidence offered, it would be the duty of the court to set the same aside, (5) there was no evidence that either plaintiff or her husband claimed the purse within the time limit fixed by defendants, (6) there was no relevant,

competent or material proof that the name of either plaintiff or her husband was drawn, (7) if there is any legal or sufficient consideration for the promise sought to be enforced, then such consideration would constitute the transaction a lottery and, therefore, an illegal transaction upon which no recovery could be had.

- [9] The court sustained the motion generally. A verdict for the defendants was returned accordingly and judgment was entered dismissing the action at plaintiff's costs. Plaintiff appeals, assigning as error the sustaining of the motion and the entry of judgment pursuant thereto.

I.

- [10] Since the motion was sustained generally, it is incumbent upon appellant, before she would be entitled to a reversal at our hands, to establish that the motion was not good upon any ground thereof. *People's Trust & Savings Bank v. Smith*, 212 Iowa 124, 126, 236 N.W. 30, 31; *Slippy Eng. Corp. v. City of Grinnell*, 226 Iowa 1293, 286 N.W. 508, 513. Realizing such burden, and undertaking to discharge the same, appellant has made seven assignments of error, each attacking a similarly numbered paragraph of the motion for directed verdict.

II.

- [11] Appellant's assignments of error Nos. 1, 3 and 7, attacking paragraphs 1, 3 and 7 of the motion for directed verdict, are definitely related to each other, and will be considered together. In such consideration, we are faced at the outset with our decision in the case of *State v. Hundling*, 220 Iowa 1369, 264 N.W. 608, 103 A.L.R. 861, heretofore referred to, wherein we held that an arrangement such as is involved herein does not constitute a lottery, and that the proprietor of the theatre is not subject to criminal prosecution on account thereof. In defining a lottery, we state at page 1370 of 220 Iowa, at page 609 of 264 N.W., 103 A.L.R. 861, as follows: "The giving away of property or prizes is not unlawful, nor is

the gift made unlawful by the fact that the recipient is determined by lot. Our statute provides that the recipient of a public office may be determined by lot in certain cases where there is a tie vote. Section 883, Code 1931. To constitute a lottery there must be a further element, and that is the payment of a valuable consideration for the chance to receive the prize. Thus, it is quite generally recognized that there are three elements necessary to constitute a lottery: First, a prize to be given; second, upon a contingency to be determined by chance; and, third, to a person who has paid some valuable consideration or hazarded something of value for the chance.”

[12] In applying such definition to the facts presented in that case, we state at page 1371 of 220 Iowa, at page 609 of 264 N.W., 103 A.L.R. 861, as follows:

The term “lottery,” as popularly and generally used, refers to a gambling scheme in which chances are sold or disposed of for value and the sums thus paid are hazarded in the hope of winning a much larger sum. That is the predominant characteristic of lotteries which has become known to history and is the source of the evil which attends a lottery, in that it arouses the gambling spirit and leads people to hazard their substance on a mere chance. It is undoubtedly the evil against which our statute is directed. The provisions of the statute making it a crime to have possession of lottery tickets with intent to sell or dispose of them indicates not only what is regarded as characteristic of a lottery, but it indicates the particular incident of a lottery which is regarded as an evil. To have a lottery, therefore, he who has the chance to win the prize must pay, or agree to pay, something of value for that chance.

In the particular scheme under consideration here, there is no question but [that] two elements of a lottery are present, first, a prize, and, second, a determination of the recipient by lot. Difficulty arises in the third element, namely, the payment of some valuable consideration for the chance by the holder thereof. The holder of the chance to win the prize in the case at bar was required to do two things in order to be eligible to receive the prize, first, to sign his name in the book, and, second, be in such proximity to the theater as that he could claim the prize within two and one-half minutes after his name was announced. He was not required to purchase a ticket of admission to the theater either as a condition to signing the registration book or claiming the prize when his name was drawn. In other words, paying admission to the theater added nothing to the chance. Where then is the payment by the holder of the chance of a valuable consideration for the chance, which is necessary in order to make the scheme a lottery?

- [13] In holding that there was not such a valuable consideration as would constitute the arrangement a lottery, we state at page 1372 of 220 Iowa, at page 610 of 264 N.W., 103 A.L.R. 861, as follows: "It is urged on behalf of the state that the defendant theater manager gained some benefit, or hoped to gain some benefit, from the scheme in the way of increased attendance at his theater, and that this would afford the consideration required. If it be conceded that the attendance at the theater on the particular night that the prize was to be given away was stimulated by reason of the scheme, it is difficult to see how that would make the scheme a lottery. The question is not whether the donor of the prize makes a profit in some remote and indirect way, but, rather, whether those who have a chance at the prize pay anything of value

for that chance. Every scheme of advertising, including the giving away of premiums and prizes, naturally has for its object, not purely a philanthropic purpose, but increased business....Profit accruing remotely and indirectly to the person who gives the prize is not a substitute for the requirement that he who has the chance to win the prize must pay a valuable consideration therefor, in order to make the scheme a lottery.”

- [14] Appellees rely upon the language above quoted to support their contention that the arrangement involved in both cases constitutes merely an offer to make a gift, which is not supported by a valuable consideration and is, therefore, unenforceable.
- [15] In 12 American Jurisprudence, pages 564 and 565, in Section 72, it is stated, “It is well settled, however, that ordinarily consideration is an essential element of a simple contract, and want or lack of consideration is an excuse for nonperformance of a promise.” It is also stated, “The policy of the courts in requiring a consideration for the maintenance of an action of assumpsit appears to be to prevent the enforcement of gratuitous promises.” Such principles have been recognized by this court. In the case of *Farlow v. Farlow*, 154 Iowa 647, 135 N.W. 1, we held that a promise to make a gift is without consideration and not enforceable. See also, *Lanfier v. Lanfier*, Iowa, 288 N.W. 104.
- [16] Appellees contend that the foregoing principles, considered with our statements in *State v. Hundling*, *supra*, show that this action is based upon a promise that cannot be enforced. In the *Hundling* case, we state, “The giving away of property or prizes is not unlawful,” and, “profit accruing remotely and indirectly to the person who gives the prize is not a substitute for the requirement that he who has a chance to win the prize must pay a valuable consideration therefor.” Appellees contend that these pronouncements commit us to the proposition that the arrangement involved herein constituted nothing more than a promise to make a gift which is not

supported by a legal consideration, and, accordingly, is not enforceable. We are unable to agree with the contentions of appellees.

[17] At the outset, it is important to bear in mind that the plaintiff herein seeks to recover on a unilateral contract. A bilateral contract is one in which two promises are made; the promise of each party to the contract is consideration for the promise of the other party. In a unilateral contract, only one party makes a promise. If that promise is made contingent upon the other party doing some act, which he is not under legal obligation to do, or forbearing an action which he has a legal right to take, then such affirmative act or forbearance constitutes the consideration for and acceptance of the promise.

[18] In discussing the difference between bilateral contracts and unilateral contracts, this court, in the case of *Port Huron Mach. Co. v. Wohlers*, 207 Iowa 826, 829, 221 N.W. 843, 844, states as follows:

The law recognizes, as a matter of classification, two kinds of contracts—unilateral and bilateral. In the case at bar a typical example of unilateral contract is found, since it is universally agreed that a “unilateral contract” is one in which no promisor receives a promise as consideration, whereas, in a “bilateral contract” there are mutual promises between the two parties to the contract. This matter of definition has recently received careful consideration by the American Law Institute and may be found in the Restatement of the Law of Contracts. Proposed Final Draft No. 1 (April 18, 1928) p. 17, § 12.

In the instant case the offer of the defendant must be viewed as a promise. It is promissory in terms. The rule is well stated by Prof. Williston: A promise which the promisor should reasonably expect to induce action or

forbearance of a definite and substantial character on the part of the promisee, and which does induce such action or forbearance, is binding if injustice can be avoided only by enforcement of the promise. See Williston on Contracts, vol. 1, § 139. Clearly the instant offer signed by the defendant was of this character. Appellant, however, contends that there was no acceptance of the offer. Words are not the only medium of expression of mutual assent. An offer may invite an acceptance to be made by merely an affirmative answer or by performing a specific act. True, if an act other than a promise is requested, no contract exists until what is requested is performed or tendered in whole or in part. We are here dealing with a unilateral contract, and the act requested and performed as consideration for the contract indicates acceptance as well as furnishes the consideration.

- [19] The case of *Scott v. People's Monthly Co.*, 209 Iowa 503, 508, 228 N.W. 263, 265, 67 A.L.R. 413, involved an action for a \$1,000 prize offered in a "Word-building Contest". We there state:

In 34 Cyc. 1731, we find the following apt language:

"An offer of or promise to pay a reward is a proposal merely or a conditional promise, on the part of the offeror, and not a consummated contract. It may be said to be in effect the offer of a promise for an act, and the offer becomes a binding contract when the act is done or the service rendered in accordance with the terms of the offer."

It is the doing of the act in accordance with the terms and conditions of the offer which completes the contract. 34 Cyc. 1738. In other words, to make a binding and enforceable

contract, the act must be done in accordance with the terms and conditions of the offer. 34 Cyc. 1742. See, also, 13 Corpus Juris 275; 13 C.J. 379; 13 C.J. 281-283; 13 C.J. 289; Baker v. Johnson County, 37 Iowa 186; Breen v. Mayne, 141 Iowa 399, 118 N.W. 441.

- [20] The principles applicable to the question of the adequacy of the consideration are clearly and concisely stated by Chief Justice Wright in the early case of *Blake v. Blake*, 7 Iowa 46, 51, as follows: “The essence and requisite of every consideration is, that it should create some benefit to the party promising, or some trouble, prejudice, or inconvenience to the party to whom the promise is made. Whenever, therefore, any injury to the one party, or any benefit to the other, springs from a consideration, it is sufficient to support a contract. Each party to a contract may, ordinarily, exercise his own discretion, as to the adequacy of the consideration; and if the agreement be made bona fide, it matters not how insignificant the benefit may apparently be to the promisor, or how slight the inconvenience or damage appear to be to the promisee, provided it be susceptible of legal estimation. Story on Contracts, section 431. Of course, however, if the inadequacy is so gross as to create a presumption of fraud, the contract founded thereon would not be enforced. But, even then, it is the fraud which is thereby indicated, and not the inadequacy of consideration, which invalidates the contract.”
- [21] The principles announced in the above quotation have been recognized and applied by us in our later decisions. *State ex rel. v. American Bonding & Casualty Co.*, 213 Iowa 200, 206, 238 N.W. 726; *Edwards v. Foley*, 187 Iowa 5, 9, 173 N.W. 914; *Harlan v. Harlan*, 102 Iowa 701, 704, 72 N.W. 286.
- [22] Applying the principles above reviewed, it is readily apparent that, in this action on a unilateral contract, it was necessary for the plaintiff to show that a promise had been made which might be accepted by the doing of an act, which act would

constitute consideration for the promise and performance of the contract. There is no basis for any claim of fraud herein. Plaintiff had nothing to do with inducing the defendants' promise. That promise was voluntarily and deliberately made. Defendants exercised their own discretion in determining the adequacy of the consideration for their promise. If the plaintiff did the acts called for by that promise, defendants cannot complain of the adequacy of the consideration.

- [23] Of course, it is fundamental that the act which is asserted as the consideration for acceptance and performance of a unilateral contract must be an act which the party sought to be bound bargained for, and the acts must have been induced by the promise made. Appellees contend that the facts are wholly insufficient to meet such requirements, contending as follows: "Although the action of Appellant in writing her name or standing in front of the theater might under some circumstances be such an act as would furnish a consideration for a promise, yet under the facts in the case at bar,...no reasonable person could say that the requested acts were actually bargained for in a legal sense so as to give rise to an enforceable promise."
- [24] We are unable to concur in the contentions of counsel above quoted. We think that the requested acts were bargained for. We see nothing unreasonable in such holding. If there is anything unreasonable in this phase of the case, it would appear to be the contentions of counsel.
- [25] This brings us to the proposition raised by paragraph 7 of the motion for directed verdict, wherein it is asserted that, if there was a legal consideration for the promise sought to be enforced, then such consideration would constitute the transaction a lottery. To sustain such contention would require us to overrule *State v. Hundling, supra*, and to overrule such contention requires a differentiating of that case from this case. We think that the two questions are different and may be logically distinguished.

[26] In the *Hundling* case, we point out that the source of the evil which attends a lottery is that it arouses the gambling spirit and leads people to hazard their substance on a mere chance. Accordingly, it is vitally necessary to constitute a lottery that one who has the chance to win the prize must pay something of value for that chance. The value of the consideration, from a monetary standpoint, is the essence of the crime. However, in a civil action to enforce the promise to pay a prize, the monetary value of the consideration is in no wise controlling. It is only necessary that the act done be that which the promisor specified. The sufficiency of the consideration lies wholly within the discretion of the one who offers to pay the prize. “It matters not how insignificant the benefit may apparently be to the promisor, or how slight the inconvenience or damage appear to be to the promisee, provided it be susceptible of legal estimation.” *Blake v. Blake, supra*. Accordingly, it is entirely possible that the act, specified by the promisor as being sufficient in his discretion to constitute consideration for and acceptance of his promise, might have no monetary value and yet constitute a legal consideration for the promise. Under such circumstances, the arrangement is not a lottery. The promoter of the scheme cannot be prosecuted criminally. But, if the act specified is done, the unilateral contract is supported by a consideration, and, having been performed by the party doing the act, can be enforced against the party making the promise. We hold that such is the situation here. There is no merit in grounds 1, 3 and 7 of the motion for directed verdict.

III.

[27] Appellant's second assignment of error challenges paragraph 2 of the motion for directed verdict, which asserted that the evidence was insufficient to establish that Alice Kafer was employed by or authorized by defendants to announce the winner of the drawing, and that defendants were not bound by her statements. The answer admitted that Parkinson was manager of the theatre. As manager of the theatre, he

asserted that he had a lady hired to call out the name outside the theatre. This assertion upon his part is binding upon the defendants. The evidence shows that the only person who called out the name other than Parkinson was Alice Kafer, and that she habitually announced the name that had been drawn on prior occasions. The evidence was sufficient to establish her agency and to make her announcement binding on defendants.

IV.

[28] Appellants' fifth assignment of error challenges paragraph 5 of the motion for directed verdict, which asserts that there was no evidence that either plaintiff or her husband claimed the purse within the time limit fixed by defendants. The evidence shows that, when the plaintiff claimed the prize, Parkinson said, "I am sorry, but it was your husband's name that was called, where is your husband?" When her husband came, he said to him, "You are too late, just one second too late." Obviously, under Parkinson's statement, plaintiff claimed the prize in time. If her husband was the one entitled to it, the delay on his part was due to the defendants' act in permitting their agent, Alice Kafer, to announce the wrong name outside the theatre. Under such circumstances, defendants are estopped to claim the advantage of the one second delay. The basis for such estoppel was pleaded in the petition. It must be enforced against defendants.

V.

[29] Appellant's sixth assignment of error challenges paragraph 6 of the motion for directed verdict, which asserted that no relevant, competent, or material proof tended to establish that the name of either the plaintiff or her husband was drawn. Plaintiff's name was announced by one agent, her husband's name by another agent, both of whom were in a position to bind the defendants. There is no merit in this ground of the motion.

VI.

[30] Appellant's fourth assignment of error attacks paragraph 4 of the motion for directed verdict, which is a blanket statement that under the evidence it would be the duty of the court to set aside a verdict for the plaintiff. The disposition of the other propositions herein demonstrates that there is no merit in this ground of the motion.

[31] All of appellant's assignments of error are well grounded. No ground of the motion for directed verdict was sufficient to warrant a sustaining of the motion. The court's ruling was erroneous.

The judgment entered pursuant thereto must be and it is reversed.

1.2.1 The Legality of “Bank Nights” in Iowa

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

1.2.2 Discussion of *St. Peter v. Pioneer Theatre*

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

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

Consider whether there is anything fishy about Pioneer Theatre's arguments. Do you see any problem with arguing that the promotional scheme is not an illegal lottery while also maintaining that the Bank Night prize is merely an unenforceable promise to give a gift?

1.2.3 Problem on Consideration

Consider the following variation on *Hamer v. Sidway*. Suppose that New York state law made it illegal for Willie to drink, smoke or gamble

before the age of 21. Uncle William offers, and Willie accepts, \$5,000 to abstain from these vices until age 21.

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

What about under the principles of Restatement (Second) § 71?

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

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

How would you expect a court to analyze this promise?

2. Bargain or Gift?

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

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

Professor Lon Fuller proposed that consideration doctrine serves four important objectives: an evidentiary function, a cautionary function, a deterrent function and a channeling function. See Lon Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 800-802 (1941). According to Fuller, satisfying the formal requirement of

consideration provides evidentiary assurance about the existence of an agreement. This legal formality also has the potential to check rash or impulsive action and prevent parties from assuming legally enforceable obligations without sufficient deliberation. Finally, the consideration requirement allows parties to choose a legally binding form for certain important promises. Fuller sought to explain this final channeling function of legal formalities with an analogy to the use of language.

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

Id. at 801.

2.1 Principal Case – *Kirksey v. Kirksey*

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

Kirksey v. Kirksey

Supreme Court of Alabama

8 Ala. 131 (1845)

- [1] Assumpsit by the defendant, against the plaintiff in error. The question is presented in this Court, upon a case agreed, which shows the following facts:

- [2] The plaintiff was the wife of defendant's brother, but had for some time been a widow, and had several children. In 1840, the plaintiff resided on public land, under a contract of lease, she had held over, and was comfortably settled, and would have attempted to secure the land she lived on. The defendant resided in Talladega county, some sixty, or seventy miles off. On the 10th October, 1840, he wrote to her the following letter:

Dear sister Antilico--Much to my mortification, I heard, that brother Henry was dead, and one of his children. I know that your situation is one of grief, and difficulty. You had a bad chance before, but a great deal worse now. I should like to come and see you, but cannot with convenience at present. ...I do not know whether you have a preference on the place you live on, or not. If you had, I would advise you to obtain your preference, and sell the land and quit the country, as I understand it is very unhealthy, and I know society is very bad. If you will come down and see me, I will let you have a place to raise your family, and I have more open land than I can tend; and on the account of your situation, and that of your family, I feel like I want you and the children to do well.

- [3] Within a month or two after the receipt of this letter, the plaintiff abandoned her possession, without disposing of it, and removed with her family, to the residence of the defendant, who put her in comfortable houses, and gave her land to cultivate for two years, at the end of which time he notified her to remove, and put her in a house, not comfortable, in the woods, which he afterwards required her to leave.
- [4] A verdict being found for the plaintiff, for two hundred dollars, the above facts were agreed, and if they will sustain

the action, the judgment is to be affirmed, otherwise it is to be reversed.

ORMOND, J.

[5] The inclination of my mind, is, that the loss and inconvenience, which the plaintiff sustained in breaking up, and moving to the defendant's, a distance of sixty miles, is a sufficient consideration to support the promise, to furnish her with a house, and land to cultivate, until she could raise her family. My brothers, however think, that the promise on the part of the defendant, was a mere gratuity, and that an action will not lie for its breach. The judgment of the Court below must therefore be reversed, pursuant to the agreement of the parties.

2.1.1 The Law of Gifts

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

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

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

2.1.2 Williston's Tramp and Conditional Gifts

It is something of a puzzle in *Kirksey* that the trouble and inconvenience Antillico suffered in moving her family was not sufficient consideration to support her brother-in-law's promise. Resolving this puzzle requires us to determine whether what Antillico did was the price of a bargain with Isaac or merely a condition precedent to receiving a gift. Professor Samuel Williston used the following hypothetical to distinguish contractual consideration from a conditional gift:

If a benevolent man says to a tramp: "If you go around the corner to the clothing shop there, you may purchase an overcoat on my credit," no reasonable person would understand that the short walk was requested as consideration for the promise, but that in the event of the tramp going to the shop the promisor would make him a gift. Yet the walk to the shop is in its nature capable of being consideration. It is a legal detriment to the tramp to make the walk, and the only reason why the walk is not consideration is because on a reasonable construction it must be held that the walk was not requested as the price of the promise, but was merely a condition of a gratuitous promise. It is often difficult to determine whether words of condition in a promise indicate a request for consideration or state a mere condition in a gratuitous promise. An aid, though not a conclusive test in determining which construction of the promise is more reasonable is an inquiry whether the happening of the condition will be a benefit to the promisor. If so, it is a fair inference that the happening was requested as a consideration. On the other hand, if, as in the case of the tramp stated above, the happening of the condition will be not only of

no benefit to the promisor but is obviously merely for the purpose of enabling the promisee to receive a gift, the happening of the event on which the promise is conditional, though brought about by the promisee in reliance on the promise, will not properly be construed as consideration. In case of doubt where the promisee has incurred a detriment on the faith of the promise, courts will naturally be loath to regard the promise as a mere gratuity and the detriment incurred as merely a condition. But in some cases it is so clear that a conditional promise was intended even though the promisee has incurred a detriment, the promise has been held unenforceable.

1 Samuel Williston, The Law of Contracts § 112 (1922).

2.1.3 The Story of *Kirksey v. Kirksey*

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

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

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

2.1.4 Discussion of *Kirksey v. Kirksey*

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

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

2.2 Principal Case – *In re Greene*

In re Greene

United States District Court, Southern District of New York
45 F.2d 428 (1930)

WOOLSEY, District Judge.

- [1] The petition for review is granted, and the order of the referee is reversed.
- [2] The claimant, a woman, filed proof of claim in the sum of \$375,700, based on an alleged contract, against this bankrupt's estate. The trustee in bankruptcy objected to the claim. A hearing was held before the referee in bankruptcy and testimony taken. The referee held the claim valid and dismissed the objections. The correctness of this ruling is raised by the trustee's petition to review and the referee's certificate.
- [3] For several years prior to April 28, 1926, the bankrupt, a married man, had apparently lived in adultery with the claimant. He gave her substantial sums of money. He also paid \$70,000 for a house on Long Island acquired by her, which she still owns. Throughout their relations the bankrupt was a married man, and the claimant knew it. The claimant was well over thirty years of age when the connection began. She testified that the bankrupt has promised to marry her as soon as his wife should get a divorce from him; this the bankrupt denied. The relations of intimacy between them were discontinued in April, 1926, and they then executed a written instrument under seal which is alleged to be a binding

contract and which is the foundation of the claim under consideration.

- [4] In this instrument, which was made in New York, the bankrupt undertook (1) to pay to the claimant \$1,000 a month during their joint lives; (2) to assign to her a \$100,000 life insurance policy on his life and to keep up the premiums on it for life, the bankrupt to pay \$100,000 to the claimant in case the policy should lapse for nonpayment of premiums; and (3) to pay the rent for four years on an apartment which she had leased. It was declared in the instrument that the bankrupt had no interest in the Long Island house or in its contents, and that he should no longer be liable for mortgage interest, taxes, and other charges on this property. The claimant on her part released the bankrupt from all claims which she had against him. The preamble to the instrument recites as consideration the payment of \$1 by the claimant to the bankrupt, "and other good and valuable consideration." The bankrupt kept up the several payments called for by the instrument until August, 1928, but failed to make payments thereafter.
- [5] In the proof of claim it is alleged that a total of \$375,700 was due because of breach of the agreement, made up as follows: \$250,000 for failure to pay \$1,000 a month; \$99,200 for failure to maintain the insurance policy; and \$26,500 for failure to pay the rent. The claim was sustained by the referee for the full amount.
- [6] It seems clear that the \$250,000 allowed as damages for failure to pay \$1,000 a month was excessive. The bankrupt's undertaking was to pay \$1,000 a month only so long as both he and the claimant should live; it was not an annuity for the claimant's life alone, as she seems to have assumed. There is nothing in the record to indicate the bankrupt's age, and consequently there is a failure of proof as to this element of damage. In view of my conclusion that the entire claim is void, however, the matter of damages is of no present importance.

- [7] A contract for future illicit cohabitation is unlawful. There is consideration present in such a case, but the law strikes the agreement down as immoral. Williston on Contracts, Sec. 1745. Here the illicit intercourse had been abandoned prior to the making of the agreement, so that the above rule is not infringed. This case is one where the motive which led the bankrupt to make the agreement on which the claim is based was the past illicit cohabitation between him and the claimant. The law is that a promise to pay a woman on account of cohabitation which has ceased is void, not for illegality, but for want of consideration. The consideration in such a case is past. The mere fact that past cohabitation is the motive for the promise will not of itself invalidate it, but the promise in such a case, to be valid, must be supported by some consideration other than past intercourse. Williston on Contracts, Secs. 148, 1745.
- [8] The problem in the present case, therefore, is one of consideration, not of illegality, and it is clear that the past illicit intercourse is not consideration. The cases dealing with situations where there is illegitimate offspring or where there has been seduction are of doubtful authority, for the doctrine that past moral obligation is consideration is now generally exploded. But these cases and others speaking of expiation of past wrong, cited by the referee, are not in point. Here there was not any offspring as a result of the bankrupt's union with the claimant; there was not any seduction shown in the sense in which that word is used in law. Cf. New York Penal Law, art. 195, Sec. 2175. There was not any past wrong for which the bankrupt owed the claimant expiation—*volenti non fit injuria*. Cases involving deeds, mortgages, and the like are not analogous, because no consideration is necessary in an executed transaction.
- [9] The question, therefore, is whether there was any consideration for the bankrupt's promises, apart from the past cohabitation. It seems plain that no such consideration

can be found, but I will review the following points emphasized by the claimant as showing consideration:

- [10] (1) The \$1 consideration recited in the paper is nominal. It cannot seriously be urged that \$1, recited but not even shown to have been paid, will support an executory promise to pay hundreds of thousands of dollars.
- [11] (2) “Other good and valuable consideration” are generalities that sound plausible, but the words cannot serve as consideration where the facts show that nothing good or valuable was actually given at the time the contract was made.
- [12] (3) It is said that the release of claims furnishes the necessary consideration. So it would if the claimant had had any claims to release. But the evidence shows no vestige of any lawful claim. Release from imaginary claims is not valuable consideration for a promise. In this connection, apparently, the claimant testified that the bankrupt had promised to marry her as soon as he was divorced. Assuming that he did—though he denies it—the illegality of any such promise, made while the bankrupt was still married, is so obvious that no claim could possibly arise from it, and the release of such claim could not possibly be lawful consideration.
- [13] (4) The claimant also urges that by the agreement the bankrupt obtained immunity from liability for taxes and other charges on the Long Island house. The fact is that he was never chargeable for these expenses. He doubtless had been in the habit of paying them, just as he had paid many other expenses for the claimant; but such payments were either gratuitous or were the contemporaneous price of the continuance of his illicit intercourse with the claimant. It is absurd to suppose that, when a donor gives a valuable house to a donee, the fact that the donor need pay no taxes or upkeep thereafter on the property converts the gift into a contract upon consideration. The present case is even stronger, for the bankrupt had never owned the house and had never been liable for the taxes. He furnished the purchase

price, but the conveyance was from the seller direct to the claimant.

[14] (5) Finally, it is said that the parties intended to make a valid agreement. It is a non sequitur to say that therefore the agreement is valid. A man may promise to make a gift to another, and may put the promise in the most solemn and formal document possible; but, barring exceptional cases, such, perhaps, as charitable subscriptions, the promise will not be enforced. The parties may shout consideration to the housetops, yet, unless consideration is actually present, there is not a legally enforceable contract. What the bankrupt obviously intended in this case was an agreement to make financial contribution to the claimant because of his past cohabitation with her, and, as already pointed out, such an agreement lacks consideration.

[15] The presence of the seal would have been decisive in the claimant's favor a hundred years ago. Then an instrument under seal required no consideration, or, to keep to the language of the cases, the seal was conclusive evidence of consideration. In New York, however, a seal is now only presumptive evidence of consideration on an executory instrument. Civil Practice Act, Sec. 342; *Harris v. Shorall*, 230 N.Y. 343, 348, 130 N.E. 572; *Alexander v. Equitable Life Assurance Society*, 233 N.Y. 300, 307, 135 N.E. 509. This presumption was amply rebutted in this case, for the proof clearly shows, I think, that there was not in fact any consideration for the bankrupt's promise contained in the executory instrument signed by him and the claimant.

[16] An order in accordance with this opinion may be submitted for settlement on two days' notice.

2.2.1 The Use of Sealed Contracts

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

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

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

The Restatement Second makes no attempt to justify this rule. Originally, the seal was a natural formality—that is, a promissory form popularly understood to carry legal significance—which ensured both deliberation and proof by involving a writing, a ritual of hot wax, and a physical object that personified its owner. Later, however, the elements of ritual and personification eroded away, so that in most states by statute or decision a seal may now take the form of a printed device, word, or scrawl, the printed initials “L.S.,” or a printed recital of sealing. Few promisors today have even the vaguest idea of the significance of such words, letters,

or signs, if they notice them at all. The Restatement Second itself freely admits that “the seal has come to seem archaic.” Considering this drastic change in circumstances, the rule that the seal renders a promise enforceable has ceased to be tenable under modern conditions. The rule has been changed by statute in about two-thirds of the states, and at least one case held even without the benefit of a statute that the rule should no longer be strictly applied.

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

2.2.2 The Compromise of Legal Claims as Consideration

Parties most often end litigation before trial by entering into a settlement agreement. These agreements commonly require some payment by one party in exchange for a release or compromise of legal claims brought by the other party. The Restatement (Second) of Contracts (1981) explains how consideration doctrine relates to these promises.

§ 74. Settlement of Claims

- (1) Forbearance to assert or the surrender of a claim or defense which proves to be invalid is not consideration unless
 - (a) the claim or defense is in fact doubtful because of uncertainty as to the facts or the law, or
 - (b) the forbearing or surrendering party believes that the claim or defense may be fairly determined to be valid.
- (2) The execution of a written instrument surrendering a claim or defense by one who is under no duty to execute it is consideration if the execution of the written instrument is bargained for even though he is not asserting the claim or defense and believes that no valid claim or defense exists.

2.2.3 Discussion of *In re Greene*

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

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

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

3. Adequacy Doctrine

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

3.1 Principal Case – *Batsakis v. Demotsis*

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

Batsakis v. Demotsis

Court of Civil Appeals of Texas

226 S.W.2d 673 (1949)

MCGILL, Justice.

- [1] This is an appeal from a judgment of the 57th judicial District Court of Bexar County. Appellant was plaintiff and appellee was defendant in the trial court. The parties will be so designated.
- [2] Plaintiff sued defendant to recover \$2,000 with interest at the rate of 8% per annum from April 2, 1942, alleged to be due on the following instrument, being a translation from the original, which is written in the Greek language:

Peiraeus

April 2, 1942

Mr. George Batsakis

Konstantinou Diadohou #7

Mr. Batsakis:

I state by my present (letter) that I received today from you the amount of two thousand dollars (\$2,000.00) of United States of America money, which I borrowed from you for the support of my family during these difficult days and because it is impossible for me to transfer dollars of my own from America.

The above amount I accept with the expressed promise that I will return to you again in American dollars either at the end of the present war or even before in the event that you might be able to find a way to collect them (dollars) from my representative in America to whom I shall write and give him an order relative to this you understand until the final execution (payment) to the above amount an eight per cent interest will be added and paid together with the principal.

I thank you and I remain yours with respects.

The recipient,

(Signed) Eugenia The. Demotsis.

- [3] Trial to the court without the intervention of a jury resulted in a judgment in favor of plaintiff for \$750.00 principal, and interest at the rate of 8% per annum from April 2, 1942 to the date of judgment, totaling \$1163.83, with interest thereon at the rate of 8% per annum until paid. Plaintiff has perfected his appeal.
- [4] The court sustained certain special exceptions of plaintiff to defendant's first amended original answer on which the case was tried, and struck therefrom paragraphs II, III and V. Defendant excepted to such action of the court, but has not cross-assigned error here. The answer, stripped of such paragraphs, consisted of a general denial contained in paragraph I thereof, and of paragraph IV, which is as follows:

IV. That under the circumstances alleged in Paragraph II of this answer, the consideration upon which said written instrument sued upon by plaintiff herein is founded, is wanting and has failed to the extent of \$1975.00, and defendant pleads specially under the verification hereinafter made the want and failure of consideration stated, and now tenders, as defendant has heretofore tendered to plaintiff, \$25.00 as the value of the loan of money received by defendant from plaintiff, together with interest thereon.

Further, in connection with this plea of want and failure of consideration defendant alleges that she at no time received from plaintiff himself or from anyone for plaintiff any money or thing of value other than, as hereinbefore alleged, the original loan of 500,000 drachmae. That at the time of the loan by plaintiff to defendant of said 500,000 drachmae the value of 500,000 drachmae in the Kingdom of Greece in dollars of money of the United States of America, was \$25.00, and also at said

time the value of 500,000 drachmae of Greek money in the United States of America in dollars was \$25.00 of money of the United States of America.

- [5] The allegations in paragraph II which were stricken, referred to in paragraph IV, were that the instrument sued on was signed and delivered in the Kingdom of Greece on or about April 2, 1942, at which time both plaintiff and defendant were residents of and residing in the Kingdom of Greece, and

[Plaintiff] avers that on or about April 2, 1942 she owned money in the United States of America, but was then and there in the Kingdom of Greece in straitened financial circumstances due to the conditions produced by World War II and could not make use of her money and property and credit existing in the United States of America. That in the circumstances the plaintiff agreed to and did lend to defendant the sum of 500,000 drachmae, which at that time, on or about April 2, 1942, had the value of \$25.00 in money of the United States of America. That the said plaintiff, knowing defendant's financial distress and desire to return to the United States of America, exacted of her the written instrument plaintiff sues upon, which was a promise by her to pay to him the sum of \$2,000.00 of United States of America money.

- [6] Plaintiff specially excepted to paragraph IV because the allegations thereof were insufficient to allege either want of consideration or failure of consideration, in that it affirmatively appears therefrom that defendant received what was agreed to be delivered to her, and that plaintiff breached no agreement. The court overruled this exception, and such action is assigned as error. Error is also assigned because of the court's failure to enter judgment for the whole unpaid

balance of the principal of the instrument with interest as therein provided.

- [7] Defendant testified that she did receive 500,000 drachmas from plaintiff. It is not clear whether she received all the 500,000 drachmas or only a portion of them before she signed the instrument in question. Her testimony clearly shows that the understanding of the parties was that plaintiff would give her the 500,000 drachmas if she would sign the instrument. She testified:

Q...who suggested the figure of \$2,000.00?

That was how he asked me from the beginning. He said he will give me five hundred thousand drachmas provided I signed that I would pay him \$2,000.00 American money.

- [8] The transaction amounted to a sale by plaintiff of the 500,000 drachmas in consideration of the execution of the instrument sued on, by defendant. It is not contended that the drachmas had no value. Indeed, the judgment indicates that the trial court placed a value of \$750.00 on them or on the other consideration which plaintiff gave defendant for the instrument if he believed plaintiff's testimony. Therefore the plea of want of consideration was unavailing. A plea of want of consideration amounts to a contention that the instrument never became a valid obligation in the first place. *National Bank of Commerce v. Williams*, 125 Tex. 619, 84 S.W.2d 691.
- [9] Mere inadequacy of consideration will not void a contract. 10 Tex.Jur., Contracts, Sec. 89, p. 150; *Chastain v. Texas Christian Missionary Society*, Tex.Civ.App., 78 S.W.2d 728, loc. cit. 731(3), Wr. Ref.
- [10] Nor was the plea of failure of consideration availing. Defendant got exactly what she contracted for according to her own testimony. The court should have rendered judgment in favor of plaintiff against defendant for the principal sum of \$2,000.00 evidenced by the instrument sued on, with interest as therein provided. We construe the

provision relating to interest as providing for interest at the rate of 8% per annum. The judgment is reformed so as to award appellant a recovery against appellee of \$2,000.00 with interest thereon at the rate of 8% per annum from April 2, 1942. Such judgment will bear interest at the rate of 8% per annum until paid on \$2,000.00 thereof and on the balance interest at the rate of 6% per annum. As so reformed, the judgment is affirmed.

Reformed and affirmed.

3.1.1 The Background of *Batsakis v. Demotsis*

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

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

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

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

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

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

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

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

3.1.2 Adequacy Doctrine

Courts ordinarily honor the rule that the parties are the best judge of the value of the promises they choose to exchange. The Restatement (Second) puts the matter this way:

§ 79. Adequacy of Consideration; Mutuality of Obligation

If the requirement of consideration is met, there is no additional requirement of

- (a) a gain, advantage, or benefit to the promisor or a loss, disadvantage, or detriment to the promisee; or
- (b) equivalence in the values exchanged; or
- (c) “mutuality of obligation.”

Students should read Comment c to § 79 from an outside source for further elaboration.

Additionally, Comment d to § 79 explains the complementary doctrine of nominal or sham consideration and should be read.

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

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

more money than anyone else would pay for them

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

1 Corbin on Contracts § 127 (1963).

3.1.3 Discussion of *Batsakis v. Demotsis*

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

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

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

4. Promissory Estoppel

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

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

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

Commonwealth v. Scituate Savings Bank, 137 Mass. 301, 302 (1884) (Holmes, J.).

The Restatement (Second) offers the following description of the circumstances warranting reliance-based enforcement:

§ 90. Promise Reasonably Inducing Action or Forbearance

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if inj

ustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

(2) A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance.

Comment b to § 90 elaborates:

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

otherwise, and on the extent to which such other policies as the enforcement of bargains and the prevention of unjust enrichment are relevant.

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

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

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

on the ability of the court to reconcile the reliance factor implicit in promissory estoppel with a general theory of consideration which is dominated by notions of reciprocity.... Moreover, the disposition to treat action in reliance as proof of bargain ... seriously

impairs the reliance principle in the very cases [of gratuitous promises] in which reliance is likely to be the only available ground for relief.... [Thus] the risk that action in reliance will be found to be not sufficiently serious to justify application of § 90, or merely the condition of a gratuitous promise, is thereby increased.

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

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

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

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

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

- (1) Consideration for a promise is
 - (a) an act other than a promise, or
 - (b) a forbearance, or
 - (c) the creation, modification or destruction of a legal relation, or
 - (d) a return promise, bargained for and given in exchange for the promise.
- (2) Consideration may be given to the promisor or to some other person. It may be given by the promisee or by some other person.

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

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

And what is that all about? We have become accustomed to the idea, without in the least understanding it, that the universe includes both matter and anti-matter. Perhaps what we

have here is Restatement and anti-Restatement or Contract and anti-Contract. We can be sure that Holmes, who relished a good paradox, would have laughed aloud at the sequence of § 75 and § 90. The one thing that is clear is that these two contradictory propositions cannot live comfortably together: in the end one must swallow the other up.

A good many years ago Professor Corbin gave me his version of how this unlikely combination came about. When the Restaters and their advisors came to the definition of consideration, Williston proposed in substance what became § 75. Corbin submitted a quite different proposal. To understand what the Corbin proposal was about, it is necessary to backtrack somewhat. Even after the Holmesian or bargain theory of consideration had won all but universal acceptance, the New York Court of Appeals had, during the Cardozo period, pursued a line of its own. There is a long series of Cardozo contract opinions, scattered over his long tenure on that court. Taken all in all, they express what might be called an expansive theory of contract. Courts should make contracts wherever possible, rather than the other way around. Missing terms can be supplied. If an express promise is lacking, an implied promise can easily be found. In particular Cardozo delighted in weaving gossamer spider webs of consideration. There was consideration for a father's promise to pay his engaged daughter an annuity after marriage in the fact that the engaged couple, instead of breaking off the engagement, had in fact married. There was consideration for a pledge to a college endowment campaign (which the donor had later sought to revoke)

in the fact that the college, by accepting the pledge, had come under an implied duty to memorialize the donor's name: "The longing for posthumous remembrance is an emotion not so weak as to justify us in saying that its gratification is a negligible good." Evidently a judge who could find "consideration" in *DeCicco v. Schweizer* or in the *Allegheny College* case could, when he was so inclined, find consideration anywhere: the term had been so broadened as to have become meaningless. We may now return to the Restatement debate on the consideration definition. Corbin, who had been deeply influenced by Cardozo, proposed to the Restaters what might be called a Cardozoean definition of consideration—broad, vague and, essentially, meaningless—a common law equivalent of *causa*, or cause. In the debate Corbin and the Cardozoeans lost out to Williston and the Holmesians. In Williston's view, that should have been the end of the matter.

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

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

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

The Restaters, honorable men, evidently found Corbin's argument unanswerable. However, instead of reopening the debate on the

consideration definition, they elected to stand by § 75 but to add a new section—§ 90—incorporating the estoppel idea although without using the word “estoppel.” The extent to which the new section § 90 was to be allowed to undercut the underlying principle of § 75 was left entirely unresolved. The format of the Restatement included analytical, discursive, often lengthy comments, interspersed with illustrations—that is, hypothetical cases, the facts of which were frequently drawn from real cases. Section 90 is almost the only section of the Restatement of Contracts which has no Comment at all. Four hypothetical cases, none of them, so far as I know, based on a real case, are offered as “illustrations,” presumably to indicate the range which the section was meant to have. An attentive study of the four illustrations will lead any analyst to the despairing conclusion, which is of course reinforced by the mysterious text of § 90 itself, that no one had any idea what the damn thing meant.

Grant Gilmore, The Death of Contract 60-65 (1974).

4.1 Principal Case – *Feinberg v. Pfeiffer Co.*

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

Feinberg v. Pfeiffer Co.

St. Louis Court of Appeals, Missouri
322 S.W.2d 163 (1959)

DOERNER, Commissioner.

[1] This is a suit brought in the Circuit Court of the City of St. Louis by plaintiff, a former employee of the defendant corporation, on an alleged contract whereby defendant agreed to pay plaintiff the sum of \$200 per month for life upon her retirement. A jury being waived, the case was tried by the

court alone. Judgment below was for plaintiff for \$5,100, the amount of the pension claimed to be due as of the date of the trial, together with interest thereon, and defendant duly appealed.

- [2] The parties are in substantial agreement on the essential facts. Plaintiff began working for the defendant, a manufacturer of pharmaceuticals, in 1910, when she was but 17 years of age. By 1947 she had attained the position of bookkeeper, office manager, and assistant treasurer of the defendant, and owned 70 shares of its stock out of a total of 6,503 shares issued and outstanding. Twenty shares had been given to her by the defendant or its then president, she had purchased 20, and the remaining 30 she had acquired by a stock split or stock dividend. Over the years she received substantial dividends on the stock she owned, as did all of the other stockholders. Also, in addition to her salary, plaintiff from 1937 to 1949, inclusive, received each year a bonus varying in amount from \$300 in the beginning to \$2,000 in the later years.
- [3] On December 27, 1947, the annual meeting of the defendant's Board of Directors was held at the Company's offices in St. Louis, presided over by Max Lippman, its then president and largest individual stockholder. The other directors present were George L. Marcus, Sidney Harris, Sol Flammer, and Walter Weinstock, who, with Max Lippman, owned 5,007 of the 6,503 shares then issued and outstanding. At that meeting the Board of Directors adopted the following resolution, which, because it is the crux of the case, we quote in full:

The Chairman thereupon pointed out that the Assistant Treasurer, Mrs. Anna Sacks Feinberg, has given the corporation many years of long and faithful service. Not only has she served the corporation devotedly, but with exceptional ability and skill. The President pointed out that although all of the officers and directors sincerely hoped and

desired that Mrs. Feinberg would continue in her present position for as long as she felt able, nevertheless, in view of the length of service which she has contributed provision should be made to afford her retirement privileges and benefits which should become a firm obligation of the corporation to be available to her whenever she should see fit to retire from active duty, however many years in the future such retirement may become effective. It was, accordingly, proposed that Mrs. Feinberg's salary which is presently \$350.00 per month, be increased to \$400.00 per month, and that Mrs. Feinberg would be given the privilege of retiring from active duty at any time she may elect to see fit so to do upon a retirement pay of \$200.00 per month for life, with the distinct understanding that the retirement plan is merely being adopted at the present time in order to afford Mrs. Feinberg security for the future and in the hope that her active services will continue with the corporation for many years to come. After due discussion and consideration, and upon motion duly made and seconded, it was—

Resolved, that the salary of Anna Sacks Feinberg be increased from \$350.00 to \$400.00 per month and that she be afforded the privilege of retiring from active duty in the corporation at any time she may elect to see fit so to do upon retirement pay of \$200.00 per month, for the remainder of her life.

- [4] At the request of Mr. Lippman his sons-in-law, Messrs. Harris and Flammer, called upon the plaintiff at her apartment on the same day to advise her of the passage of the resolution. Plaintiff testified on cross-examination that she had no prior information that such a pension plan was contemplated, that it came as a surprise to her, and that she

would have continued in her employment whether or not such a resolution had been adopted. It is clear from the evidence that there was no contract, oral or written, as to plaintiff's length of employment, and that she was free to quit, and the defendant to discharge her, at any time.

[5] Plaintiff did continue to work for the defendant through June 30, 1949, on which date she retired. In accordance with the foregoing resolution, the defendant began paying her the sum of \$200 on the first of each month. Mr. Lippman died on November 18, 1949, and was succeeded as president of the company by his widow. Because of an illness, she retired from that office and was succeeded in October, 1953, by her son-in-law, Sidney M. Harris. Mr. Harris testified that while Mrs. Lippman had been president she signed the monthly pension check paid plaintiff, but fussed about doing so, and considered the payments as gifts. After his election, he stated, a new accounting firm employed by the defendant questioned the validity of the payments to plaintiff on several occasions, and in the Spring of 1956, upon its recommendation, he consulted the Company's then attorney, Mr. Ralph Kalish. Harris testified that both Ernst and Ernst, the accounting firm, and Kalish told him there was no need of giving plaintiff the money. He also stated that he had concurred in the view that the payments to plaintiff were mere gratuities rather than amounts due under a contractual obligation, and that following his discussion with the Company's attorney plaintiff was sent a check for \$100 on April 1, 1956. Plaintiff declined to accept the reduced amount, and this action followed. Additional facts will be referred to later in this opinion.

[6] Appellant's first assignment of error relates to the admission in evidence of plaintiff's testimony over its objection, that at the time of trial she was sixty-five and a half years old, and that she was no longer able to engage in gainful employment because of the removal of a cancer and the performance of a colocholecystostomy operation on November 25, 1957. Its

complaint is not so much that such evidence was irrelevant and immaterial, as it is that the trial court erroneously made it one basis for its decision in favor of plaintiff. As defendant concedes, the error (if it was error) in the admission of such evidence would not be a ground for reversal, since, this being a jury-waived case, we are constrained by the statutes to review it upon both the law and the evidence, Sec. 510.310 R.S. Mo. 1949, V.A.M.S., and to render such judgment as the court below ought to have given. Section 512.160, *Minor v. Lillard*, Mo., 289 S.W.2d 1; *Thumm v. Lohr*, Mo. App., 306 S.W.2d 604. We consider only such evidence as is admissible, and need not pass upon questions of error in the admission and exclusion of evidence. *Hussey v. Robinson*, Mo., 285 S.W.2d 603. However, in fairness to the trial court it should be stated that while he briefly referred to the state of plaintiff's health as of the time of the trial in his amended findings of fact, it is obvious from his amended grounds for decision and judgment that it was not, as will be seen, the basis for his decision.

- [7] Appellant's next complaint is that there was insufficient evidence to support the court's findings that plaintiff would not have quit defendant's employ had she not known and relied upon the promise of defendant to pay her \$200 a month for life, and the finding that, from her voluntary retirement until April 1, 1956, plaintiff relied upon the continued receipt of the pension installments. The trial court so found, and, in our opinion, justifiably so. Plaintiff testified, and was corroborated by Harris, defendant's witness, that knowledge of the passage of the resolution was communicated to her on December 27, 1947, the very day it was adopted. She was told at that time by Harris and Flammer, she stated, that she could take the pension as of that day, if she wished. She testified further that she continued to work for another year and a half, through June 30, 1949; that at that time her health was good and she could have continued to work, but that after working for almost

forty years she thought she would take a rest. Her testimony continued:

Q. Now, what was the reason-I'm sorry. Did you then quit the employment of the company after you-after this year and a half?

Yes.

Q. What was the reason that you left?

Well, I thought almost forty years, it was a long time and I thought I would take a little rest.

Q. Yes.

And with the pension and what earnings my husband had, we figured we could get along.

Q. Did you rely upon this pension?

We certainly did.

Q. Being paid?

Very much so. We relied upon it because I was positive that I was going to get it as long as I lived.

Q. Would you have left the employment of the company at that time had it not been for this pension?

No.

Mr. Allen: Just a minute, I object to that as calling for a conclusion and conjecture on the part of this witness.

The Court: It will be overruled.

Q. (Mr. Agatstein continuing): Go ahead, now. The question is whether you would have quit the employment of the company at that time had you not relied upon this pension plan?

No, I wouldn't.

Q. You would not have. Did you ever seek employment while this pension was being paid to you-

(interrupting): No.

Q. Wait a minute, at any time prior-at any other place?

No, sir.

Q. Were you able to hold any other employment during that time?

Yes, I think so.

Q. Was your health good?

My health was good.

[8] It is obvious from the foregoing that there was ample evidence to support the findings of fact made by the court below.

[9] We come, then, to the basic issue in the case. While otherwise defined in defendant's third and fourth assignments of error, it is thus succinctly stated in the argument in its brief: "...whether plaintiff has proved that she has a right to recover from defendant based upon a legally binding contractual obligation to pay her \$200 per month for life."

[10] It is defendant's contention, in essence, that the resolution adopted by its Board of Directors was a mere promise to make a gift, and that no contract resulted either thereby, or when plaintiff retired, because there was no consideration given or paid by the plaintiff. It urges that a promise to make a gift is not binding unless supported by a legal consideration; that the only apparent consideration for the adoption of the foregoing resolution was the "many years of long and faithful service" expressed therein; and that past services are not a valid consideration for a promise. Defendant argues further that there is nothing in the resolution which made its effectiveness conditional upon plaintiff's continued employment, that she was not under contract to work for any

length of time but was free to quit whenever she wished, and that she had no contractual right to her position and could have been discharged at any time.

- [11] Plaintiff concedes that a promise based upon past services would be without consideration, but contends that there were two other elements which supplied the required element: First, the continuation by plaintiff in the employ of the defendant for the period from December 27, 1947, the date when the resolution was adopted, until the date of her retirement on June 30, 1949. And, second, her change of position, i. e., her retirement, and the abandonment by her of her opportunity to continue in gainful employment, made in reliance on defendant's promise to pay her \$200 per month for life.
- [12] We must agree with the defendant that the evidence does not support the first of these contentions. There is no language in the resolution predicating plaintiff's right to a pension upon her continued employment. She was not required to work for the defendant for any period of time as a condition to gaining such retirement benefits. She was told that she could quit the day upon which the resolution was adopted, as she herself testified, and it is clear from her own testimony that she made no promise or agreement to continue in the employ of the defendant in return for its promise to pay her a pension. Hence there was lacking that mutuality of obligation which is essential to the validity of a contract. *Middleton v. Holecraft*, Mo. App., 270 S.W.2d 90; *Solace v. T. J. Moss Tie Co.*, Mo. App., 142 S.W.2d 1079; *Aslin v. Stoddard County*, 341 Mo. 138, 106 S.W.2d 472; *Fuqua v. Lumbermen's Supply Co.*, 229 Mo. App. 210, 76 S.W.2d 715; *Hudson v. Browning*, 264 Mo. 58, 174 S.W. 393; *Campbell v. American Handle Co.*, 117 Mo. App. 19, 94 S.W. 815.
- [13] But as to the second of these contentions we must agree with plaintiff. By the terms of the resolution defendant promised to pay plaintiff the sum of \$200 a month upon her retirement.

Consideration for a promise has been defined in the Restatement of the Law of Contracts, Section 75, as:

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

bargained for and given in exchange for the promise.

[14] As the parties agree, the consideration sufficient to support a contract may be either a benefit to the promisor or a loss or detriment to the promisee. *Industrial Bank & Trust Co. v. Hesselberg*, Mo., 195 S.W.2d 470; *State ex rel. Kansas City v. State Highway Commission*, 349 Mo. 865, 163 S.W.2d 948; *Duwall v. Duncan*, 341 Mo. 1129, 111 S.W.2d 89; *Thompson v. McCune*, 333 Mo. 758, 63 S.W.2d 41.

[15] Section 90 of the Restatement of the Law of Contracts states that: "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." This doctrine has been described as that of "promissory estoppel," as distinguished from that of equitable estoppel or estoppel *in pais*, the reason for the differentiation being stated as follows:

It is generally true that one who has led another to act in reasonable reliance on his representations of fact cannot afterwards in litigation between the two deny the truth of the representations, and some courts have sought to apply this principle to the formation of contracts, where, relying on a gratuitous promise, the promisee has suffered detriment. It is to be noticed, however, that such a case does not come within the ordinary definition

of estoppel. If there is any representation of an existing fact, it is only that the promisor at the time of making the promise intends to fulfill it. As to such intention there is usually no misrepresentation and if there is, it is not that which has injured the promisee. In other words, he relies on a promise and not on a misstatement of fact; and the term “promissory” estoppel or something equivalent should be used to make the distinction.

WILLISTON ON CONTRACTS, Rev. Ed., Sec. 139, Vol. 1.

- [16] In speaking of this doctrine, Judge Learned Hand said in *Porter v. Commissioner of Internal Revenue*, 2 Cir., 60 F.2d 673, 675, that “...‘promissory estoppel’ is now a recognized species of consideration.”
- [17] As pointed out by our Supreme Court in *In re Jamison's Estate*, Mo., 202 S.W.2d 879, 887, it is stated in the Missouri Annotations to the Restatement under Section 90 that: “There is a variance between the doctrine underlying this section and the theoretical justifications that have been advanced for the Missouri decisions.”
- [18] That variance, as the authors of the Annotations point out, is that:

This § 90, when applied with § 85, means that the promise described is a contract without any consideration. In Missouri the same practical result is reached without in theory abandoning the doctrine of consideration. In Missouri three theories have been advanced as ground for the decisions (1) *Theory of act for promise*. The induced “action or forbearance” is the consideration for the promise. *Underwood Typewriter Co. v. Century Realty Co.* (1909) 220 Mo. 522, 119 S.W. 400, 25 L.R.A., N.S., 1173. See § 76. (2) *Theory of promissory estoppel*.

The induced “action or forbearance” works an estoppel against the promisor. (Citing *School District of Kansas City v. Sheidley* (1897) 138 Mo. 672, 40 S. W. 656 [37 L.R.A. 406]...)(3) *Theory of bilateral contract*. When the induced ‘action or forbearance’ is begun, a promise to complete is implied, and we have an enforceable bilateral contract, the implied promise to complete being the consideration for the original promise.

- [19] Was there such an act on the part of plaintiff, in reliance upon the promise contained in the resolution, as will estop the defendant, and therefore create an enforceable contract under the doctrine of promissory estoppel? We think there was. One of the illustrations cited under Section 90 of the Restatement is: “2. A promises B to pay him an annuity during B's life. B thereupon resigns a profitable employment, as A expected that he might. B receives the annuity for some years, in the meantime becoming disqualified from again obtaining good employment. A's promise is binding.” This illustration is objected to by defendant as not being applicable to the case at hand. The reason advanced by it is that in the illustration B became “disqualified” from obtaining other employment *before* A discontinued the payments, whereas in this case the plaintiff did not discover that she had cancer and thereby became unemployable until *after* the defendant had discontinued the payments of \$200 per month. We think the distinction is immaterial. The only reason for the reference in the illustration to the disqualification of A is in connection with that part of Section 90 regarding the prevention of injustice. The injustice would occur regardless of when the disability occurred. Would defendant contend that the contract would be enforceable if the plaintiff's illness had been discovered on March 31, 1956, the day before it discontinued the payment of the \$200 a month, but not if it occurred on April 2nd, the day after? Furthermore, there are more ways to become disqualified for work, or unemployable,

than as the result of illness. At the time she retired plaintiff was 57 years of age. At the time the payments were discontinued she was over 63 years of age. It is a matter of common knowledge that it is virtually impossible for a woman of that age to find satisfactory employment, much less a position comparable to that which plaintiff enjoyed at the time of her retirement.

- [20] The fact of the matter is that plaintiff's subsequent illness was not the "action or forbearance" which was induced by the promise contained in the resolution. As the trial court correctly decided, such action on plaintiff's part was her retirement from a lucrative position in reliance upon defendant's promise to pay her an annuity or pension. In a very similar case, *Ricketts v. Scotborn*, 57 Neb. 51, 77 N.W. 365, 367, 42 L.R.A. 794, the Supreme Court of Nebraska said:

According to the undisputed proof, as shown by the record before us, the plaintiff was a working girl, holding a position in which she earned a salary of \$10 per week. Her grandfather, desiring to put her in a position of independence, gave her the note accompanying it with the remark that his other grandchildren did not work, and that she would not be obliged to work any longer. In effect, he suggested that she might abandon her employment, and rely in the future upon the bounty which he promised. He doubtless desired that she should give up her occupation, but, whether he did or not, it is entirely certain that he contemplated such action on her part as a reasonable and probable consequence of his gift. Having intentionally influenced the plaintiff to alter her position for the worse on the faith of the note being paid when due, it would be grossly inequitable to permit the maker, or his executor, to resist payment on the ground that the promise was given without consideration.

[21] The Commissioner therefore recommends, for the reasons stated, that the judgment be affirmed.

4.1.1 Discussion of *Feinberg v. Pfeiffer Co.*

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

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

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

- (a) "If you agree to continue working for me, I'll give you a fair share of the profits at the end of the year."
- (b) "If you will voluntarily retire, I will give you a pension of \$200 per month for life."

Is there consideration in these cases?

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

4.2 Principal Case – *Hayes v. Plantations Steel Co.*

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

Hayes v. Plantations Steel Co.

Supreme Court of Rhode Island

438 A.2d 1091 (1982)

SHEA, Justice.

[1] The defendant employer, Plantations Steel Company (Plantations), appeals from a Superior Court judgment for the plaintiff employee, Edward J. Hayes (Hayes). The trial justice, sitting without a jury, found that Plantations was obligated to

Hayes on the basis of an implied-in-fact contract to pay him a yearly pension of \$5,000. The award covered three years in which payment had not been made. The trial justice ruled, also, that Hayes had made a sufficient showing of detrimental reliance upon Plantations's promise to pay to give rise to its obligation based on the theory of promissory estoppel. The trial justice, however, found in part for Plantations in ruling that the payments to Hayes were not governed by the Employee Retirement Income Security Act, 29 U.S.C.A. §§ 1001-1461 (West 1975), and consequently he was not entitled to attorney's fees under § 1132(g) of that act. Both parties have appealed.

- [2] We reverse the findings of the trial justice regarding Plantations's contractual obligation to pay Hayes a pension. Consequently we need not deal with the cross-appeal concerning the award of attorney's fees under the federal statute.
- [3] Plantations is a closely held Rhode Island corporation engaged in the manufacture of steel reinforcing rods for use in concrete construction. The company was founded by Hugo R. Mainelli, Sr., and Alexander A. DiMartino. A dispute between their two families in 1976 and 1977 left the DiMartinos in full control of the corporation. Hayes was an employee of the corporation from 1947 until his retirement in 1972 at age of sixty-five. He began with Plantations as an “estimator and draftsman” and ended his career as general manager, a position of considerable responsibility. Starting in January 1973 and continuing until January 1976, Hayes received the annual sum of \$5,000 from Plantations. Hayes instituted this action in December 1977, after the then company management refused to make any further payments.
- [4] Hayes testified that in January 1972 he announced his intention to retire the following July, after twenty-five years of continuous service. He decided to retire because he had worked continuously for fifty-one years. He stated, however, that he would not have retired had he not expected to receive

a pension. After he stopped working for Plantations, he sought no other employment.

- [5] Approximately one week before his actual retirement Hayes spoke with Hugo R. Mainelli, Jr., who was then an officer and a stockholder of Plantations. This conversation was the first and only one concerning payments of a pension to Hayes during retirement. Mainelli said that the company “would take care” of him. There was no mention of a sum of money or a percentage of salary that Hayes would receive. There was no formal authorization for payments by Plantations's shareholders and/or board of directors. Indeed, there was never any formal provision for a pension plan for any employee other than for unionized employees, who benefit from an arrangement through their union. The plaintiff was not a union member.
- [6] Mr. Mainelli, Jr., testified that his father, Hugo R. Mainelli, Sr., had authorized the first payment “as a token of appreciation for the many years of (Hayes's) service.” Furthermore, “it was implied that that check would continue on an annual basis.” Mainelli also testified that it was his “personal intention” that the payments would continue for “as long as I was around.”
- [7] Mainelli testified that after Hayes's retirement, he would visit the premises each year to say hello and renew old acquaintances. During the course of his visits, Hayes would thank Mainelli for the previous check and ask how long it would continue so that he could plan an orderly retirement.
- [8] The payments were discontinued after 1976. At that time a succession of several poor business years plus the stockholders' dispute, resulting in the takeover by the DiMartino family, contributed to the decision to stop the payments.
- [9] The trial justice ruled that Plantations owed Hayes his annual sum of \$5,000 for the years 1977 through 1979. The ruling implied that barring bankruptcy or the cessation of business

for any other reason, Hayes had a right to expect continued annual payments.

- [10] The trial justice found that Hugo Mainelli, Jr.'s statement that Hayes would be taken care of after his retirement was a promise. Although no sum of money was mentioned in 1972, the four annual payments of \$5,000 established that otherwise unspecified term of the contract. The trial justice also found that Hayes supplied consideration for the promise by voluntarily retiring, because he was under no obligation to do so. From the words and conduct of the parties and from the surrounding circumstances, the trial justice concluded that there existed an implied contract obligating the company to pay a pension to Hayes for life. The trial justice made a further finding that even if Hayes had not truly bargained for a pension by voluntarily retiring, he had nevertheless incurred the detriment of foregoing other employment in reliance upon the company's promise. He specifically held that Hayes's retirement was in response to the promise and held also that Hayes refrained from seeking other employment in further reliance thereon.
- [11] The findings of fact of a trial justice sitting without a jury are entitled to great weight when reviewed by this court. His findings will not be disturbed unless it can be shown that they are clearly wrong or that the trial justice misconceived or overlooked material evidence. *Lisi v. Marra*, R.I., 424 A.2d 1052 (1981); *Rabeb v. Lemenski*, 115 R.I. 576, 350 A.2d 397 (1976). After careful review of the record, however, we conclude that the trial justice's findings and conclusions must be reversed.
- [12] Assuming for the purpose of this discussion that Plantations in legal effect made a promise to Hayes, we must ask whether Hayes did supply the required consideration that would make the promise binding? And, if Hayes did not supply consideration, was his alleged reliance sufficiently induced by the promise to estop defendant from denying its obligation to him? We answer both questions in the negative.

- [13] We turn first to the problem of consideration. The facts at bar do not present the case of an express contract. As the trial justice stated, the existence of a contract in this case must be determined from all the circumstances of the parties' conduct and words. Although words were expressed initially in the remark that Hayes "would be taken care of," any contract in this case would be more in the nature of an implied contract. Certainly the statement of Hugo Mainelli, Jr., standing alone is not an expression of a direct and definite promise to pay Hayes a pension. Though we are analyzing an implied contract, nevertheless we must address the question of consideration.
- [14] Contracts implied in fact require the element of consideration to support them as is required in express contracts. The only difference between the two is the manner in which the parties manifest their assent. *J. Koury Steel Erectors, Inc. v. San-Vel Concrete Corp.*, 387 A.2d 694 (R.I. 1978); *Bailey v. West*, 249 A.2d 414 (R.I. 1969). In this jurisdiction, consideration consists either in some right, interest, or benefit accruing to one party or some forbearance, detriment, or responsibility given, suffered, or undertaken by the other. See *Dockery v. Greenfield*, 136 A.2d 682 (R.I. 1957); *Darcey v. Darcey*, 71 A. 595 (R.I. 1909). Valid consideration furthermore must be bargained for. It must induce the return act or promise. To be valid, therefore, the purported consideration must not have been delivered before a promise is executed, that is, given without reference to the promise. *Plowman v. Indian Refining Co.*, 20 F. Supp. 1 (E.D.Ill.1937). Consideration is therefore a test of the enforceability of executory promises, *Angel v. Murray*, 322 A.2d 630 (R.I. 1974), and has no legal effect when rendered in the past and apart from an alleged exchange in the present. *Zanturjian v. Boornazian*, 55 A. 199 (R.I. 1903).
- [15] In the case before us, Plantations's promise to pay Hayes a pension is quite clearly not supported by any consideration supplied by Hayes. Hayes had announced his intent to retire

well in advance of any promise, and therefore the intention to retire was arrived at without regard to any promise by Plantations. Although Hayes may have had in mind the receipt of a pension when he first informed Plantations, his expectation was not based on any statement made to him or on any conduct of the company officer relative to him in January 1972. In deciding to retire, Hayes acted on his own initiative. Hayes's long years of dedicated service also is legally insufficient because his service too was rendered without being induced by Plantations's promise. See *Plowman v. Indian Refining Co.*, *supra*.

- [16] Clearly then this is not a case in which Plantations's promise was meant to induce Hayes to refrain from retiring when he could have chosen to do so in return for further service. 1 WILLISTON ON CONTRACTS § 130B (3d ed., Jaeger 1957). Nor was the promise made to encourage long service from the start of his employment. *Weesner v. Electric Power Board of Chattanooga*, 344 S.W.2d 766 (Tenn. App. 1961). Instead, the testimony establishes that Plantations's promise was intended “as a token of appreciation for (Hayes's) many years of service.” As such it was in the nature of a gratuity paid to Hayes for as long as the company chose. In *Spickelmier Industries, Inc. v. Passander*, 359 N.E.2d 563 (Ind. App. 1977), an employer's promise to an employee to pay him a year-end bonus was unenforceable because it was made after the employee had performed his contractual responsibilities for that year.
- [17] The plaintiff's most relevant citations are still inapposite to the present case. *Bredemann v. Vaughan Mfg. Co.*, 188 N.E.2d 746 (Ill. App. 1963), presents similar yet distinguishable facts. There, the appellate court reversed a summary judgment granted to the defendant employer, stating that a genuine issue of material fact existed regarding whether the plaintiff's retirement was in consideration of her employer's promise to pay her a lifetime pension. As in the present case, the employer made the promise one week prior to the employee's

retirement, and in almost the same words. However, *Bredemann* is distinguishable because the court characterized that promise as a concrete offer to pay if she would retire immediately. In fact, the defendant wanted her to retire. *Id.* 188 N.E.2d at 749. On the contrary, Plantations in this case did not actively seek Hayes's retirement. DiMartino, one of Plantations's founders, testified that he did not want Hayes to retire. Unlike *Bredemann*, here Hayes announced his unsolicited intent to retire.

[18] Hayes also argues that the work he performed during the week between the promise and the date of his retirement constituted sufficient consideration to support the promise. He relies on *Ulmann v. Sunset-McKee Co.*, 221 F.2d 128 (9th Cir. 1955), in which the court ruled that work performed during the one-week period of the employee's notice of impending retirement constituted consideration for the employer's offer of a pension that the employee had solicited some months previously. But there the court stated that its prime reason for upholding the agreement was that sufficient consideration existed in the employee's consent not to compete with his employer. These circumstances do not appear in our case. Hayes left his employment because he no longer desired to work. He was not contemplating other job offers or considering going into competition with Plantations. Although Plantations did not want Hayes to leave, it did not try to deter him, nor did it seek to prevent Hayes from engaging in other activity.

[19] Hayes argues in the alternative that even if Plantations's promise was not the product of an exchange, its duty is grounded properly in the theory of promissory estoppel. This court adopted the theory of promissory estoppel in *East Providence Credit Union v. Geremia*, 239 A.2d 725, 727 (R.I. 1968) (quoting 1 RESTATEMENT CONTRACTS § 90 at 110 (1932)) stating:

“A promise which the promisor should reasonably expect to induce action or forbearance of a

definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of its promise.”

- [20] In *East Providence Credit Union* this court said that the doctrine of promissory estoppel is invoked “as a substitute for a consideration, rendering a gratuitous promise enforceable as a contract.” *Id.* To restate the matter differently, “the acts of reliance by the promisee to his detriment (provide) a substitute for consideration.” *Id.*
- [21] Hayes urges that in the absence of a bargained-for promise the facts require application of the doctrine of promissory estoppel. He stresses that he retired voluntarily while expecting to receive a pension. He would not have otherwise retired. Nor did he seek other employment.
- [22] We disagree with this contention largely for the reasons already stated. One of the essential elements of the doctrine of promissory estoppel is that the promise must induce the promisee's action or forbearance. The particular act in this regard is plaintiff's decision whether or not to retire. As we stated earlier, the record indicates that he made the decision on his own initiative. In other words, the conversation between Hayes and Mainelli which occurred a week before Hayes left his employment cannot be said to have induced his decision to leave. He had reached that decision long before.
- [23] An example taken from the Restatement provides a meaningful contrast:
2. A promises B to pay him an annuity during B's life. B thereupon resigns profitable employment, as A expected that he might. B receives the annuity for some years, in the meantime becoming disqualified from again obtaining good employment. A's promise is binding.

1 Restatement OF CONTRACTS § 90 at 111 (1932).

- [24] In *Feinberg v. Pfeiffer Co.*, 322 S.W.2d 163 (Mo. App.1959), the plaintiff-employee had worked for her employer for nearly forty years. The defendant corporation's board of directors resolved, in view of her long years of service, to obligate itself to pay “retirement privileges” to her. The resolution did not require the plaintiff to retire. Instead, the decision whether and when to retire remained entirely her own. The board then informed her of its resolution. The plaintiff worked for eighteen months more before retiring. She sued the corporation when it reduced her monthly checks seven years later. The court held that a pension contract existed between the parties. Although continued employment was not a consideration to her receipt of retirement benefits, the court found sufficient reliance on the part of the plaintiff to support her claim. The court based its decision upon the above restatement example, that is, the defendant informed the plaintiff of its plan, and the plaintiff in reliance thereon, retired. *Feinberg* presents factors that also appear in the case at bar. There, the plaintiff had worked many years and desired to retire; she would not have left had she not been able to rely on a pension; and once retired, she sought no other employment.
- [25] However, the important distinction between *Feinberg* and the case before us is that in *Feinberg* the employer's decision definitely shaped the thinking of the plaintiff. In this case the promise did not. It is not reasonable to infer from the facts that Hugo R. Mainelli, Jr., expected retirement to result from his conversation with Hayes. Hayes had given notice of his intention seven months previously. Here there was thus no inducement to retire which would satisfy the demands of § 90 of the Restatement. Nor can it be said that Hayes's refraining from other employment was “action or forbearance of a definite and substantial character.” The underlying assumption of Hayes's initial decision to retire was that upon leaving the defendant's employ, he would no longer work. It

is impossible to say that he changed his position any more so because of what Mainelli had told him in light of his own initial decision. These circumstances do not lead to a conclusion that injustice can be avoided only by enforcement of Plantations's promise. Hayes received \$20,000 over the course of four years. He inquired each year about whether he could expect a check for the following year. Obviously, there was no absolute certainty on his part that the pension would continue. Furthermore, in the face of his uncertainty, the mere fact that payment for several years did occur is insufficient by itself to meet the requirements of reliance under the doctrine of promissory estoppel.

[26] For the foregoing reasons, the defendant's appeal is sustained and the judgment of the Superior Court is reversed. The papers of the case are remanded to the Superior Court.

4.2.1 Discussion of Hayes v. Plantation Steel Co.

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

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

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

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

5. The Material Benefit Rule

Another alternative basis for enforcement of promises in the absence of consideration is the so-called material benefit rule. In a mere handful of cases, courts have chosen to enforce promises made in recognition of prior benefits received. The Restatement (Second) expresses this doctrinal principle in the following terms:

§ 86. Promise for Benefit Received

- (1) A promise made in recognition of a benefit previously received by the promisor from the promisee is binding to the extent necessary to prevent injustice.

- (2) A promise is not binding under Subsection (1)
- (a) if the promisee conferred the benefit as a gift or for other reasons the promisor has not been unjustly enriched; or
 - (b) to the extent that its value is disproportionate to the benefit.

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

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

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

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

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

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

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

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

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

time we get to Restatement (Third) it may well be that § [86] will have flowered like Jack's bean-stalk....

Grant Gilmore, The Death of Contract 74-76 (1974).

III. Contract Formation

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

All of these rules derive from the fundamental principle that contractual obligations are based on consent. For centuries, courts applied a subjective test to determine whether each of the parties truly intended to form a binding contract. They spoke of “a meeting of the minds” between the parties. As we have already seen in discussing *Lucy v. Zehmer*, however, more modern decisions focus instead on the parties’ outward manifestations to determine their contractual intent. Older cases used various legal fictions and other devices to protect promisees who reasonably believed that a promisor had made a binding commitment. Thus, the Restatement (Second) of Contracts (1981) § 17 requires only “a manifestation of mutual assent” to an exchange. This so-called “objective theory” of contract finds expression in the Restatement (Second) and in the cases that follow.

1. Offer

Parties ordinarily manifest their mutual assent to a contract by means of an offer and acceptance. The Restatement (Second) describes mutual assent in the following terms:

§ 22 Mode of Assent: Offer and Acceptance

- (1) The manifestation of mutual assent to an exchange ordinarily takes the form of an offer or proposal by one party followed by an acceptance by the other party or parties.
- (2) A manifestation of mutual assent may be made even though neither offer nor acceptance can be identified and even though

the moment of formation cannot be determined.

Comment:

a. The usual practice. Subsection (1) states the usual practice in the making of bargains. One party ordinarily first announces what he will do and what he requires in exchange, and the other then agrees. Where there are more than two parties, the second party to agree may be regarded as accepting the offer made by the first party and as making a similar offer to subsequent parties, and so on. It is theoretically possible for a third person to state a suggested contract to the parties and for them to say simultaneously that they assent. Or two parties may sign separate duplicates of the same agreement, each manifesting assent whether the other signs before or after him. Compare Illustration 5 to § 23.

b. Assent by course of conduct. Problems of offer and acceptance are important primarily in cases where advance commitment serves to shift a risk from one party to the other, as in sales of goods which are subject to rapid price fluctuations, in sales of land, and in insurance contracts. Controversies as to whether and when the commitment is made are less likely to be important even in such cases once performance is well under way. Offer and acceptance become still less important after there have been repeated occasions for performance by one party where the other knows the nature of the performance and has an opportunity for objection to it. See Uniform Commercial Code § 2-208(1); compare Comment *a* to § 19. In such cases it is unnecessary to determine the moment of making of the contract, or which party made

the offer and which the acceptance. Thus, Uniform Commercial Code §§ 2-204 and 2-207(3), relating to contracts for the sale of goods, provide that conduct by both parties which recognizes the existence of a contract is sufficient to establish it although the writings of the parties do not otherwise establish a contract. The principle has also been applied in non-sales contexts.

The Uniform Commercial Code adopts an even more liberal approach to demonstrating mutual assent.

§ 2-204. Formation in General.

(1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

Although more complicated situations sometimes arise, it is often helpful to begin to analyze parties' negotiations by trying to identify an offer made and an acceptance given. One prominent commentator explained the essential elements of contract formation as follows:

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

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

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

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

§ 24. Offer Defined

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

§ 26. Preliminary Negotiations

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

1.0.1 Hypo on Offer Rules

A listing on www.craigslist.org advertised the following vehicle for sale:

2004 GMC Suburban 4WD. Rare 9-seat model. Under warranty! Original MSRP \$43,000, current blue book \$13-14,000, will sacrifice for \$10K. Call Kim at (913) 240-6349 or (434) 985-2101.

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

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

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

1.1 Principal Case – Dyno Construction Co. v. McWane, Inc.

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

Dyno Construction Company v. McWane, Inc.

United States Court of Appeals, Sixth Circuit

198 F.3d 567 (1999)

QUIST, District Judge.

[1] Plaintiff, Dyno Construction Company, sued Defendant, McWane, Inc., alleging various breach of contract claims arising out of Dyno's purchase of ductile iron pipe from McWane that was later found to be defective. The district court denied the parties' cross-motions for summary judgment, and a jury returned a general verdict in favor of McWane. The district court denied Dyno's motion for a new trial. Dyno appeals the order denying its motion for summary judgment, the judgment entered after trial, and the order denying Dyno's motion for a new trial. We find no error and affirm.

I. FACTUAL AND PROCEDURAL BACKGROUND

[2] Dyno is a company engaged in the business of constructing underground utility projects, specifically underground water and sewer lines. Dyno was purchased in the fall of 1995 by Frederick Harrah, Laymond Lewis, and a third party. Prior to purchasing Dyno, Harrah and Lewis were employees of Reynolds, Inc., a large underground pipeline

construction company also in the business of installing underground water and sewer lines.

[3] McWane is a manufacturer and seller of ductile iron pipe and fittings for underground utility projects. Harrah and Lewis frequently purchased pipe from McWane during their employment with Reynolds, as McWane was the exclusive supplier of certain types of ductile iron products to Reynolds.

[4] Sometime shortly before November 6, 1995, Dyno submitted a bid to the City of Perrysburg, Ohio, for a multimillion dollar water and sewer system project. In order to prepare the bid, Lewis contacted various suppliers, including McWane, to obtain quotes for necessary materials. On November 6, 1995, Dyno learned that it was the low bidder on the project and would be awarded the contract.

[5] On November 8, 1995, McWane's district sales manager, Kevin Ratcliffe, faxed Dyno a document containing quantities and prices for the materials Dyno requested for the Perrysburg Project.¹ Ratcliffe sent a second fax to Lewis on November 13, 1995, which included handwritten prices and notes next to each item. On the fax cover sheet, Ratcliffe asked Lewis to “[p]lease call.”

[6] On or prior to November 22, 1995, Lewis phoned Ratcliffe and told him to order the materials. Lewis testified at his deposition that he thought that there was a “done deal” when he got off the phone with Ratcliffe. However, after the phone call, Ratcliffe prepared and sent a package to Lewis via Federal Express. The Federal Express package included a purchase order, a credit application, and a cover letter in which Ratcliffe asked Lewis to review and sign the purchase order and credit application and return the originals to Ratcliffe. The purchase order and credit application each stated that the sale of the materials was subject to the terms

¹ Ratcliffe was actually the district sales manager for Clow Water Systems, Co., a division of McWane. To avoid confusion, the Court will refer to the Clow division as McWane.

and conditions printed on the reverse sides of those documents. The reverse side of each document contained additional terms and conditions, including a provision which limited McWane's liability for defective materials. The Federal Express invoice kept in McWane's files showed that Dyno received the package on November 24, 1995, at 8:53 a.m.

[7] Lewis called Ratcliffe on December 1, 1995, to inquire about the status of Dyno's order. Lewis testified that Ratcliffe told him that "you have to sign our forms." Lewis indicated both in his deposition and at trial that he was not surprised when Ratcliffe told him that the purchase order and credit application would have to be signed before McWane would ship the materials. Lewis told Ratcliffe that he had not received the forms Ratcliffe sent via Federal Express and could not find the package in his office. At Lewis' request, in order to expedite the transaction, Ratcliffe faxed Lewis copies of the documents that were sent on November 22, 1995. However, Ratcliffe did not fax the back sides of the documents which included, among other things, this provision limiting McWane's liability:

SELLER SHALL NOT BE LIABLE FOR EXEMPLARY, PUNITIVE, SPECIAL, INCIDENTAL, CONSEQUENTIAL DAMAGES OR EXPENSES, INCLUDING BUT NOT LIMITED TO, LOSS PROFIT REVENUES, LOSS OF USE OF THE GOODS, OR ANY ASSOCIATED GOODS OR EQUIPMENT, DAMAGE TO PROPERTY OF BUYER, COST OF CAPITAL, COST OF SUBSTITUTE GOODS, DOWNTIME, LIQUIDATED DAMAGES, OR THE CLAIMS OF BUYER'S CUSTOMERS FOR ANY OF THE AFORESAID DAMAGES, OR FROM ANY OTHER CAUSE RELATING THERETO, AND SELLER'S LIABILITY HEREUNDER IN ANY CASE IS

EXPRESSLY LIMITED TO THE REPLACEMENT (IN THE FORM ORIGINALLY SHIPPED) OF GOODS NOT COMPLYING WITH THIS AGREEMENT, OR, AT SELLER'S ELECTION, TO THE REPAYMENT OF, OR CREDITING BUYER WITH, AN AMOUNT EQUAL TO THE PURCHASE PRICE OF SUCH GOODS PRIOR PAID TO AND RECEIVED BY SELLER, WHETHER SUCH CLAIMS ARE FOR BREACH OF WARRANTY OR NEGLIGENCE....

[8] Dyno signed the faxed pages without the quoted damages limitation provision and returned them to Ratcliffe later that day.

[9] Dyno had substantial problems with the pipes it purchased from McWane. Although McWane repaired and reinstalled the pipe to the satisfaction of Dyno, it refused to pay Dyno for consequential damages suffered as a result of the defects in the pipes on the basis of the limitation of damages provision on the back of the purchase order. Dyno filed this suit in an attempt to recover its consequential damages.

[10] Both parties moved for summary judgment with respect to the question of whether the quoted provision limiting McWane's liability for consequential damages was a part of the Dyno/McWane contract.² In denying the motions, the district court rejected Dyno's contention that the two written quotations which Ratcliffe sent to Lewis were offers that Dyno accepted when Lewis informed Ratcliffe that Dyno wished to purchase the pipe from McWane because the quotations were part of preliminary negotiations between the parties. Instead, the court concluded that the contract was

² McWane also sought summary judgment on the issue of whether the pipe was defective.

formed or, alternatively, modified, when Lewis signed the documents he received from Ratcliffe by fax on December 1, 1995. The district court also rejected as a matter of law McWane's arguments that Dyno's acceptance of documents containing the warranty limitation provision established a course of performance and that a course of dealing was established by Lewis' dealings with McWane while Lewis was employed at Reynolds. Instead, the district court found that McWane's argument that Lewis had knowledge of the disputed provision based upon his receipt of the Federal Express package presented a genuine issue of material fact. Thus, the district court framed the issue for the jury with respect to the limitation of damages provision as whether Lewis knew or should have known about McWane's terms and conditions at the time he signed the fax copy.

[11]At trial, during the conference on jury instructions, the district court rejected Dyno's proposed instruction number 7, which would have allowed the jury to find that the contract had been formed on or before November 22, 1995, on the basis of its ruling with respect to the summary judgment motions that the contract was formed on December 1, 1995.³ At the conclusion of trial, the jury returned a verdict in favor of McWane.

II. ANALYSIS

A. Summary Judgment

[12]Dyno first contends that the district court erred when it found that the contract was formed on December 1, 1995, rather than on November 22, 1995. Although Dyno does not argue that the denial of its motion for summary judgment was erroneous, Dyno asserts that the determination made by the district court in ruling on the motion that the contract was

³ Judge James G. Carr, to whom the case was initially assigned, made the ruling on the parties' cross motions for summary judgment. The case was then reassigned to Senior Judge John W. Potter, who conducted the trial.

made on December 1, 1995, when Lewis signed the fax documents, was erroneous.

[13]Dyno asserted in its motion for summary judgment, and continues to argue to this Court, that the contract was actually entered into on November 22, 1995, when Lewis told Ratcliffe to go ahead and order the materials that Ratcliffe had listed in his November 8 and November 13 faxes. Dyno claims that the parties agreed to the essential terms of price, quantity, and description, and any other terms to the contract could be supplied by the “gap-filler” provisions of the Uniform Commercial Code, which do not limit the seller's liability for consequential damages.

[14]In order to prove the existence of a contract, a plaintiff is required to demonstrate the essential requirements of an offer, acceptance, and consideration. See *Helle v. Landmark, Inc.*, 15 Ohio App.3d 1, 8, 472 N.E.2d 765, 773 (1984). A valid and binding contract comes into existence when an offer is accepted. See *Realty Dev., Inc. v. Kosydar*, 322 N.E.2d 328, 332 (Ohio Ct.App.1974) (per curiam). Dyno contends that the written price quotations Ratcliffe faxed to Lewis on November 8, 1995, and November 13, 1995, constituted the offer, which Lewis accepted on behalf of Dyno on or about November 22, 1995, when Lewis told Ratcliffe to order the materials listed on the price quote.

[15]“Typically, a price quotation is considered an invitation for an offer, rather than an offer to form a binding contract.” *White Consol. Indus., Inc. v. McGill Mfg. Co.*, 165 F.3d 1185, 1190 (8th Cir.1999) (citing *Litton Microwave Cooking Prods. v. Leviton Mfg. Co.*, 15 F.3d 790, 794 (8th Cir.1994)); see also *Realty Dev., Inc.*, 322 N.E.2d at 332 (finding that the price quotation furnished to the appellant was “susceptible to the interpretation that [it] was nothing more than an invitation to appellant to make an offer”). Instead, a buyer's purchase agreement submitted in response to a price quotation is usually deemed the offer. See *Master Palletizer Sys., Inc. v. T.S. Ragsdale Co.*, 725 F.Supp. 1525, 1531

(D.Colo.1989). However, a price quotation may suffice for an offer if it is sufficiently detailed and it “reasonably appear[s] from the price quotation that assent to that quotation is all that is needed to ripen the offer into a contract.” *Quaker State Mushroom Co. v. Dominick's Finer Foods, Inc.*, of Illinois, 635 F.Supp. 1281, 1284 (N.D.Ill.1986); see also *Master Palletizer Sys.*, 725 F.Supp. at 1531. While the inclusion of a description of the product, price, quantity, and terms of payment may indicate that the price quotation is an offer rather than a mere invitation to negotiate, the determination of the issue depends primarily upon the intention of the person communicating the quotation as demonstrated by all of the surrounding facts and circumstances. See *Interstate Indus., Inc. v. Barclay Indus., Inc.*, 540 F.2d 868, 871 (7th Cir.1976) (quoting *R.E. Crummer & Co. v. Nuveen*, 147 F.2d 3, 5 (7th Cir.1945)); *Maurice Elec. Supply Co. v. Anderson Safeway Guard Rail Corp.*, 632 F.Supp. 1082, 1089 (D.D.C.1986) (mem.op.). Thus, to constitute an offer, a price quotation must “be made under circumstances evidencing the express or implied intent of the offeror that its acceptance shall constitute a binding contract.” *Maurice Elec. Supply*, 632 F.Supp. at 1087.

[16]In *Interstate Industries, Inc. v. Barclay Industries, Inc.*, 540 F.2d 868 (7th Cir.1976), the court determined that a letter sent by the defendant to the plaintiff stating that the defendant would be able to manufacture fiberglass panels for the plaintiff pursuant to specified standards at certain prices did not constitute an offer. Among other things, the court found that the letter's use of the term “price quotation,” lack of language indicating that an offer was being made, and absence of terms regarding quantity, time of delivery, or payment terms established that the letter was not intended as an offer. See *id.* at 873. *Thos. J. Sheehan Co. v. Crane Co.*, 418 F.2d 642 (8th Cir.1969), cited by the court in *Interstate Industries*, concluded that a price list for copper tubing which a supplier furnished to a subcontractor in connection with the

latter's bid on a job was merely an invitation to engage in future negotiations. The court observed:

The only evidence of defendant's alleged September 1963 offer is the oral communication to plaintiff that Crane Company could supply copper for the Mansion House Project at a lower price than originally quoted. Reference was made to the new "Chase" price sheet concerning deliveries in minimum quantities of 5000 pounds or 5000 feet, and that prices for copper would be guaranteed for the "duration of the job." At this time nothing was stated by the defendant or plaintiff as to (1) the time in which plaintiff had to accept the "offer," (2) the quantity of copper tubing, fittings, or other supplies to be ordered, (3) the terms of payment or (4) the time when Crane Company promised to perform....

The "Chase" price sheet was nothing more than a circular sent to distributors by the manufacturer, Wolverine. Without other terms of commitment, we find that the proposal as to "price protection" was related only to the quoted price as a condition upon which the supplier would be willing *in the future* to negotiate a contract of shipment....

Prices and price factors quoted by suppliers to contractors for the purposes of aiding contractors to make bid estimates, without more specific terms, do not obligate the supplier to comply with any purchase order upon whatever terms and conditions the contractor may choose to offer at some undetermined date in the future. The fact that the prices quoted are not withdrawn or that a withdrawal of them is not communicated to the contractor is immaterial. No duty exists to revoke terms which without words of

commitment merely quote an existing price at which a contract of purchase might be negotiated.

Thos. J. Sheehan, 418 F.2d at 645-46 (italics in original).

[17]Similarly, in *Day v. Amax, Inc.*, 701 F.2d 1258 (8th Cir.1983), the Seventh Circuit affirmed the district court's grant of a directed verdict to the defendant on the issue of whether the defendant's description of mining equipment and a quotation of prices constituted an offer, reasoning that “[a]lthough questions of intent are usually for the jury to decide ... the record discloses no evidence that any of the defendants manifested an intent to enter into a contract with [the plaintiff].” *Id.* at 1263. Thus, the plaintiff's evidence that the defendant had given the plaintiff signed writings containing detailed descriptions of the mining equipment and the terms of sale and had set up an escrow account were insufficient to demonstrate the defendant's intent to enter into a contract. *See id.* at 1264-65; *accord Maurice Elec. Supply*, 632 F.Supp. at 1088 (concluding that the defendant's price quote “was simply a statement of price for three individual high mast poles of varying height” because “[i]t did not specify quality or quantity, time and place of delivery, or terms of payment” and “[t]here was no promise that the quote would remain open for a specified period of time”).

[18]In contrast to the cases discussed above, the court in *Bergquist Co. v. Sunroc Corp.*, 777 F.Supp. 1236 (E.D.Pa.1991), found that the question of whether the price quotation at issue constituted an offer was a question of fact for the jury. Some of the factors cited by the court as creating an issue for the jury were: (i) the price quotation was developed by the defendant after the parties had engaged in substantial negotiations; (ii) the quotation included a description of the product, a list of various quantities at various prices, terms of payment, and delivery terms; (iii) the quotation contained the statement “This quotation is offered for your acceptance within 30 days”; and (iv) the price which the purchaser paid

was the price listed in the price quotation rather than the price listed in the purchaser's subsequent purchase order. *See id.* at 1249.

[19] In this case, the facts before the district court furnished a sufficient basis for it to conclude as a matter of law that the contract was formed when Lewis signed the fax from Ratcliffe on December 1, 1995, rather than when Lewis told Ratcliffe to order the materials on November 22, 1995. In particular, neither the November 8 nor the November 13 price quotations contained words indicating that Ratcliffe intended to make an offer to Dyno. The word "Estimate" was printed at the top of the document faxed on November 8, and the message "Please call" was printed on the cover sheet for the document faxed on November 13. These words are indicative of an invitation to engage in future negotiations rather than an offer to enter into a contract. Although both price lists set forth descriptions of the materials, prices, and quantities, nothing was stated about the place of delivery, time of performance, or terms of payment. *See Litton Microwave Cooking Prods.*, 15 F.3d at 795 (rejecting the contention that the defendant's price letters and catalogs, which failed to address the place of delivery, quantities, and availability of parts to be purchased were not offers). Finally, the fact that Lewis voluntarily signed the December 1 fax demonstrated that he understood that a binding contract had not been formed as a result of the previous price quotations sent by Ratcliffe. In light of these facts, we agree with the district court that McWane's price quotations did not

constitute offers and that the contract was formed on December 1, 1995.⁴

B. Motion for New Trial

[Students may wish to skim the rest of this opinion because it deals with issues that, though interesting, are peripheral to our discussion of offer.]

[20]Dyno also contends that the trial court erred in denying its motion for a new trial. Dyno argued to the district court that it was entitled to a new trial because the district court made several erroneous rulings on evidentiary issues and jury instructions. Motions for a new trial are addressed to the sound discretion of the trial court. *See Hopkins v. Coen*, 431 F.2d 1055, 1059 (6th Cir.1970). We review a district court's denial of a motion for a new trial under an abuse of discretion standard. *See Holmes v. City of Massillon*, 78 F.3d 1041, 1045 (6th Cir.1996). An abuse of discretion occurs when this Court has “a definite and firm conviction that the trial court committed a clear error in judgment.” *Logan v. Dayton Hudson Corp.*, 865 F.2d 789, 790 (6th Cir.1989).

1. Evidentiary Issues

[21]Dyno first argues that the district court erred in allowing testimony concerning Lewis' familiarity with McWane's standard purchase order, including its terms and conditions, based on Lewis' prior dealings with McWane as an employee of Reynolds. Dyno argues that Lewis' prior dealings with McWane as an employee of Reynolds are completely irrelevant to the issue of whether the contract between Dyno

⁴ The cases cited by Dyno, *Reaction Molding Technologies, Inc. v. General Electric Co.*, 585 F.Supp. 1097 (E.D.Pa.1984), and *Loranger Plastics Corp. v. Incoe Corp.*, 670 F.Supp. 145 (W.D.Pa.1987), are both distinguishable from the instant case on their facts. In *Reaction Molding Technologies*, the quotations contained payment and delivery terms and thus were substantially more detailed than the price quotations at issue in this case. *See Reaction Molding Tech.*, 585 F.Supp. at 1099. In *Loranger Plastics*, the quotation stated that it was “subject to acceptance without modification within 30 days” from the date it was issued. *See Loranger Plastics*, 670 F.Supp. at 146. The language in the quotation therefore indicated that it was intended as an offer.

and McWane included a limitation of liability provision and that this evidence confused the jury and caused prejudicial error.

[22]We agree with the district court that the evidence about Lewis' prior dealings with McWane, particularly as it related to Lewis' knowledge of McWane's standard terms and conditions, was relevant and properly admitted. The faxed copy of the purchase order signed by Lewis on December 1, 1995, stated on the front in large print directly above his signature that the purchase order was subject to the terms and conditions on the reverse side. There is no disputing that McWane intended those terms and conditions on the back of the purchase order to be part of the contract but that Ratcliffe inadvertently failed to fax the back of the purchase order to Lewis. Therefore, Lewis' knowledge of those terms or his knowledge that McWane used standard terms and conditions in its sales, based on his prior dealings with McWane, was particularly relevant to whether those terms and conditions became part of the contract. The jury could properly determine whether Lewis knew or should have known about the limitation of liability in McWane's standard terms and conditions, and therefore intended that the limitation of liability be part of the contract.

[23]Dyno next contends that the district court abused its discretion and committed prejudicial error when it refused to admit Lewis' testimony that McWane had waived its limitation of liability for consequential damages on several occasions in its dealings with Reynolds while Lewis was an employee of that company. Dyno contends that if Lewis' prior dealings with McWane as an employee of Reynolds were relevant, McWane's waiver of its limitation of liability clause for Reynolds was also relevant.

[24]We agree with the decision to exclude this evidence because its admission would have likely caused jury confusion. The issue for the jury was whether McWane's standard terms and conditions were part of the contract, not

whether those terms and conditions would be enforced. Had the district court admitted the evidence, McWane would have been entitled to explore the circumstances under which consequential damages were allegedly paid and explain why those circumstances were different from those at issue in the case. The whole foray into the issue, which was collateral to the actual issues at trial, would have caused substantial prejudice to McWane. Furthermore, McWane's terms and conditions stated that any waiver of a right by McWane in a particular instance would not constitute a future waiver of that right.

[25]Dyno's final evidentiary argument is that the district court erred in admitting Federal Express delivery records generated from Federal Express' computer system. McWane sought to lay the foundation for introduction of these records under the business records exception to the hearsay rule through the testimony of Fred Jacobs, the Operations Manager at the Federal Express office in Wauseon, Ohio. Jacobs explained that he was fully familiar with Federal Express' system for moving and tracking packages and testified that these records were generated and kept in the regular course of business by Federal Express in its centralized computer system in Memphis, Tennessee.

[26]Dyno objected to the admission of the records, arguing that the records were not under Jacobs' "custody or control" because: (1) he was not responsible for the geographic area in Ohio where the package was shipped; and (2) the computer records were printed in Memphis. Dyno contends that because these records were not under Jacobs' custody or control, Jacobs could not lay a proper foundation for introduction of the records and they are therefore inadmissible as hearsay.

[27]Federal Rule of Evidence 803(6) provides that the following evidence is not excluded by the hearsay rule:

A memorandum, report, record, or data compilation, in any form, of acts, events, conditions, opinions, or diagnoses, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation, all as shown by the testimony of the custodian or other qualified witness, unless the source of the information or the method or circumstances of preparation indicate lack of trustworthiness....

Fed. R. Evid. 803(6).

[28]While Dyno is correct that Jacobs could not lay a foundation for introduction of the Federal Express records under Rule 803(6) as a “custodian” of the records, Jacobs would be a proper witness to lay a foundation as an “other qualified witness” as described in the Rule. To be an “other qualified witness,” it is not necessary that the person laying the foundation for the introduction of the business record have personal knowledge of their preparation. *See United States v. Franks*, 939 F.2d 600, 602-03 (8th Cir.1991) (rejecting the defendant's contention that the district court erred in admitting Federal Express records on the basis that the witness laying the foundation was unable to determine which employees prepared delivery records and airbills). All that is required of the witness is that he or she be familiar with the record-keeping procedures of the organization. *See United States v. Wables*, 731 F.2d 440, 449 (7th Cir.1984)(stating that “[i]t is clear that, in admitting documents under the business records exception to the hearsay rule, ‘the testimony of the custodian or otherwise qualified witness who can explain the record-keeping of his organization is ordinarily essential’ ”) (quoting 4 Weinstein, Evidence ¶ 803(6)[02] (1981)); *NLRB v. First Termite Control Co.*, 646 F.2d 424, 427 (9th Cir.1981)

(noting that through the custodian or “other qualified witness” requirement, Rule 803(6) “insures the presence of some individual at trial who can testify to the methods of keeping the information”). Thus, in *United States v. Hathaway*, 798 F.2d 902 (6th Cir.1986), we stated that “[w]hen a witness is used to lay the foundation for admitting records under Rule 803(6), all that is required is that the witness be familiar with the record keeping system.” *Hathaway*, 798 F.2d at 906. In that case, we rejected the defendant's contention that the government could not lay a foundation through the testimony of an FBI agent for the admission of records seized from the defendant's business offices under the business records exception. We found “no reason why a proper foundation for application of Rule 803(6) cannot be laid, in part or in whole, by the testimony of a government agent or other person outside the organization whose records are sought to be admitted.” *Id.* at 906; *see also Zayre Corp. v. S.M. & R. Co.*, 882 F.2d 1145, 1150 (7th Cir.1989) (noting that a person qualified to lay the foundation under Rule 803(6) need not even be an employee of the entity keeping the records, as long as the witness understands the system by which they are made).

[29] Jacobs testified in depth about his understanding of Federal Express' system for delivering and tracking documents, as well as its system for central storage of its voluminous computerized records in Memphis. That Jacobs was not involved in the preparation of the documents or that he did not know who prepared them were not matters that precluded the admission of the documents as business records. Therefore, the district court did not abuse its discretion in admitting the Federal Express records.

[30] Furthermore, there was other evidence from which the jury could have concluded that Dyno received the Federal Express package by December 1, 1995. For instance, McWane also introduced into evidence a copy of a Federal Express invoice kept in its files as a business record, for which there is no dispute that a proper foundation was laid

for admission at trial under the business records exception, through the testimony of its custodian, Ratcliffe. The invoice showed that Dyno received the package on November 24, 1995, at 8:53 a.m. Accordingly, there was sufficient evidence for the jury to find that Dyno was or should have been aware of McWane's terms and conditions, including its limitation of liability, at the time it signed the faxed purchase order on December 1, 1995.

2. Jury Instructions

[31]Dyno argues that the district court committed reversible error in refusing to give two of its proposed jury instructions. Jury instructions in civil cases are reviewed “as a whole to determine whether they adequately inform the jury of the relevant considerations and provide a basis in law for aiding the jury in reaching its decision. A judgment on a jury verdict may be vacated when the instructions, viewed as a whole, were confusing, misleading and prejudicial.” *Jones v. Consolidated Rail Corp.*, 800 F.2d 590, 592 (6th Cir.1986) (citation omitted).

[32]Dyno first argues that the district court committed reversible error in refusing to give Dyno's proposed jury instruction number seven, which would have allowed the jury to find that the contract was formed on November 22, 1995, when Lewis told Ratcliffe by telephone to go ahead and order the materials. Because this Court has already affirmed the district court's conclusion that the contract was formed on December 1, 1995, when Lewis signed the document faxed by Ratcliffe, it would have been improper for the district court to instruct the jury that it could find that the contract was formed on November 22, 1995. Accordingly, the district court properly rejected Dyno's proposed instruction.

[33]Dyno's final argument is that the district court committed reversible error in not giving its proposed instruction number twelve, which read:

McWane must show that the agent designated to receive such information as Federal Express packages actually received and had knowledge of the contents of the package before Dyno is deemed to have knowledge of the disputed terms.

[34]We believe that this instruction is an erroneous statement of the law and would have placed an unwarranted burden on McWane at trial. The evidence presented at trial was sufficient to allow the jury to find that the Federal Express documents had been delivered to an authorized agent of Dyno because the Federal Express documents were actually located in Dyno's job file for the Perrysburg project and contained Lewis' handwriting at the top of the documents. In addition, McWane's evidence showed that the documents were actually delivered to Dyno's offices on November 24, 1995. Moreover, McWane could demonstrate that Dyno had received and had knowledge of the contents of the package even if the "agent designated to receive such information" did not actually receive and have knowledge of the contents of the package. For example, if some agent of Dyno other than the "agent designated to receive such information" received the package, that knowledge could be imputed to Dyno. There was also evidence that Lewis had knowledge of the contents of the package, in that he had previous knowledge about McWane's credit application and terms and conditions, even though he testified that he never received the package. This instruction thus ignored other means by which McWane could have demonstrated Dyno's knowledge of McWane's terms and conditions and would have placed an unreasonable burden on McWane to prove actual receipt and review of the documents by the specified Dyno agent. That burden would have been extremely difficult to meet because no one at McWane specifically observed Dyno's handling and receipt of the November 22 documents. Thus, the failure to give this instruction does not render the instructions, "viewed

as a whole, [] confusing, misleading and prejudicial...” *Jones*, 800 F.2d at 592.

[35]Therefore, Dyno was not entitled to a new trial.

III. CONCLUSION

[36]For the foregoing reasons, the judgment of the district court is AFFIRMED.

1.1.1 Discussion of *Dyno Construction v. McWane, Inc.*

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

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

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

1.1.2 Hypo on Seed Sale

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

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

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

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

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

I am asking 23 cents per pound for the car of red clover seed from which your sample was taken. No. 1 seed, practically no plantain

whatever. Have an offer 22 3/4 per pound,
f.o.b. Amity.

Courteen responded the next day:

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

Amity Seed has now refused to deliver. How would you apply the offer rules to this situation?

1.2 Principal Case – Lefkowitz v. Great Minneapolis Surplus Store

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

Lefkowitz v. Great Minneapolis Surplus Store, Inc.

Supreme Court of Minnesota

251 Minn. 188, 86 N.W.2d 689 (1957)

MURPHY, Justice.

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

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

Saturday 9 A.M. Sharp
3 Brand New Fur Coats
Worth to \$100.00

First Come First Served

\$1 Each

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

Saturday 9 A.M.

2 Brand New Pastel

Mink 3-Skin Scarfs

Selling for \$89.50

Out they go

Saturday. Each \$1.00

1 Black Lapin Stole

Beautiful

worth \$139.50 \$1.00

First Come -- First Served

[4] The record supports the findings of the court that on each of the Saturdays following the publication of the above-described ads the plaintiff was the first to present himself at the appropriate counter in the defendant's store and on each occasion demanded the coat and the stole so advertised and indicated his readiness to pay the sale price of \$1. On both occasions, the defendant refused to sell the merchandise to the plaintiff, stating on the first occasion that by a 'house rule' the offer was intended for women only and sales would not be made to men, and on the second visit that plaintiff knew defendant's house rules.

[5] The trial court properly disallowed plaintiff's claim for the value of the fur coats since the value of these articles was speculative and uncertain. The only evidence of value was the advertisement itself to the effect that the coats were "Worth to \$100.00," how much less being speculative especially in view of the price for which they were offered for sale. With reference to the offer of the defendant on April 13, 1956, to sell the "1 Black Lapin Stole...worth \$139.50..." the trial court held that the value of this article was established and

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

[6] The defendant contends that a newspaper advertisement offering items of merchandise for sale at a named price is a “unilateral offer” which may be withdrawn without notice. He relies upon authorities which hold that, where an advertiser publishes in a newspaper that he has a certain quantity or quality of goods which he wants to dispose of at certain prices and on certain terms, such advertisements are not offers which become contracts as soon as any person to whose notice they may come signifies his acceptance by notifying the other that he will take a certain quantity of them. Such advertisements have been construed as an invitation for an offer of sale on the terms stated, which offer, when received, may be accepted or rejected and which therefore does not become a contract of sale until accepted by the seller; and until a contract has been so made, the seller may modify or revoke such prices or terms. *Montgomery Ward & Co. v. Johnson*, 209 Mass. 89, 95 N.W. 290; *Nickel v. Theresa Farmers Co-op. Ass'n*, 247 Wis. 412, 20 N.W.2d 117; *Lovett v. Frederick Loeser & Co. Inc.*, 124 Misc. 81, 207 N.Y.S. 753; *Schenectady Stove Co. v. Holbrook*, 101 N.Y. 45, 4 N.E. 4; *Georgian Co. v. Bloom*, 27 Ga. App. 468, 108 S.E. 813; *Craft v. Elder & Johnson Co.*, 38 N.E.2d 416, 34 Ohio L.A. 603; Annotation, 157 A.L.R. 746.

[7] The defendant relies principally on *Craft v. Elder & Johnston Co.*, *supra*. In that case, the court discussed the legal effect of an advertisement offering for sale, as a one-day special, an electric sewing machine at a named price. The view was expressed that the advertisement was (38 N.E.2d 417, 34 Ohio L.A. 605) “not an offer made to any specific person but was made to the public generally. Thereby it would be properly designated as a unilateral offer and not being supported by any consideration could be withdrawn at will and without notice.” It is true that such an offer may be withdrawn before acceptance. Since all offers are by their

nature unilateral because they are necessarily made by one party or on one side in the negotiation of a contract, the distinction made in that decision between a unilateral offer and a unilateral contract is not clear. On the facts before us we are concerned with whether the advertisement constituted an offer, and, if so, whether the plaintiff's conduct constituted an acceptance.

[8] There are numerous authorities which hold that a particular advertisement in a newspaper or circular letter relating to a sale of articles may be construed by the court as constituting an offer, acceptance of which would complete a contract. *J. E. Pinkham Lumber Co. v. C. W. Griffin & Co.*, 212 Ala. 341, 102 So. 689; *Seymour v. Armstrong & Kassebaum*, 62 Kan. 720, 64 P. 612; *Payne v. Lautz Bros. & Co.*, City Ct., 166 N.Y.S. 844, affirmed, 168 N.Y.S. 369, affirmed, 185 App.Div. 904, 171 N.Y.S. 1094; *Arnold v. Phillips*, 1 Ohio Dec. Reprint 195, 3 West. Law J. 448; *Oliver v. Henley*, Tex. Civ. App., 21 S.W.2d 576; Annotation, 157 A.L.R. 744, 746.

[9] The test of whether a binding obligation may originate in advertisements addressed to the general public is "whether the facts show that some performance was promised in positive terms in return for something requested." 1 WILLISTON, CONTRACTS (Rev. ed.) § 27.

[10] The authorities above cited emphasize that, where the offer is clear, definite, and explicit, and leaves nothing open for negotiation, it constitutes an offer, acceptance of which will complete the contract. The most recent case on the subject is *Johnson v. Capital City Ford Co.*, La. App., 85 So.2d 75, in which the court pointed out that a newspaper advertisement relating to the purchase and sale of automobiles may constitute an offer, acceptance of which will consummate a contract and create an obligation in the offeror to perform according to the terms of the published offer.

[11] Whether in any individual instance a newspaper advertisement is an offer rather than an invitation to make an

offer depends on the legal intention of the parties and the surrounding circumstances. Annotation, 157 A.L.R. 744, 751; 77 C.J.S., SALES, § 25b; 17 C.J.S., CONTRACTS, § 389. We are of the view on the facts before us that the offer by the defendant of the sale of the Lapin fur was clear, definite, and explicit, and left nothing open for negotiation. The plaintiff having successfully managed to be the first one to appear at the seller's place of business to be served, as requested by the advertisement, and having offered the stated purchase price of the article, he was entitled to performance on the part of the defendant. We think the trial court was correct in holding that there was in the conduct of the parties a sufficient mutuality of obligation to constitute a contract of sale.

[12]The defendant contends that the offer was modified by a “house rule” to the effect that only women were qualified to receive the bargains advertised. The advertisement contained no such restriction. This objection may be disposed of briefly by stating that, while an advertiser has the right at any time before acceptance to modify his offer, he does not have the right, after acceptance, to impose new or arbitrary conditions not contained in the published offer. *Payne v. Lautz Bros. & Co.*, City Ct., 166 N.Y.S. 844, 848; *Mooney v. Daily News Co.*, 116 Minn. 212, 133 N.W. 573.

Affirmed.

1.2.1 Punitive Enforcement

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

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

offers against the offeror can one drive out indefinite offers.

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

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

1.2.2 Discussion of Lefkowitz v. Great Minneapolis Surplus Store

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

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

1.2.3 Hypo on Killer Collecting Reward

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

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

2. Acceptance

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

§ 30. Form of Acceptance Invited

- (1) An offer may invite or require acceptance to be made by an affirmative answer in words, or by performing or refraining from performing a specified act, or may empower the offeree to make a selection of terms in his acceptance.
- (2) Unless otherwise indicated by the language or the circumstances, an offer invites acceptance in any manner and by any medium reasonable in the circumstances.

§ 50. Acceptance of Offer Defined; Acceptance by Performance; Acceptance by Promise

- (1) Acceptance of an offer is a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer.
- (2) Acceptance by performance requires that at least part of what the offer requests be performed or tendered and includes acceptance by a performance which operates as a return promise.
- (3) Acceptance by a promise requires that the offeree complete every act essential to the making of the promise.

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

An acceptance is a voluntary act of the offeree whereby he exercises the power conferred on him by the offer, and thereby creates the set of legal relations called a contract. What acts are sufficient to secure this purpose? We must

look first to the terms in which the offer was expressed, either by words or by other conduct. The offeror is the creator of the power and at the time of its creation he has full control over both the fact of its existence and its terms. The offeror has, in the beginning, full power to determine the acts that are to constitute acceptance. After he has once created the power, he may lose his control over it, and may become disabled to change or revoke it; but the fact that, in the beginning, the offeror has full control ... is the characteristic that distinguishes contractual relations from noncontractual ones. After the offeror has created the power [of acceptance], the legal consequences are out of his hands, and he may be brought into numerous consequential relations of which he did not dream, and to which he might not have consented. These later relations are nevertheless called contractual.

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

2.1 Principal Case – Ever-Tite Roofing Corp. v. Green

Ever-Tite Roofing Corp. v. Green

Court of Appeals of Louisiana

83 So. 2d 449 (1955)

AYRES, Judge.

[1] This is an action for damages allegedly sustained by plaintiff as the result of the breach by the defendants of a written contract for the re-roofing of defendants' residence. Defendants denied that their written proposal or offer was ever accepted by plaintiff in the manner stipulated therein for its acceptance, and hence contended no contract was ever entered into. The trial court sustained defendants' defense and rejected plaintiff's demands and dismissed its suit at its

costs. From the judgment thus rendered and signed, plaintiff appealed.

[2] Defendants executed and signed an instrument June 10, 1953, for the purpose of obtaining the services of plaintiff in re-roofing their residence situated in Webster Parish, Louisiana. The document set out in detail the work to be done and the price therefor to be paid in monthly installments. This instrument was likewise signed by plaintiff's sales representative, who, however, was without authority to accept the contract for and on behalf of the plaintiff. This alleged contract contained these provisions:

This agreement shall become binding only upon written acceptance hereof, by the principal or authorized officer of the Contractor, *or upon commencing performance of the work*. This contract is Not Subject to Cancellation. It is understood and agreed that this contract is payable at office of Ever-Tite Roofing Corporation, 5203 Telephone, Houston, Texas. It is understood and agreed that this Contract provides for attorney's fees and in no case less than ten per cent attorney's fees in the event same is placed in the hands of an attorney for collecting or collected through any court, and further provides for accelerated maturity for failure to pay any installment of principal or interest thereon when due.

This written agreement is the only and entire contract covering the subject matter hereof and no other representations have been made unto Owner except these herein contained. No guarantee on repair work, partial roof jobs, or paint jobs. (Emphasis supplied.)

[3] Inasmuch as this work was to be performed entirely on credit, it was necessary for plaintiff to obtain credit reports and approval from the lending institution which was to

finance said contract. With this procedure defendants were more or less familiar and knew their credit rating would have to be checked and a report made. On receipt of the proposed contract in plaintiff's office on the day following its execution, plaintiff requested a credit report, which was made after investigation and which was received in due course and submitted by plaintiff to the lending agency. Additional information was requested by this institution, which was likewise in due course transmitted to the institution, which then gave its approval.

[4] The day immediately following this approval, which was either June 18 or 19, 1953, plaintiff engaged its workmen and two trucks, loaded the trucks with the necessary roofing materials and proceeded from Shreveport to defendants' residence for the purpose of doing the work and performing the services allegedly contracted for the defendants. Upon their arrival at defendants' residence, the workmen found others in the performance of the work which plaintiff had contracted to do. Defendants notified plaintiff's workmen that the work had been contracted to other parties two days before and forbade them to do the work.

[5] Formal acceptance of the contract was not made under the signature and approval of an agent of plaintiff. It was, however, the intention of plaintiff to accept the contract by commencing the work, which was one of the ways provided for in the instrument for its acceptance, as will be shown by reference to the extract from the contract quoted hereinabove. Prior to this time, however, defendants had determined on a course of abrogating the agreement and engaged other workmen without notice thereof to plaintiff.

[6] The basis of the judgment appealed was that defendants had timely notified plaintiff before "commencing performance of work." The trial court held that notice to plaintiff's workmen upon their arrival with the materials that defendants did not desire them to commence the actual work was sufficient and timely to signify their intention to

withdraw from the contract. With this conclusion we find ourselves unable to agree.

[7] Defendants' attempt to justify their delay in thus notifying plaintiff for the reason they did not know where or how to contact plaintiff is without merit. The contract itself, a copy of which was left with them, conspicuously displayed plaintiff's name, address and telephone number. Be that as it may, defendants at no time, from June 10, 1953, until plaintiff's workmen arrived for the purpose of commencing the work, notified or attempted to notify plaintiff of their intention to abrogate, terminate or cancel the contract.

[8] Defendants evidently knew this work was to be processed through plaintiff's Shreveport office. The record discloses no unreasonable delay on plaintiff's part in receiving, processing or accepting the contract or in commencing the work contracted to be done. No time limit was specified in the contract within which it was to be accepted or within which the work was to be begun. It was nevertheless understood between the parties that some delay would ensue before the acceptance of the contract and the commencement of the work, due to the necessity of compliance with the requirements relative to financing the job through a lending agency. The evidence as referred to hereinabove shows that plaintiff proceeded with due diligence.

[9] The general rule of law is that an offer proposed may be withdrawn before its acceptance and that no obligation is incurred thereby. This is, however, not without exceptions. For instance, Restatement of the Law of Contracts stated:

(1) The power to create a contract by acceptance of an offer terminates at the time specified in the offer, or, if no time is specified, at the end of a reasonable time. What is a reasonable time is a question of fact depending on the nature of the contract proposed, the usages of business and other circumstances of the case which the offeree at

the time of his acceptance either knows or has reason to know.

[10]These principles are recognized in the Civil Code. LSA-C.C. Art. 1800 provides that an offer is incomplete as a contract until its acceptance and that before its acceptance the offer may be withdrawn. However, this general rule is modified by the provisions of LSA-C.C. Arts. 1801, 1802, 1804 and 1809, which read as follows:

Art. 1801. The party proposing shall be presumed to continue in the intention, which his proposal expressed, if, on receiving the unqualified assent of him to whom the proposition is made, he do not signify the change of his intention.

Art. 1802. He is bound by his proposition, and the signification of his dissent will be of no avail, if the proposition be made in terms, which evince a design to give the other party the right of concluding the contract by his assent; and if that assent be given within such time as the situation of the parties and the nature of the contract shall prove that it was the intention of the proposer to allow....

Art. 1804. The acceptance needs (need) not be made by the same act, or in point of time, immediately after the proposition; if made at any time before the person who offers or promises has changed his mind, or may reasonably be presumed to have done so, it is sufficient....

Art. 1809. The obligation of a contract not being complete, until the acceptance, or in cases where it is implied by law, until the circumstances, which raise such implication, are known to the party proposing; *he may therefore revoke his offer or proposition before such acceptance, but not without allowing such reasonable*

time as from the terms of his offer he has given, or from the circumstances of the case he may be supposed to have intended to give to the party, to communicate his determination. (Emphasis supplied.)

[11]Therefore, since the contract did not specify the time within which it was to be accepted or within which the work was to have been commenced, a reasonable time must be allowed therefor in accordance with the facts and circumstances and the evident intention of the parties. A reasonable time is contemplated where no time is expressed. What is a reasonable time depends more or less upon the circumstances surrounding each particular case. The delays to process defendants' application were not unusual. The contract was accepted by plaintiff by the commencement of the performance of the work contracted to be done. This commencement began with the loading of the trucks with the necessary materials in Shreveport and transporting such materials and the workmen to defendants' residence. Actual commencement or performance of the work therefore began before any notice of dissent by defendants was given plaintiff. The proposition and its acceptance thus became a completed contract.

[12]By their aforesaid acts defendants breached the contract. They employed others to do the work contracted to be done by plaintiff and forbade plaintiff's workmen to engage upon that undertaking. By this breach defendants are legally bound to respond to plaintiff in damages. LSA-C.C. Art. 1930 provides:

The obligations of contract (contracts) extending to whatsoever is incident to such contracts, the party who violates them, is liable, as one of the incidents of his obligations, to the payment of the damages, which the other party has sustained by his default.

[13]The same authority in Art. 1934 provides the measure of damages for the breach of a contract. This article, in part, states:

Where the object of the contract is anything but the payment of money, the damages due to the creditor for its breach are the amount of the loss he has sustained, and the profit of which he has been deprived,....

Plaintiff expended the sum of \$85.37 in loading the trucks in Shreveport with materials and in transporting them to the site of defendants' residence in Webster Parish and in unloading them on their return, and for wages for the workmen for the time consumed. Plaintiff's Shreveport manager testified that the expected profit on this job was \$226. None of this evidence is controverted or contradicted in any manner.

[14]True, as plaintiff alleges, the contract provides for attorney's fees where an attorney is employed to collect under the contract, but this is not an action on the contract or to collect under the contract but is an action for damages for a breach of the contract. The contract in that respect is silent with reference to attorney's fees. In the absence of an agreement for the payment of attorney's fees or of some law authorizing the same, such fees are not allowed.

[15]For the reasons assigned, the judgment appealed is annulled, avoided, reversed and set aside and there is now judgment in favor of plaintiff, Ever-Tite Roofing Corporation, against the defendants, G. T. Green and Mrs. Jessie Fay Green, for the full sum of \$311.37, with 5 per cent per annum interest thereon from judicial demand until paid, and for all costs.

Reversed and rendered.

2.1.1 Selecting the Permissible Mode of Acceptance

Both the Restatement (Second) of Contracts (1981) and the Uniform Commercial Code include rules to govern the permissible mode of

acceptance. Here is how the Restatement (Second) addresses the issue:

§ 32. Invitation of Promise or Performance

In case of doubt an offer is interpreted as inviting the offeree to accept either by promising to perform what the offer requests or by rendering the performance, as the offeree chooses.

§ 60. Acceptance of Offer Which States Place, Time or Manner of Acceptance

If an offer prescribes the place, time or manner of acceptance its terms in this respect must be complied with in order to create a contract. If an offer merely suggests a permitted place, time or manner of acceptance, another method of acceptance is not precluded.

The UCC specifies similarly permissive rules for situations in which the offer leaves open the means of acceptance but makes the offeror “master of the offer” when she chooses to specify how it should be accepted.

§ 2-206. Offer and Acceptance in Formation of Contract

(1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming

goods does not constitute acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

2.1.2 Antonucci v. Stevens Dodge

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

In the bottom lefthand corner of the agreement there is printed in large underlined type: “... THIS ORDER SHALL NOT BECOME BINDING UNTIL ACCEPTED BY DEALER OR HIS AUTHORIZED REPRESENTATIVE.” At the bottom of the paragraph containing this sentence is a blank line under which is printed “purchaser's signature.” Plaintiff signed on this line. Below this is a blank line which has printed before it “Accepted By.” Under this line is printed “Dealer or his Authorized Representative.” This line bears no signature.

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

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

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

2.1.3 Discussion of Ever-Tite Roofing v. Green

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

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

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

Does the Restatement (Second) have anything to say about this situation?

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

2.2 Principal Case – Ciaramella v. Reader’s Digest Association

Ciaramella v. Reader’s Digest Association, Inc.

United States Court of Appeals, Second Circuit
131 F.3d 320 (1997)

OAKES, Senior Circuit Judge:

[1] Plaintiff filed suit against Reader's Digest Association (“RDA”) alleging employment discrimination under the Americans with Disabilities Act, 42 U.S.C. §§ 12101-12213 (1994) (“ADA”), and article 15 of the New York State

Executive Law, N.Y. Exec. Law §§ 290-301 (McKinney 1993), and also violations of the Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (1994) (“ERISA”). Shortly after the commencement of the action, the parties negotiated a settlement which Ciaramella later refused to sign. RDA moved for an order to enforce the settlement agreement. The United States District Court for the Southern District of New York (Charles L. Bricant, *J.*), granted the motion and dismissed the plaintiff’s complaint with prejudice. Ciaramella argues that enforcement of the settlement agreement was improper because he had never signed the written agreement and the parties had specifically agreed that the settlement would not become binding until signed by all the parties. We agree, and reverse.

I. BACKGROUND

[2] In November 1995, Ciaramella filed suit against his former employer, RDA, alleging that RDA failed to give him reasonable accommodations for his disability of chronic depression and subsequently terminated his employment in violation of the ADA and article 15 of New York State Executive Law. Ciaramella also raised a claim under ERISA for failure to pay severance benefits.

[3] Before the exchange of any discovery, the parties entered into settlement negotiations. The negotiations resulted in an agreement in principle to settle the case in May, 1996. RDA prepared a draft agreement and sent it to Ciaramella’s then attorney, Herbert Eisenberg, for review. This draft, as well as all subsequent copies, contained language indicating that the settlement would not be effective until executed by all the parties and their attorneys. Eisenberg explained the terms of the settlement to Ciaramella, who authorized Eisenberg to accept it. Eisenberg then made several suggestions for revision to RDA which were incorporated into a revised draft. After reviewing the revised draft, Eisenberg asked for a few final changes and then allegedly stated to RDA’s lawyer, “We have a deal.” RDA forwarded several execution copies

of the settlement to Eisenberg. However, before signing the agreement, Ciaramella consulted a second attorney and ultimately decided that the proposed settlement agreement was not acceptable to him and that he would not sign it. Eisenberg then moved to withdraw as plaintiff's counsel.

[4] RDA, claiming that the parties had reached an enforceable oral settlement, filed a motion to enforce the settlement agreement on September 3, 1996. At a hearing on September 13, the district court granted Eisenberg's motion to withdraw, and stayed proceedings on the motion to enforce the settlement for thirty days to give Ciaramella time to obtain another attorney. On October 25, the district court heard RDA's motion to enforce the settlement agreement. Ciaramella had not yet obtained substitute counsel and appeared pro se at the hearing. The district court, after considering RDA's unopposed motion papers and questioning Ciaramella about the formation of the settlement agreement, granted RDA's motion to enforce the settlement by order dated October 28, 1996. The district court entered a judgment of dismissal on October 29, 1996. This Court has jurisdiction under 28 U.S.C. § 1291.

II. DISCUSSION

A. Choice of Law

[5] An initial question presented is whether New York or federal common law determines whether the parties reached a settlement of claims brought under the ADA, ERISA, and state law. The district court analyzed the issue using federal common law and concluded that the parties had intended to enter into a binding oral agreement. We review the district court's findings of law under a de novo standard, and its factual conclusions under a clearly erroneous standard of review. *See Hirschfeld v. Spanakos*, 104 F.3d 16, 19 (2d Cir.1997).

[6] Because we find that there is no material difference between the applicable state law or federal common law

standard, we need not decide this question here. *See Bowden v. United States*, 106 F.3d 433, 439 (D.C.Cir.1997) (declining to decide whether state or federal common law governs the interpretation of a settlement agreement under Title VII where both sources of law dictate the same result); *Davidson Pipe Co. v. Laventhol & Horwath*, Nos. 84 Civ. 5192(LBS), 84 Civ. 6334(LBS), 1986 WL 2201, at *2 (S.D.N.Y. Feb. 11, 1986) (finding no federal rule that would differ critically from New York's rule governing the validity of oral settlement agreements). New York relies on settled common law contract principles to determine when parties to a litigation intended to form a binding agreement.¹ *See Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78, 80-81 (2d Cir.1985) (applying principles drawn from the Restatement (Second) of Contracts to determine whether a binding settlement agreement existed under New York law); *see also Jim Bouton Corp. v. William Wrigley Jr. Co.*, 902 F.2d 1074, 1081 (2d Cir.1990) (describing the New York rule of contract formation as “generally accepted”). Under New York law, parties are free to bind themselves orally, and the fact that they contemplate later memorializing their agreement in an executed document will not prevent them from being bound by the oral agreement. However, if the parties intend not to be bound until the agreement is set forth in writing and signed, they will not be bound until then. *See Winston*, 777 F.2d at 80; *V'Soske v. Barnwick*, 404 F.2d 495, 499 (2d Cir.1968). The intention of the parties on this issue is a

¹ We note that New York Civil Practice Law and Rules 2104, N.Y. C.P.L.R. 2104 (McKinney 1997), which sets out technical requirements that must be met for a settlement agreement to be enforceable under New York law, may also apply. However, we need not address the issue whether section 2104 applies in federal cases or is consistent with federal policies favoring settlement. *Cf. Monaghan v. SZS 33 Assoc.*, 73 F.3d 1276, 1283 n. 3 (2d Cir.1996) (reserving decision on whether federal courts sitting in diversity must apply section 2104 when relying on New York law). Because we agree with Ciaramella that, under common law contract principles, Ciaramella never formed an agreement with RDA, we have no reason to rely on section 2104 in this case. *See Sears, Roebuck and Co. v. Sears Realty Co.*, 932 F.Supp. 392, 401-02 (N.D.N.Y.1996) (interpreting section 2104 as a defense to contract enforcement, and not as a rule of contract formation).

question of fact, to be determined by examination of the totality of the circumstances. See *International Telemeter Corp. v. Teleprompter Corp.*, 592 F.2d 49, 56 (2d Cir.1979). This same standard has been applied by courts relying on federal common law. See *Taylor v. Gordon Flesch Co.*, 793 F.2d 858, 862 (7th Cir.1986) (enforcing an oral settlement of a Title VII case where the parties had not specified the need for a final, signed document); *Board of Trustees of Sheet Metal Workers Local Union No. 137 Ins. Annuity & Apprenticeship Training Funds v. Vic Constr. Corp.*, 825 F.Supp. 463, 466 (E.D.N.Y.1993) (adopting the *Winston* analysis as based on “general contract principles” to uphold an oral settlement of an ERISA case); see also 1 Samuel Williston & Walter H.E. Jaeger, *A Treatise on the Law of Contracts* § 28 (3d ed. 1957) (“It is ... everywhere agreed that if the parties contemplate a reduction to writing of their agreement before it can be considered complete, there is no contract until the writing is signed.”).

[7] RDA urges us to fashion a federal rule of decision that would disregard this longstanding rule of contract interpretation and would hold parties to an oral settlement whenever their attorneys arrive at an agreement on all material terms.² We reject this suggestion. Even in cases where federal courts can choose the governing law to fill gaps in federal legislation, the Supreme Court has directed that state law be applied as the federal rule of decision unless it presents a significant conflict with federal policy. See *Atherton v. FDIC*, 519 U.S. 213 (1997); *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 87 (1994) (noting that “cases in which judicial creation of a federal rule would be justified...are...‘few and restricted’”) (quoting *Wheeldin v. Wheeler*, 373 U.S. 647, 651 (1963)).

² RDA relies on the Fifth Circuit's opinion in *Fulgence v. J. Ray McDermott & Co.*, 662 F.2d 1207 (5th Cir.1981) as support for this standard. However, RDA's reliance on *Fulgence* is misplaced because there was no suggestion in that case that the parties had ever explicitly reserved the right not to be bound until the execution of a written agreement.

[8] We can find no federal objective contained in the ADA or ERISA that would be compromised by the application of the common law rules described above. RDA is correct that at least one of the federal statutes at issue expresses a preference for voluntary settlements of claims. *See* 42 U.S.C. § 12212 (1994) (encouraging the use of alternative means of dispute resolution, such as settlement, to resolve claims arising under the ADA). However, the common law rule does not conflict with this policy. The rule aims to ascertain and give effect to the intent of the parties at the time of contract. Such a rule promotes settlements that are truly voluntary. *See, e.g., Winston, 777 F.2d at 80* (“Because of this freedom to determine the exact point at which an agreement becomes binding, a party can negotiate candidly, secure in the knowledge that he will not be bound until execution of what both parties consider to be final document [sic].”).

[9] In fact, it is the rule suggested by RDA that would conflict with federal policy. Enforcing premature oral settlements against the expressed intent of one of the parties will not further a policy of encouraging settlements. People may hesitate to enter into negotiations if they cannot control whether and when tentative proposals become binding. We therefore decline to adopt a federal rule concerning the validity of oral agreements that is in conflict with federal policy and the settled common law principles of contract law.

B. Existence of a Binding Agreement

[10] This court has articulated four factors to guide the inquiry regarding whether parties intended to be bound by a settlement agreement in the absence of a document executed by both sides. *Winston, 777 F.2d at 80*. We must consider (1) whether there has been an express reservation of the right not to be bound in the absence of a signed writing; (2) whether there has been partial performance of the contract; (3) whether all of the terms of the alleged contract have been agreed upon; and (4) whether the agreement at issue is the type of contract that is usually committed to writing. *Id.* No

single factor is decisive, but each provides significant guidance. *See R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 74-75 (2d Cir.1984) (granting summary judgment where all four factors indicated that the parties had not intended to be bound by an oral franchise agreement). The district court did not explicitly rely on the *Winston* test, but concluded that based on the evidence the parties intended to enter into a binding oral agreement. Considering the above factors in the context of this case, we are left with the definite and firm conviction that the district court erred in concluding that the parties intended that the unexecuted draft settlement constitute a binding agreement. *See United States v. United States Gypsum Co.*, 333 U.S. 364, 395-97, 68 S.Ct. 525, 542-43, 92 L.Ed. 746 (1948) (finding clear error where trial court's findings conflicted with uncontroverted documentary evidence); *Winston*, 777 F.2d at 83 (finding clear error where the district court had enforced an unsigned settlement and three of the four factors indicated that the parties had not intended to be bound in the absence of a signed agreement).

1. Express Reservation

[11]We find numerous indications in the proposed settlement agreement that the parties did not intend to bind themselves until the settlement had been signed. We must give these statements considerable weight, as courts should avoid frustrating the clearly-expressed intentions of the parties. *R.G. Group*, 751 F.2d at 75. For instance, in paragraph 10, the agreement states, “This Settlement Agreement and General Release shall not become effective (‘the Effective Date’) until it is signed by Mr. Ciaramella, Davis & Eisenberg, and Reader's Digest.”

[12]RDA argues that the effect of paragraph 10 was simply to define the “Effective Date” of the agreement for the purpose of establishing the time period in which RDA was obligated to deliver payment and a letter of reference to Ciaramella. RDA further urges that Ciaramella's obligation to dismiss the suit was not conditioned on paragraph 10. However, this

interpretation is belied by the language of paragraph 2, which addresses RDA's payment obligation. Paragraph 2 states that RDA must proffer payment “[w]ithin ten (10) business days following the *later* of (a) the Effective Date of this Settlement Agreement and General Release (as defined by paragraph ten ...) or (b) entry by the Court of the Stipulation of Dismissal With Prejudice” (emphasis added). Under the terms of the proposed settlement, RDA had no obligation to pay Ciaramella until the agreement was signed and became effective. Likewise, under paragraph 12 of the final draft, RDA was not required to send the letter of reference until the agreement was signed. The interpretation that RDA advances, that Ciaramella had an obligation to dismiss the suit regardless of whether the settlement was signed, leaves Ciaramella no consideration for his promise to dismiss the suit. The more reasonable inference to be drawn from the structure of paragraph 2 is that it provided Ciaramella with an incentive to dismiss the suit quickly because he would receive no payment simply by signing the agreement, but that execution was necessary to trigger either parties' obligations. *See, e.g., Davidson Pipe Co.*, 1986 WL 2201, at *4 (finding that wording in a settlement agreement that placed great significance on the execution date evinced an intent not to create a binding settlement until some formal date of execution).

[13] Similarly, several other paragraphs of the proposed agreement indicate that the parties contemplated the moment of signing as the point when the settlement would become binding. The agreement's first paragraph after the WHEREAS clauses reads, “NOW, THEREFORE, with the intent to be legally bound *hereby*, and in consideration of the mutual promises and covenants contained herein, Reader's Digest and Ciaramella agree to the terms and conditions *set forth below: ...*” (emphasis added). This language demonstrates that only the terms of the settlement agreement, and not any preexisting pact, would legally bind the parties. Read in

conjunction with paragraph 10, which provides that the settlement agreement is effective only when signed, this paragraph explicitly signals the parties' intent to bind themselves only at the point of signature. *See, e. g., R.G. Group*, 751 F.2d at 71, 76 (finding an explicit reservation of the right not to be bound absent signature in the wording of an agreement that declared, “when duly executed, [this agreement] sets forth your rights and your obligations”). In addition to the language of the first paragraph, paragraph 13 of the final draft³ contains a merger clause which states,

This Settlement Agreement and General Release constitutes the complete understanding between the parties, may not be changed orally and supersedes any and all prior agreements between the parties.... No other promises or agreements shall be binding unless in writing and signed by the parties.

[14]The presence of such a merger clause is persuasive evidence that the parties did not intend to be bound prior to the execution of a written agreement. *See, e. g., R.G. Group*, 751 F.2d at 76; *McCoy v. New York City Police Dep't*, No. 95 Civ. 4508, 1996 WL 457312, at *2 (S.D.N.Y. Aug.14, 1996) (refusing to enforce a settlement of a § 1983 claim where a signed copy of the settlement agreement containing a merger clause had never been returned by the plaintiff).

[15]Other parts of the agreement also emphasize the execution of the document. Paragraph 9 states, in relevant part,

Mr. Ciaramella represents and warrants that he ... has executed this Settlement Agreement and General Release after consultation with his ... legal counsel; ... that he voluntarily assents to all the terms and conditions contained therein; and that he is signing the

³ This language was contained in paragraph 12 of earlier drafts.

Settlement Agreement and General Release of
his own force and will.

[16] Ciaramella's signature was meant to signify his voluntary and informed consent to the terms and obligations of the agreement. By not signing, he demonstrated that he withheld such consent.

[17] The sole communication which might suggest that the parties did not intend to reserve the right to be bound is Eisenberg's alleged statement to RDA's counsel, "We have a deal." However, nothing in the record suggests that either attorney took this statement to be an explicit waiver of the signature requirement. Eisenberg's statement followed weeks of bargaining over the draft settlement, which at all times clearly expressed the requirement that the agreement be signed to become effective. This Court has held in a similar situation that an attorney's statement that "a handshake deal" existed was insufficient to overcome "months of bargaining where there were repeated references to the need for a written and signed document, and where neither party had ever ... even discussed dropping the writing requirement." *R.G. Group*, 751 F.2d at 76; *see also Davidson Pipe Co.*, 1986 WL 2201, at *5 (holding that oral statement, "we have a deal," made by one attorney to another did not in and of itself preclude a finding that the parties intended to be bound only by an executed contract).

2. Partial Performance

[18] A second factor for consideration is whether one party has partially performed, and that performance has been accepted by the party disclaiming the existence of an agreement. *R.G. Group*, 751 F.2d at 75. No evidence of partial performance of the settlement agreement exists here. RDA paid no money to Ciaramella before the district court ordered the settlement enforced, nor did it provide Ciaramella with a letter of reference. These were the two basic elements of

consideration that would have been due to Ciaramella under the settlement agreement.

3. Terms Remaining to be Negotiated

[19]Turning to the third factor, we find that the parties had not yet agreed on all material terms. The execution copy of the settlement agreement contained a new provision at paragraph 12 that was not present in earlier drafts. That provision required RDA to deliver a letter of reference concerning Ciaramella to Eisenberg. The final draft of the settlement contained an example copy of the letter of reference annexed as Exhibit B. Ciaramella was evidently dissatisfied with the example letter. At the October 25, 1996, hearing at which Ciaramella appeared pro se, he attempted to explain to the court that the proposed letter of reference differed from what he had expected. He stated, “The original settlement that was agreed to, the one that was reduced to writing for me to sign had a discrepancy about letters of recommendation. I had requested one thing and the settlement in writing did not represent that.” Because Ciaramella's attorney resigned when Ciaramella refused to sign the settlement agreement, and RDA thereafter moved to enforce the agreement, Ciaramella never had an opportunity to finish bargaining for the letter he desired.

[20]In *Winston*, this Court found that the existence of even “minor” or “technical” points of disagreement in draft settlement documents were sufficient to forestall the conclusion that a final agreement on all terms had been reached. *Winston*, 777 F.2d at 82-83. By contrast, the letter of reference from RDA was a substantive point of disagreement. It was also, from Ciaramella's perspective, a material term of the contract since it was part of Ciaramella's consideration for dismissing the suit. On this basis, we find that the parties here had not yet reached agreement on all terms of the settlement.

4. Type of Agreement That Is Usually Reduced to a Writing

[21]The final factor, whether the agreement at issue is the type of contract that is usually put in writing, also weighs in Ciaramella's favor. Settlements of any claim are generally required to be in writing or, at a minimum, made on the record in open court. *See, e.g.*, N.Y. C.P.L.R. § 2104; Cal.Civ.Proc.Code § 664.6 (West 1996). As we stated in *Winston*, “Where, as here, the parties are adversaries and the purpose of the agreement is to forestall litigation, prudence strongly suggests that their agreement be written in order to make it readily enforceable, and to avoid still further litigation.” *Winston*, 777 F.2d at 83.

[22]We have also found that the complexity of the underlying agreement is an indication of whether the parties reasonably could have expected to bind themselves orally. *See R.G. Group*, 751 F.2d at 76; *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 262-63 (2d Cir.1984) (finding that the magnitude and complexity of a four million dollar sale of six companies under the laws of five different countries reinforced the stated intent of the parties not to be bound until written contracts were signed). While this settlement agreement does not concern a complicated business arrangement, it does span eleven pages of text and contains numerous provisions that will apply into perpetuity. For instance, paragraph 6 determines how future requests for references would be handled, and also states that Ciaramella can never reapply for employment at RDA. Paragraph 7 states that Ciaramella will not publicly disparage RDA and agrees not to disclose the terms of the settlement agreement. In such a case, the requirement that the agreement be in writing and formally executed “simply cannot be a surprise to anyone.” *R.G. Group*, 751 F.2d at 77; *see also Winston*, 777 F.2d at 83 (finding a four page settlement agreement that contained obligations that would last over several years sufficiently complex to require reduction to writing).

CONCLUSION

[23]In sum, we find that the totality of the evidence before us clearly indicates that Ciaramella never entered into a binding settlement agreement with his former employer. This conclusion is supported by the text of the proposed agreement and by Ciaramella's testimony at the October 25 hearing. Accordingly, the order enforcing the settlement is vacated and the case remanded for further proceedings. Costs to appellant.

2.2.1 Preliminary Agreements

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

§ 26. Preliminary Negotiations

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

§ 27. Existence of Contract Where Written Memorial Is Contemplated

Manifestations of assent that are in themselves sufficient to conclude a contract will not be prevented from so operating by the fact that the parties also manifest an intention to prepare and adopt a written memorial thereof; but the circumstances may show that the agreements are preliminary negotiations.

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

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

The first is a fully binding preliminary agreement, which is created when the parties agree on all the points that require negotiation but agree to memorialize their agreement in a more formal document. Such an agreement is fully binding; it is “preliminary only in form — only in the sense that the parties desire a more elaborate formalization of the agreement.” A binding preliminary agreement binds both sides to their ultimate contractual objective in recognition that, “despite the anticipation of further formalities,” a contract has been reached. Accordingly, a party may demand performance of the transaction even though the parties fail to produce the “more elaborate formalization of the agreement.”

The second type of preliminary agreement, dubbed a “binding preliminary commitment” by Judge Leval, is binding only to a certain degree. It is created when the parties agree on

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

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

Courts confronted with the issue of determining whether a preliminary agreement is binding, as an agreement of either the first or the second type, must keep two competing interests in mind. First, courts must be wary

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

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

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

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

negotiations, “handshakes,” oral understandings, or course of conduct (including reliance and changes of position).

2.2.2 Discussion of *Ciaramella v. Reader’s Digest Association*

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

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

2.2.3 The Mailbox Rule

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

§ 63. Time When Acceptance Takes Effect

Unless the offer provides otherwise,

- (a) an acceptance made in a manner and by a medium invited by an offer is operative and completes the manifestation of mutual assent as soon as put out of the offeree’s possession, without regard to whether it ever reaches the offeror; but
- (b) an acceptance under an option contract is not operative until received by the offeror.

Comment:

a. Rationale. It is often said that an offeror who makes an offer by mail makes the post office his agent to receive the acceptance, or that the mailing of a letter of acceptance puts it irrevocably out of the offeree’s control. Under

United States postal regulations however, the sender of a letter has long had the power to stop delivery and reclaim the letter. A better explanation of the rule that the acceptance takes effect on dispatch is that the offeree needs a dependable basis for his decision whether to accept. In many legal systems such a basis is provided by the general rule that an offer is irrevocable unless it provides otherwise. The common law provides such a basis through the rule that a revocation of an offer is ineffective if received after an acceptance has been properly dispatched.

c. Revocation of acceptance. The fact that the offeree has power to reclaim his acceptance from the post office or telegraph company does not prevent the acceptance from taking effect on dispatch. Nor, in the absence of additional circumstances, does the actual recapture of the acceptance deprive it of legal effect, though as a practical matter the offeror cannot assert his rights unless he learns of them. An attempt to revoke the acceptance by an overtaking communication is similarly ineffective, even though the revocation is received before the acceptance is received. After mailing an acceptance of a revocable offer, the offeree is not permitted to speculate at the offeror's expense during the time required for the letter to arrive.

A purported revocation of acceptance may, however, affect the rights of the parties. It may amount to an offer to rescind the contract or to a repudiation of it, or it may bar the offeree by estoppel from enforcing it. In some cases it may be justified as an exercise of a right of stoppage in transit or a demand for assurance of performance. *Compare* Uniform Commercial Code §§ 2-609, 2-702, 2-705. Or

the contract may be voidable for mistake or misrepresentation, §§ 151-54, 164. See particularly the provisions of § 153 on unilateral mistake.

§ 66. Acceptance Must Be Properly Dispatched

An acceptance sent by mail or otherwise from a distance is not operative when dispatched, unless it is properly addressed and such other precautions are taken as are ordinarily observed to insure safe transmission of similar messages.

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

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

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

Although we will take up revocation in the next section, it is convenient to note here that when parties bargain by mail a corollary of the mailbox rule governs the timing of revocation. The Restatement (Second) of Contracts expresses the rule as follows:

§ 42. Revocation by Communication from Offeror Received by Offeree

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

3. Revocation of Offers

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

§ 36. Methods of Termination of the Power of Acceptance

- (1) An offeree's power of acceptance may be terminated by
 - (a) rejection or counter-offer by the offeree, or
 - (b) lapse of time, or
 - (c) revocation by the offeror, or
 - (d) death or incapacity of the offeror or offeree.
- (2) In addition, an offeree's power of acceptance is terminated by the non-occurrence of any condition of acceptance under the terms of the offer.

We will discuss both the common law and UCC rules governing rejection and counter-offers in the next section. For the moment, note that an offer ordinarily remains open long enough to give the offeror a reasonable opportunity to accept. An oral offer made during a face-to-face or telephone conversation expires at the end of that conversation unless the offeror has indicates a willingness to keep the offer open beyond that time. The offeror nevertheless retains the right to terminate her offer at any subsequent time unless she has also expressly agreed not to revoke it—thus creating a “firm offer.”

Recall that in order to accept an offer of a unilateral contract an offeree must tender a performance rather than a reciprocal promise. The consequences of a revocation are especially acute when an offeror revokes such an offer after the offeree has begun performing.

In the following excerpt, a scholar defends the early common law rule, which required full performance for acceptance:

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

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

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

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

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

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

§ 45. Option Contract Created by Part Performance or Tender

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

(2) The offeror's duty of performance under any option contract so created is conditional on completion or tender of the invited

performance in accordance with the terms of the offer.

3.1 Irrevocable Offers

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

Imagine, for example, that Amy is considering whether to expand her grape vineyard by buying additional acreage from Julian. Her decision about the purchase depends on the results of extensive soil tests and a detailed marketing study. Amy is unwilling to incur these costs unless she has some assurance that Julian will not sell the property to someone else. Recognizing Amy's predicament, suppose that Julian offers to sell the acreage to her for \$450,000 and further agrees to keep this offer open for one month while she completes her investigations.

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

§ 25. Option Contracts

An option contract is a promise which meets the requirements for the formation of a contract and limits the promisor's power to revoke an offer.

It is frequently not feasible, however, to pay for an option contract. Under the Uniform Commercial Code, a merchant may also make a "firm offer" that will be binding as an option contract. The statutory

provisions governing firm offers combine both formal and substantive requirements.

§ 2-205. Firm Offers

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

Students should also read Official Comments 1-5 from an outside source.

The Restatement (Second) provides a somewhat similar doctrinal mechanism for making firm offers.

§ 87. Option Contract

- (1) An offer is binding as an option contract if it
 - (a) is in writing and signed by the offeror, recites a purported consideration for the making of the offer, and proposes an exchange on fair terms within a reasonable time; or
 - (b) is made irrevocable by statute.
- (2) An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice.

3.1.1 Discussion of Revocation and Firm Offers

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

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

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

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

3.2 Principal Case – Pavel Enterprises, Inc. v. A.S. Johnson Co.

Pavel Enterprises, Inc. v. A.S. Johnson Company, Inc.

Court of Appeals of Maryland
342 Md. 143, 674 A.2d 521 (1996)

KARWACKI, Judge.

[1] In this case we are invited to adapt the “modern” contractual theory of detrimental reliance,¹ or promissory estoppel, to the relationship between general contractors and their subcontractors. Although the theory of detrimental reliance is available to general contractors, it is not applicable to the facts of this case. For that reason, and because there was no traditional bilateral contract formed, we shall affirm the trial court.

I

[2] The National Institutes of Health [hereinafter, “NIH”], solicited bids for a renovation project on Building 30 of its Bethesda, Maryland campus. The proposed work entailed some demolition work, but the major component of the job was mechanical, including heating, ventilation and air conditioning [“HVAC”]. Pavel Enterprises Incorporated [hereinafter, “PEI”], a general contractor from Vienna, Virginia and appellant in this action, prepared a bid for the NIH work. In preparing its bid, PEI solicited sub-bids from various mechanical subcontractors. The A.S. Johnson Company [hereinafter, “Johnson”], a mechanical subcontractor located in Clinton, Maryland and the appellee here, responded with a written scope of work proposal on July 27, 1993.² On the morning of August 5, 1993, the day NIH opened the general contractors' bids, Johnson verbally

¹ We prefer to use the phrase detrimental reliance, rather than the traditional nomenclature of “promissory estoppel,” because we believe it more clearly expresses the concept intended. Moreover, we hope that this will alleviate the confusion which until now has permitted practitioners to confuse promissory estoppel with its distant cousin, equitable estoppel. See Note, *The “Firm Offer” Problem in Construction Bids and the Need for Promissory Estoppel*, 10 WM & MARY L.REV. 212, 214 n. 17 (1968) [hereinafter, “*The Firm Offer Problem*”].

² The scope of work proposal listed all work that Johnson proposed to perform, but omitted the price term. This is a standard practice in the construction industry. The subcontractor's bid price is then filled in immediately before the general contractor submits the general bid to the letting party.

submitted a quote of \$898,000 for the HVAC component.³ Neither party disputes that PEI used Johnson's sub-bid in computing its own bid. PEI submitted a bid of \$1,585,000 for the entire project.

[3] General contractors' bids were opened on the afternoon of August 5, 1993. PEI's bid was the *second* lowest bid. The government subsequently disqualified the apparent low bidder,⁴ however, and in mid-August, NIH notified PEI that its bid would be accepted.

[4] With the knowledge that PEI was the lowest responsive bidder, Thomas F. Pavel, president of PEI, visited the offices of A.S. Johnson on August 26, 1993, and met with James Kick, Johnson's chief estimator, to discuss Johnson's proposed role in the work. Pavel testified at trial to the purpose of the meeting:

I met with Mr. Kick. And the reason for me going to their office was to look at their offices, to see their facility, to basically sit down and talk with them, as I had not done, and my company had not performed business with them on a direct relationship, but we had heard of their reputation. I wanted to go out and see where their facility was, see where they were located, and basically just sit down and talk to them. Because if we were going to use them on a project, I wanted to know who I was dealing with.

Pavel also asked if Johnson would object to PEI subcontracting directly with Powers for electric controls,

³ PEI alleged at trial that Johnson's bid, as well as the bids of the other potential mechanical subcontractors contained a fixed cost of \$355,000 for a sub-sub-contract to "Landis and Gear Powers" [hereinafter, "Powers"]. Powers was the sole source supplier of the electric controls for the project.

⁴ The project at NIH was part of a set-aside program for small business. The apparent low bidder, J.J. Kirlin, Inc. was disqualified because it was not a small business.

rather than the arrangement originally envisioned in which Powers would be Johnson's subcontractor.⁵ Johnson did not object.

[5] Following that meeting, PEI sent a fax to all of the mechanical subcontractors from whom it had received sub-bids on the NIH job. The text of that fax is reproduced:

Pavel Enterprises, Inc.

TO: PROSPECTIVE MECHANICAL
SUBCONTRACTORS

FROM: ESTIMATING DEPARTMENT

REFERENCE: NIH, BLDG 30
RENOVATION

We herewith respectfully request that you review your bid on the above referenced project that was bid on 8/05/93. PEI has been notified that we will be awarded the project as J.J. Kirlin, Inc. [the original low bidder] has been found to be nonresponsive on the solicitation. We anticipate award on or around the first of September and therefore request that you supply the following information.

1. Please break out your cost for the "POWERS" supplied control work as we will be subcontracting directly to "POWERS".

Please resubmit your quote deleting the above referenced item.

We ask this in an effort to allow all prospective bidders to compete on an even playing field.

Should you have any questions, please call us immediately as time is of the essence.

⁵ Pavel testified at trial that restructuring the arrangement in this manner would reduce the amount PEI needed to bond and thus reduce the price of the bond.

[6] On August 30, 1993, PEI informed NIH that Johnson was to be the mechanical subcontractor on the job. On September 1, 1993, PEI mailed and faxed a letter to Johnson formally accepting Johnson's bid. That letter read:

Pavel Enterprises, Inc.

September 1, 1993

Mr. James H. Kick, Estimating Mngr.

A.S. Johnson Company

8042 Old Alexandria Ferry Road

Clinton, Maryland 20735

Re: NIH Bldg 30 HVAC Modifications

RC: IFB # 263-93-B (CM)-0422

Subject: Letter of Intent to Award
Subcontract

Dear Mr. Kick:

We herewith respectfully inform your office of our intent to award a subcontract for the above referenced project per your quote received on 8/05/93 in the amount of \$898,000.00. This subcontract will be forwarded upon receipt of our contract from the NIH, which we expect any day. A preconstruction meeting is currently scheduled at the NIH on 9/08/93 at 10 AM which we have been requested that your firm attend.

As discussed with you, a meeting was held between NIH and PEI wherein PEI confirmed our bid to the government, and designated your firm as our HVAC Mechanical subcontractor. This action was taken after several telephonic and face to face discussions with you regarding the above referenced bid submitted by your firm.

We look forward to working with your firm on this contract and hope that this will lead to a long and mutually beneficial relationship

Sincerely,
/s/ Thomas F. Pavel

President

[7] Upon receipt of PEI's fax of September 1, James Kick called and informed PEI that Johnson's bid contained an error, and as a result the price was too low. According to Kick, Johnson had discovered the mistake earlier, but because Johnson believed that PEI had not been awarded the contract, they did not feel compelled to correct the error. Kick sought to withdraw Johnson's bid, both over the telephone and by a letter dated September 2, 1993:

A.S. Johnson Co.

September 2, 1993

PEI Construction
780 West Maples Avenue, Suite 101
Vienna, Virginia 22180

Attention: Thomas Pavel, President

Reference: NIH Building 30 HVAC
Modifications

Dear Mr. Pavel,

We respectfully inform you of our intention to withdraw our proposal for the above referenced project due to an error in our bid.

As discussed in our telephone conversation and face to face meeting, the management of A.S. Johnson Company was reviewing this proposal, upon which we were to confirm our pricing to you.

Please contact Mr. Harry Kick, General Manager at [telephone number deleted] for any questions you may have.

Very truly yours,

/s/ James H. Kick

Estimating Manager

[8] PEI responded to both the September 1 phone call, and the September 2 letter, expressing its refusal to permit Johnson to withdraw.

[9] On September 28, 1993, NIH formally awarded the construction contract to PEI. PEI found a substitute subcontractor to do the mechanical work, but at a cost of \$930,000.⁶ PEI brought suit against Johnson in the Circuit Court for Prince George's County to recover the \$32,000 difference between Johnson's bid and the cost of the substitute mechanical subcontractor.

[10]The case was heard by the trial court without the aid of a jury. The trial court made several findings of fact, which we summarize:

1. PEI relied upon Johnson's sub-bid in making its bid for the entire project;
2. The fact that PEI was not the low bidder, but was awarded the project only after the apparent low bidder was disqualified, takes this case out of the ordinary;
3. Prior to NIH awarding PEI the contract on September 28, Johnson, on September 2, withdrew its bid; and
4. PEI's letter to all potential mechanical subcontractors, dated August 26, 1993, indicates that there was no definite agreement

⁶ The record indicates that the substitute mechanical subcontractor used "Powers" as a sub-subcontractor and did not "break out" the "Powers" component to be directly subcontracted by PEI.

between PEI and Johnson, *and* that PEI was not relying upon Johnson's bid.

[11]The trial court analyzed the case under both a traditional contract theory and under a detrimental reliance theory. PEI was unable to satisfy the trial judge that under either theory a contractual relationship had been formed.

[12]PEI appealed to the Court of Special Appeals, raising both traditional offer and acceptance theory, and “promissory estoppel.” Before our intermediate appellate court considered the case, we issued a writ of certiorari on our own motion.

II

[13]The relationships involved in construction contracts have long posed a unique problem in the law of contracts. A brief overview of the mechanics of the construction bid process, as well as our legal system's attempts to regulate the process, is in order.

A. CONSTRUCTION BIDDING.

[14]Our description of the bid process in *Maryland Supreme Corp. v. Blake Co.*, 279 Md. 531, 369 A.2d 1017 (1977) is still accurate:

In such a building project there are basically three parties involved: the letting party, who calls for bids on its job; the general contractor, who makes a bid on the whole project; and the subcontractors, who bid only on that portion of the whole job which involves the field of its specialty. The usual procedure is that when a project is announced, a subcontractor, on his own initiative or at the general contractor's request, prepares an estimate and submits a bid to one or more of the general contractors interested in the project. The general contractor evaluates the bids made by the subcontractors in each field and uses them to compute its total bid to the letting party. After receiving

bids from general contractors, the letting party ordinarily awards the contract to the lowest reputable bidder.

Id. at 533-34, 369 A.2d at 1020-21 (citing [Franklin M. Schulz, *The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry*, 19 U. CHI. L. REV. 237 (1952)])

B. THE CONSTRUCTION BIDDING CASES-AN HISTORICAL OVERVIEW

[15]The problem the construction bidding process poses is the determination of the precise points on the timeline that the various parties become bound to each other. The early landmark case was *James Baird Co. v. Gimbel Bros., Inc.*, 64 F.2d 344 (2d Cir.1933). The plaintiff, James Baird Co., [“Baird”] was a general contractor from Washington, D.C., bidding to construct a government building in Harrisburg, Pennsylvania. Gimbel Bros., Inc., [“Gimbel”], the famous New York department store, sent its bid to supply linoleum to a number of bidding general contractors on December 24, and Baird received Gimbel's bid on December 28. Gimbel realized its bid was based on an incorrect computation and notified Baird of its withdrawal on December 28. The letting authority awarded Baird the job on December 30. Baird formally accepted the Gimbel bid on January 2. When Gimbel refused to perform, Baird sued for the additional cost of a substitute linoleum supplier. The Second Circuit Court of Appeals held that Gimbel's initial bid was an offer to contract and, under traditional contract law, remained open only until accepted or withdrawn. Because the offer was withdrawn before it was accepted there was no contract. Judge Learned Hand, speaking for the court, also rejected two alternative theories of the case: unilateral contract and promissory estoppel. He held that Gimbel's bid was not an offer of a unilateral contract⁷ that Baird could accept by performing, *i.e.*,

⁷ A unilateral contract is a contract which is accepted, not by traditional acceptance, but by performance. 2 *Williston on Contracts* § 6:2 (4th ed.).

submitting the bid as part of the general bid; and second, he held that the theory of promissory estoppel was limited to cases involving charitable pledges.

[16]Judge Hand's opinion was widely criticized, *see* Note, *Contracts-Promissory Estoppel*, 20 VA. L. REV. 214 (1933) [hereinafter, “*Promissory Estoppel*”]; Note, *Contracts-Revocation of Offer Before Acceptance-Promissory Estoppel*, 28 ILL. L. REV. 419 (1934), but also widely influential. The effect of the *James Baird* line of cases, however, is an “obvious injustice without relief of any description.” *Promissory Estoppel*, at 215. The general contractor is bound to the price submitted to the letting party, but the subcontractors are not bound, and are free to withdraw.⁸ As one commentator described it, “If the subcontractor revokes his bid before it is accepted by the general, any loss which results is a deduction from the general's profit and conceivably may transform overnight a profitable contract into a losing deal.” Franklin M. Schultz, *The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry*, 19 U. Chi. L. Rev. 237, 239 (1952).

[17]The unfairness of this regime to the general contractor was addressed in *Drennan v. Star Paving*, 333 P.2d 757, 51 Cal.2d 409 (1958). Like *James Baird*, the *Drennan* case arose in

⁸ Note that under the *Baird* line of cases, the general contractor, while bound by his offer to the letting party, is not bound to any specific subcontractor, and is free to “bid shop” prior to awarding the subcontract. Michael L. Clozen & Donald G. Weiland, *The Construction Industry Bidding Cases: Application of Traditional Contract, Promissory Estoppel, and Other Theories to the Relations Between General Contractors and Subcontractors*, 13 J. Marshall L.Rev. 565, 583 (1980). At least one commentator argues that although potentially unfair, this system creates a necessary symmetry between general and subcontractors, in that neither party is bound. Note, *Construction Contracts-The Problem of Offer and Acceptance in the General Contractor-Subcontractor Relationship*, 37 U.Cinn.L.Rev. 798 (1980) [hereinafter, “*The Problem of Offer and Acceptance*”].

the context of a bid mistake.⁹ Justice Traynor, writing for the Supreme Court of California, relied upon § 90 of the *Restatement (First) of Contracts*:

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

Restatement (First) of Contracts § 90 (1932).¹⁰

[18]Justice Traynor reasoned that the subcontractor's bid contained an implied subsidiary promise not to revoke the bid. As the court stated:

When plaintiff[, a General Contractor,] used defendant's offer in computing his own bid, he bound himself to perform in reliance on defendant's terms. Though defendant did not bargain for the use of its bid neither did defendant make it idly, indifferent to whether it would be used or not. On the contrary it is reasonable to suppose that defendant submitted its bid to obtain the subcontract. It was bound to realize the substantial possibility that its bid would be the lowest, and that it would be included by plaintiff in his bid. It was to its own interest that the contractor be

⁹ Commentators have suggested that the very fact that many of these cases have arisen from bid mistake, an unusual subspecies, rather than from more typical cases, has distorted the legal system's understanding of these cases. Comment, *Bid Shopping and Peddling in the Subcontract Construction Industry*, 18 UCLA L.Rev. 389, 409 (1970) [hereinafter, "*Bid Shopping*"]. See also note, *Once Around the Flag Pole: Construction Bidding and Contracts at Formation*, 39 N.Y.U.L.Rev. 816, 818 (1964) [hereinafter, "*Flag Pole*"] (bid mistake cases generally portray general contractor as victim, but market reality is that subs are usually in weaker negotiating position).

¹⁰ This section of the Restatement has been supplanted by the Restatement (Second) of Contracts § 90(1) (1979). That provision will be discussed, *infra*.

awarded the general contract; the lower the subcontract bid, the lower the general contractor's bid was likely to be and the greater its chance of acceptance and hence the greater defendant's chance of getting the paving subcontract. Defendant had reason not only to expect plaintiff to rely on its bid but to want him to. Clearly defendant had a stake in plaintiff's reliance on its bid. Given this interest and the fact that plaintiff is bound by his own bid, it is only fair that plaintiff should have at least an opportunity to accept defendant's bid after the general contract has been awarded to him.

Drennan, 51 Cal.2d at 415, 333 P.2d at 760.

[19]The *Drennan* court however did not use “promissory estoppel” as a substitute for the entire contract, as is the doctrine's usual function. Instead, the *Drennan* court, applying the principle of § 90, interpreted the subcontractor's bid to be irrevocable. Justice Traynor's analysis used promissory estoppel as consideration for an implied promise to keep the bid open for a reasonable time. Recovery was then predicated on traditional bilateral contract, with the sub-bid as the offer and promissory estoppel serving to replace acceptance.

[20]The *Drennan* decision has been very influential. Many states have adopted the reasoning used by Justice Traynor. See, e.g., *Debron Corp. v. National Homes Constr. Corp.*, 493 F.2d 352 (8th Cir.1974) (applying Missouri law); *Reynolds v. Texarkana Constr. Co.*, 237 Ark. 583, 374 S.W.2d 818 (1964); *Mead Assocs. Inc. v. Antonsen*, 677 P.2d 434 (Colo.1984); *Illinois Valley Asphalt v. J.F. Edwards Constr. Co.*, 45 Ill.Dec. 876, 413 N.E.2d 209, 90 Ill.App.3d 768 (Ill.Ct.App.1980); *Lichtefeld-Massaró, Inc. v. R.J. Manteuffel Co.*, 806 S.W.2d 42 (Ky.App.1991); *Constructors Supply Co. v. Bostrom Sheet Metal Works, Inc.*, 291 Minn. 113, 190 N.W.2d 71 (1971); *E.A. Coronis Assocs. v. M. Gordon Constr. Co.*, 90 N.J. Super 69, 216 A.2d 246 (1966).

[21]Despite the popularity of the *Drennan* reasoning, the case has subsequently come under some criticism.¹¹ The criticism centers on the lack of symmetry of detrimental reliance in the bid process, in that subcontractors are bound to the general, but the general is not bound to the subcontractors.¹² The result is that the general is free to bid shop,¹³ bid chop,¹⁴ and to encourage bid peddling,¹⁵ to the detriment of the subcontractors. One commentator described the problems that these practices create:

Bid shopping and peddling have long been recognized as unethical by construction trade organizations. These ‘unethical,’ but common practices have several detrimental results. First, as bid shopping becomes common within a particular trade, the subcontractors will pad their initial bids in order to make further reductions during post-award negotiations. This artificial inflation of subcontractor's offers makes the bid process

¹¹ Home Elec. Co. v. Underdown Heating & Air Conditioning Co., 86 N.C.App. 540, 358 S.E.2d 539 (1987). See also, The Problem of Offer and Acceptance.

¹² See *Williams v. Favret*, 161 F.2d 822, 823 n. 1 (5th Cir.1947); *Merritt-Chapman & Scott Corp. v. Gunderson Bros. Eng'g Corp.*, 305 F.2d 659 (9th Cir.1962). But see *Electrical Constr. & Maintenance Co. v. Maeda Pac. Corp.*, 764 F.2d 619 (9th Cir.1985) (subcontractor rejected by general contractor could maintain an action in both traditional contract or promissory estoppel). See Bid Shopping, at 405-09 (suggesting using “promissory estoppel” to bind generals to subcontractors, as well as subs to generals, in appropriate circumstances).

¹³ Bid shopping is the use of the lowest subcontractor's bid as a tool in negotiating lower bids from other subcontractors post-award.

¹⁴ “The general contractor, having been awarded the prime contract, may pressure the subcontractor whose bid was used for a particular portion of the work in computing the overall bid on the prime contract to reduce the amount of the bid.” *Closen & Weiland*, at 566 n. 6.

¹⁵ An unscrupulous subcontractor can save estimating costs, and still get the job by not entering a bid or by entering an uncompetitive bid. After bid opening, this unscrupulous subcontractor, knowing the price of the low sub-bid, can then offer to perform the work for less money, precisely because the honest subcontractor has already paid for the estimate and included that cost in the original bid. This practice is called bid peddling.

less effective. Second, subcontractors who are forced into post-award negotiations with the general often must reduce their sub-bids in order to avoid losing the award. Thus, they will be faced with a Hobson's choice between doing the job at a loss or doing a less than adequate job. Third, bid shopping and peddling tend to increase the risk of loss of the time and money used in preparing a bid. This occurs because generals and subcontractors who engage in these practices use, without expense, the bid estimates prepared by others. Fourth, it is often impossible for a general to obtain bids far enough in advance to have sufficient time to properly prepare his own bid because of the practice, common among many subcontractors, of holding sub-bids until the last possible moment in order to avoid pre-award bid shopping by the general. Fifth, many subcontractors refuse to submit bids for jobs on which they expect bid shopping. As a result, competition is reduced, and, consequently, construction prices are increased. Sixth, any price reductions gained through the use of post-award bid shopping by the general will be of no benefit to the awarding authority, to whom these price reductions would normally accrue as a result of open competition before the award of the prime contract. Free competition in an open market is therefore perverted because of the use of post-award bid shopping.

Bid Shopping, at 394-96 (citations omitted). *See also Flag Pole*, at 818 (bid mistake cases generally portray general contractor as victim, but market reality is that subs are usually in weaker negotiating position); Jay M. Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 707-08 (1984). These problems have caused at least one court to reject promissory

estoppel in the contractor-subcontractor relationship. *Home Elec. Co. v. Underdown Heating & Air Conditioning Co.*, 86 N.C.App. 540, 358 S.E.2d 539 (1987). See also Note, *Construction Contracts-The Problem of Offer and Acceptance in the General Contractor-Subcontractor Relationship*, 37 U. CINN. L. REV. 798 (1980). But other courts, while aware of the limitations of promissory estoppel, have adopted it nonetheless. See, e.g., *Alaska Bussell Elec. Co. v. Vern Hickel Constr. Co.*, 688 P.2d 576 (Alaska 1984).¹⁶

[22]The doctrine of detrimental reliance has evolved in the time since *Drennan* was decided in 1958. The American Law Institute, responding to *Drennan*, sought to make detrimental reliance more readily applicable to the construction bidding scenario by adding § 87. This new section was intended to make subcontractors' bids binding:

§ 87. Option Contract

...

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

Restatement (Second) of Contracts § 87 (1979).¹⁷

[23]Despite the drafter's intention that § 87 of the *Restatement (Second) of Contracts* (1979) should replace *Restatement (First) of*

¹⁶ The critical literature also contains numerous suggestions that might be undertaken by the legislature to address the problems of bid shopping, chopping, and peddling. See Note, *Construction Bidding Problem: Is There a Solution Fair to Both the General Contractor and Subcontractor?*, 19 St. Louis L.Rev. 552, 568-72 (1975) (discussing bid depository and bid listing schemes); *Flag Pole*, at 825-26.

¹⁷ This provision was derived from *Restatement (Second) of Contracts* § 89B(2) (Tent.Drafts Nos. 1-7, 1973). There are cases that refer to the tentative drafts. See *Loranger Constr. Corp. v. E.F. Hauserman Co.*, 384 N.E.2d 176, 179, 376 Mass. 757, 763 (1978). See also *Closen & Weiland*, at 593-97.

Contracts § 90 (1932) in the construction bidding cases, few courts have availed themselves of the opportunity. *But see, Arango Constr. Co. v. Success Roofing, Inc.*, 46 Wash.App. 314, 321-22, 730 P.2d 720, 725 (1986). Section 90(1) of the *Restatement (Second) of Contracts* (1979) modified the first restatement formulation in three ways, by: 1) deleting the requirement that the action of the offeree be “definite and substantial;” 2) adding a cause of action for third party reliance; and 3) limiting remedies to those required by justice.¹⁸

[24] Courts and commentators have also suggested other solutions intended to bind the parties without the use of detrimental reliance theory. The most prevalent suggestion¹⁹ is the use of the firm offer provision of the Uniform Commercial Code. Maryland Code (1992 Repl.Vol.), § 2-205 of the Commercial Law Article. That statute provides:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during

¹⁸ Section 90 of the *Restatement (First) of Contracts* (1932) explains detrimental reliance as follows:

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

Section 90(1) of the *Restatement (Second) Contracts* (1979) defines the doctrine of detrimental reliance as follows:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

¹⁹ See *Bid Shopping and Peddling* at 399-401; *Firm Offer Problem* at 215; Closen & Weiland, at 604 n. 133.

the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

[25]In this manner, subcontractor's bids, made in writing and giving some assurance of an intent that the offer be held open, can be found to be irrevocable.

[26]The Supreme Judicial Court of Massachusetts has suggested three other traditional theories that might prove the existence of a contractual relationship between a general contractor and a sub: conditional bilateral contract analysis; unilateral contract analysis; and unrevoked offer analysis. *Loranger Constr. Corp. v. E.F. Hauserman Co.*, 384 N.E.2d 176, 376 Mass. 757 (1978). If the general contractor could prove that there was an exchange of promises binding the parties to each other, and that exchange of promises was made before bid opening, that would constitute a valid bilateral promise conditional upon the general being awarded the job. *Loranger*, 384 N.E.2d at 180, 376 Mass. at 762. This directly contrasts with Judge Hand's analysis in *James Baird*, that a general's use of a sub-bid constitutes acceptance conditional upon the award of the contract to the general. *James Baird*, 64 F.2d at 345-46.

[27]Alternatively, if the subcontractor intended its sub-bid as an offer to a unilateral contract, use of the sub-bid in the general's bid constitutes part performance, which renders the initial offer irrevocable under the *Restatement (Second) of Contracts* § 45 (1979). *Loranger*, 384 N.E.2d at 180, 376 Mass. at 762. This resurrects a second theory dismissed by Judge Learned Hand in *James Baird*.

[28]Finally, the *Loranger* court pointed out that a jury might choose to disbelieve that a subcontractor had withdrawn the winning bid, meaning that acceptance came before

withdrawal, and a traditional bilateral contract was formed. *Loranger*, 384 N.E.2d at 180, 376 Mass. at 762-63.²⁰

[29] Another alternative solution to the construction bidding problem is no longer seriously considered—revitalizing the common law seal. William Noel Keyes, *Consideration Reconsidered—The Problem of the Withdrawn Bid*, 10 STAN. L. REV. 441, 470 (1958). Because a sealed option contract remains firm without consideration this alternative was proposed as a solution to the construction bidding problem.²¹

III

[30] If PEI is able to prove by any of the theories described that a contractual relationship existed, but Johnson failed to perform its end of the bargain, then PEI will recover the \$32,000 in damages caused by Johnson's breach of contract. Alternatively, if PEI is unable to prove the existence of a contractual relationship, then Johnson has no obligation to PEI. We will test the facts of the case against the theories described to determine if such a relationship existed.

[31] The trial court held, and we agree, that Johnson's sub-bid was an offer to contract and that it was sufficiently clear and definite. We must then determine if PEI made a timely and valid acceptance of that offer and thus created a traditional bilateral contract, or in the absence of a valid acceptance, if PEI's detrimental reliance served to bind Johnson to its sub-

²⁰ For an excellent analysis of the *Loranger* case, see Closen & Weiland at 597-603.

²¹ Of course, general contractors could require their subcontractors to provide their bids under seal. The fact that they do not is testament to the lack of appeal this proposal holds. It is here that the state of the law rests.

bid. We examine each of these alternatives, beginning with traditional contract theory.²²

A. TRADITIONAL BILATERAL CONTRACT

[32]The trial judge found that there was not a traditional contract binding Johnson to PEI. A review of the record and the trial judge's findings make it clear that this was a close question. On appeal however, our job is to assure that the trial judge's findings were not clearly erroneous. Maryland Rule 8-131(c). This is an easier task.

[33]The trial judge rejected PEI's claim of bilateral contract for two separate reasons: 1) that there was no meeting of the minds; and 2) that the offer was withdrawn prior to acceptance. Both need not be proper bases for decision; if either of these two theories is not clearly erroneous, we must affirm.

[34]There is substantial evidence in the record to support the judge's conclusion that there was no meeting of the minds. PEI's letter of August 26, to all potential mechanical subcontractors, reproduced *supra* [¶ 5], indicates, as the trial judge found, that PEI and Johnson “did not have a definite, certain meeting of the minds on a certain price for a certain quantity of goods....” Because this reason is itself sufficient to

²² Because they were not raised, either below or in this Court, we need not address the several methods in which a court might interpret a subcontractor's bid as a firm, and thus irrevocable, offer. Nevertheless, for the benefit of bench and bar, we review those theories as applied to this case. First, PEI could have purchased an option, thus supplying consideration for making the offer irrevocable. This did not happen. Second, Johnson could have submitted its bid as a sealed offer. Md.Code (1995 Repl.Vol.), § 5-102 of the Courts & Judicial Proceedings Article. An offer under seal supplants the need for consideration to make an offer firm. This did not occur in the instant case. The third method of Johnson's offer becoming irrevocable is by operation of Md.Code (1992 Repl.Vol.), § 2-205 of the Commercial Law Article. We note that Johnson's sub-bid was made in the form of a signed writing, but without further evidence we are unable to determine if the offer “by its terms gives assurance that it will be held open” and if the sub-bid is for “goods” as that term is defined by Md.Code (1994 Repl.Vol.), § 2-105(1) of the Commercial Law Article and by decisions of this Court, including *Anthony Pools v. Sheehan*, 295 Md. 285, 455 A.2d 434 (1983) and *Burton v. Artery Co.*, 279 Md. 94, 367 A.2d 935 (1977).

sustain the trial judge's finding that no contract was formed, we affirm.

[35]Alternatively, we hold, that the evidence permitted the trial judge to find that Johnson revoked its offer prior to PEI's final acceptance. We review the relevant chronology. Johnson made its offer, in the form of a sub-bid, on August 5. On September 1, PEI accepted. Johnson withdrew its offer by letter dated September 2. On September 28, NIH awarded the contract to PEI. Thus, PEI's apparent acceptance came one day *prior* to Johnson's withdrawal.

[36]The trial court found, however, “that before there was ever a final agreement reached with the contract awarding authorities, that Johnson made it clear to [PEI] that they were not going to continue to rely on their earlier submitted bid.” Implicit in this finding is the judge's understanding of the contract. Johnson's sub-bid constituted an offer of a contingent contract. PEI accepted that offer subject to the condition precedent of PEI's receipt of the award of the contract from NIH. Prior to the occurrence of the condition precedent, Johnson was free to withdraw. *See 2 Williston on Contracts* § 6:14 (4th ed.). On September 2, Johnson exercised that right to revoke.²³ The trial judge's finding that withdrawal proceeded valid final acceptance is therefore logical and supported by substantial evidence in the record. It was not clearly erroneous, so we shall affirm.

B. DETRIMENTAL RELIANCE

²³ We have also considered the possibility that Johnson's offer was not to enter into a contingent contract. This is unlikely because there is no incentive for a general contractor to accept a non-contingent contract prior to contract award but it would bind the general to purchase the subcontractor's services even if the general did not receive the award. Moreover, PEI's September 1 letter clearly “accepted” Johnson's offer subject to the award from NIH. If Johnson's bid was for a non-contingent contract, PEI's response substantially varied the offer and was therefore a counter-offer, not an acceptance. *Post v. Gillespie*, 219 Md. 378, 385-86, 149 A.2d 391, 395-96 (1959); 2 *Williston on Contracts* § 6:13 (4th ed.).

[37]PEI's alternative theory of the case is that PEI's detrimental reliance binds Johnson to its bid. We are asked, as a threshold question, if detrimental reliance applies to the setting of construction bidding. Nothing in our previous cases suggests that the doctrine was intended to be limited to a specific factual setting. The benefits of binding subcontractors outweigh the possible detriments of the doctrine.²⁴

[38]This Court has decided cases based on detrimental reliance as early as 1854,²⁵ and the general contours of the doctrine are well understood by Maryland courts. The historical development of promissory estoppel, or detrimental reliance, in Maryland has mirrored the development nationwide. It was originally a small exception to the general consideration requirement, and found in “cases dealing with such narrow problems as gratuitous agencies and bailments, waivers, and promises of marriage settlement.” Jay M. Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 680 (1984). The early Maryland cases applying “promissory estoppel” or detrimental reliance primarily involve charitable pledges.

[39]The leading case is *Maryland Nat'l Bank v. United Jewish Appeal Fed'n of Greater Washington*, 286 Md. 274, 407 A.2d 1130 (1979), where this Court's opinion was authored by the late Judge Charles E. Orth, Jr. In that case, a decedent, Milton Polinger, had pledged \$200,000 to the United Jewish Appeal [“UJA”]. The UJA sued Polinger's estate in an attempt to collect the money promised them. Judge Orth reviewed four

²⁴ General contractors, however, should not assume that we will also adopt the holdings of our sister courts who have refused to find general contractors bound to their subcontractors. See, e.g., *N. Litterio & Co. v. Glasman Constr. Co.*, 319 F.2d 736 (D.C.Cir.1963).

²⁵ *Gittings v. Mayhew*, 6 Md. 113 (1854).

prior decisions of this Court²⁶ and determined that RESTATEMENT (FIRST) OF CONTRACTS § 90 (1932) applied. *Id.* at 281, 407 A.2d at 1134. Because the Court found that the UJA had not acted in a “definite or substantial” manner in reliance on the contribution, no contract was found to have been created. *Id.* at 289-90, 407 A.2d at 1138-39.

[40]Detrimental reliance doctrine has had a slow evolution from its origins in disputes over charitable pledges, and there remains some uncertainty about its exact dimensions.²⁷ Two cases from the Court of Special Appeals demonstrate that confusion.

[41]The first, *Snyder v. Snyder*, 79 Md.App. 448, 558 A.2d 412 (1989), arose in the context of a suit to enforce an antenuptial agreement. To avoid the statute of frauds, refuge was sought in the doctrine of “promissory estoppel.”²⁸ The court held

²⁶ The cases reviewed were *Gittings v. Mayben*, 6 Md. 113 (1854); *Erdman v. Trustees Eutaw M.P. Ch.*, 129 Md. 595, 99 A. 793 (1917); *Sterling v. Cushwa & Sons*, 170 Md. 226, 183 A. 593 (1936); and *American University v. Collings*, 190 Md. 688, 59 A.2d 333 (1948).

²⁷ Other cases merely acknowledged the existence of a doctrine of “promissory estoppel,” but did not comment on the standards for the application of this doctrine. *See, e.g., Chesapeake Supply & Equip. Co. v. Manitowoc Eng'g Corp.*, 232 Md. 555, 566, 194 A.2d 624, 630 (1963).

²⁸ Section 139 of the *Restatement (Second) of Contracts* (1979) provides that detrimental reliance can remove a case from the statute of frauds:

Enforcement by Virtue of Action in Reliance

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce the action or forbearance is enforceable notwithstanding the Statute of Frauds if injustice can be avoided only by enforcement of the promise. The remedy granted for breach is to be limited as justice requires.

(2) In determining whether injustice can be avoided only by enforcement of the promise, the following circumstances are significant:

(a) the availability and adequacy of other remedies, particularly cancellation and restitution;

(b) the definite and substantial character of the action or forbearance in relation to the remedy sought;

that “promissory estoppel” requires a finding of *fraudulent* conduct on the part of the promisor. *See also Friedman & Fuller v. Funkhouser*, 107 Md.App. 91, 666 A.2d 1298 (1995).

[42]The second, *Kiley v. First Nat'l Bank*, 102 Md.App. 317, 649 A.2d 1145 (1994), the court stated that “[i]t is unclear whether Maryland continues to adhere to the more stringent formulation of promissory estoppel, as set forth in the original RESTATEMENT OF CONTRACTS, or now follows the more flexible view found in the RESTATEMENT (SECOND) OF CONTRACTS.” *Id.* at 336, 649 A.2d at 1154.

[43]To resolve these confusions we now clarify that Maryland courts are to apply the test of the RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1979), which we have recast as a four-part test:

1. a clear and definite promise;
2. where the promisor has a reasonable expectation that the offer will induce action or forbearance on the part of the promisee;
3. which does induce actual and reasonable action or forbearance by the promisee; and
4. causes a detriment which can only be avoided by the enforcement of the promise.²⁹

[44]We have adopted language of the RESTATEMENT (SECOND) OF CONTRACTS (1979) because we believe each of the three changes made to the previous formulation were for the better. As discussed earlier, the

(c) the extent to which the action or forbearance corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence;

(d) the reasonableness of the action or forbearance;

(e) the extent to which the action or forbearance was foreseeable by the promisor.

²⁹ This comports with the formulation given by the United States District Court for the District of Maryland in *Union Trust Co. of Md. v. Charter Medical Corp.*, 663 F.Supp. 175, 178 n. 4 (D.Md.1986) *aff'd w/o opinion*, 823 F.2d 548 (4th Cir.1987).

first change was to delete the requirement that the action of the offeree be “definite and substantial.” Although the Court of Special Appeals in *Kiley v. First Nat'l Bank*, 102 Md.App. 317, 336, 649 A.2d 1145, 1154 (1994) apparently presumed this to be a major change from the “stringent” first restatement to the “more flexible” second restatement, we perceive the language to have always been redundant. If the reliance is not “substantial and definite” justice will not compel enforcement.

[45]The decisions in *Snyder v. Snyder*, 79 Md.App. 448, 558 A.2d 412 (1989) and *Friedman & Fuller v. Funkhouser*, 107 Md.App. 91, 666 A.2d 1298 (1995) to the extent that they required a showing of fraud on the part of the offeree are therefore disapproved.

[46]In a construction bidding case, where the general contractor seeks to bind the subcontractor to the sub-bid offered, the general must first prove that the subcontractor's sub-bid constituted an offer to perform a job at a given price. We do not express a judgment about how precise a bid must be to constitute an offer, or to what degree a general contractor may request to change the offered scope before an acceptance becomes a counter-offer. That fact-specific judgment is best reached on a case-by-case basis. In the instant case, the trial judge found that the sub-bid was sufficiently clear and definite to constitute an offer, and his finding was not clearly erroneous.

[47]Second, the general must prove that the subcontractor reasonably expected that the general contractor would rely upon the offer. The subcontractor's expectation that the

general contractor will rely upon the sub-bid may dissipate through time.³⁰

[48]In this case, the trial court correctly inquired into Johnson's belief that the bid remained open, and that consequently PEI was not relying on the Johnson bid. The judge found that due to the time lapse between bid opening and award, "it would be unreasonable for offers to continue." This is supported by the substantial evidence. James Kick testified that although he knew of his bid mistake, he did not bother to notify PEI because J.J. Kirlin, Inc., and not PEI, was the apparent low bidder. The trial court's finding that Johnson's reasonable expectation had dissipated in the span of a month is not clearly erroneous.

[49]As to the third element, a general contractor must prove that he actually and reasonably relied on the subcontractor's sub-bid. We decline to provide a checklist of potential methods of proving this reliance, but we will make several observations. First, a showing by the subcontractor, that the general contractor engaged in "bid shopping," or actively encouraged "bid chopping," or "bid peddling" is strong evidence that the general did *not* rely on the sub-bid. Second, prompt notice by the general contractor to the subcontractor that the general intends to use the sub on the job, is weighty evidence that the general *did* rely on the bid.³¹ Third, if a sub-bid is so low that a reasonably prudent general contractor would not rely upon it, the trier of fact may infer that the general contractor did not in fact rely upon the erroneous bid.

[50]In this case, the trial judge did not make a specific finding that PEI failed to prove its reasonable reliance upon Johnson's sub-bid. We must assume, however, that it was his

³⁰ We expect that evidence of "course of dealing" and "usage of the trade," *see Restatement (Second) of Contracts* §§ 219-223 (1979), will provide strong indicies of the reasonableness of a subcontractor's expectations.

³¹ Prompt notice and acceptance also significantly dispels the possibility of bid shopping, bid chopping, and bid peddling.

conclusion based on his statement that “the parties did not have a definite, certain meeting of the minds on a certain price for a certain quantity of goods and wanted to renegotiate....” The August 26, 1993, fax from PEI to all prospective mechanical subcontractors, is evidence supporting this conclusion. Although the finding that PEI did not rely on Johnson's bid was indisputably a close call, it was not clearly erroneous.

[51] Finally, as to the fourth prima facie element, the trial court, and not a jury, must determine that binding the subcontractor is necessary to prevent injustice. This element is to be enforced as required by common law equity courts—the general contractor must have “clean hands.” This requirement includes, as did the previous element, that the general did not engage in bid shopping, chopping or peddling, but also requires the further determination that justice compels the result. The fourth factor was not specifically mentioned by the trial judge, but we may infer that he did not find this case to merit an equitable remedy.

[52] Because there was sufficient evidence in the record to support the trial judge's conclusion that PEI had not proven its case for detrimental reliance, we must, and hereby do, affirm the trial court's ruling.

IV

[53] In conclusion, we emphasize that there are different ways to prove that a contractual relationship exists between a general contractor and its subcontractors. Traditional bilateral contract theory is one. Detrimental reliance can be another. However, under the evidence in this case, the trial judge was not clearly erroneous in deciding that recovery by the general contractor was not justified under either theory.

JUDGMENT AFFIRMED, WITH COSTS.

3.2.1 Discussion of *Pavel Enterprises*

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

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

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

3.3 The Mirror Image Rule

Recall from our discussion of Restatement (Second) § 36 that an offeree loses the power of acceptance when she rejects an offer or makes a counter-offer. The following case involves an application of this rule.

3.4 Principal Case – *Dataserv Equipment, Inc. v. Technology Finance Leasing*

Dataserv Equipment, Inc. v. Technology Finance Leasing Corp.

Court of Appeals of Minnesota
364 N.W.2d 838 (1985)

WOZNIAK, Judge.

[1] This is an appeal from a judgment entered after trial to the district court determining that appellant was subject to the jurisdiction of Minnesota courts and that appellant breached a contract to purchase certain computer equipment. We ... reverse on the question of contract formation.

FACTS

[2] Appellant Technology Finance Group, Inc. (Technology), a Nevada corporation with its principal place of business in

Connecticut, and Respondent Dataserv Equipment, Inc. (Dataserv), a Minnesota corporation with its principal place of business in Minneapolis, are dealers in new and used computer equipment.

[3] On or about August 29, 1979, Dataserv's Jack Skjonsby telephoned Technology's Ron Finerty in Connecticut and proposed to sell to Technology, for the price of \$100,000, certain IBM computer "features" which Dataserv had previously purchased in Canada.

[4] As a result of long distance telephone conversations between Skjonsby and Finerty, on August 30, 1979, Finerty sent Skjonsby a written offer to purchase the features and on September 6, 1979, Dataserv sent to Technology a proposed form of contract. Dataserv's proposed contract form included a nonstandard provision, appearing in the contract form as clause 8 and referred to by the parties as the "Indepth Clause." The clause provided that installation of the features would be done by Indepth, a third party. The contract also provided that "[t]his agreement is subject to acceptance by the seller ... and shall only become effective on the date thereof," and "[t]his agreement is made subject to the terms and conditions included herein and Purchaser's acceptance is effective only to the extent that such terms and conditions are conditions herein. Any acceptance which contains conditions which are in addition to or inconsistent with the terms and conditions herein will be a counter offer and will not be binding unless agreed to in writing by the Seller."

[5] On October 1, Finerty wrote Skjonsby that three changes "need to be made" in the contract, one of which was the deletion of clause 8. The letter closed with: "Let me know and I will make the changes and sign." Two of the changes were thereafter resolved, but the resolution of clause 8 remained in controversy.

[6] Later in October 1979, Dataserv offered to accept, in substitution for Indepth, any other third-party installation

company Technology would designate. Technology never agreed to this.

[7] On November 8, 1979, Dataserv by telephone offered to remove the Indepth clause from the contract form. Technology responded that it was “too late,” and that there was no deal.

[8] On November 9, 1979, Finerty called Dataserv, and informed them that “the deal was not going to get done because they'd waited until too late a point in time.” During this period of time, the market value of the features was dropping rapidly and Dataserv was anxious to complete the deal. It is undisputed that the market for used computer equipment, including its features, is downwardly price volatile.

[9] By telex dated November 12, 1979, Dataserv informed Technology that the features were ready for pickup and that the pickup and payment be no later than November 15, 1979.

[10] On November 13, 1979, Finerty responded by telex stating:

[S]ince [Dataserv] had not responded in a positive fashion to Alanthus' [Alanthus is the former name of Technology Finance Group] letter requesting contract changes...its offer to purchase [the features] was withdrawn on 11/9/79 via telephone conversation with Jack Skjonsby. Ten to fifteen days prior, I made Jack aware that this deal was dead if Dataserv did not agree to contract changes prior to the “Eleventh Hour.”

[11] On June 19, 1980, the features were sold by Dataserv to another party for \$26,000. It then sought a judgment against Technology for the difference between the sale price of the features and the contract price.

[12] By its Answer and by way of pretrial motion, Technology claimed that the court lacked jurisdiction over the person of

the defendant. The trial court denied the motion on February 20, 1981.

[13]At trial the parties stipulated that as of November 8, 1979 Dataserv telephonically offered to take out the Indepth Clause. The trial court found that this telephone call operated as an acceptance of Technology's counteroffer of October 1, 1979, thereby establishing a contract between the parties embodying the terms of Dataserv's printed standard contract dated September 6, 1979, minus clause 8 thereof. The trial court found that as of November 15, 1979, Technology breached its contract to Dataserv's damage, and awarded Dataserv \$74,000 in damages, plus interest from the date of the breach.

ANALYSIS

[14]Technology claims that the trial court erred in finding that the parties entered into a contract. It contends that Dataserv's response to its counteroffer operated, as a matter of law, as a rejection, terminating Dataserv's power to subsequently accept the counteroffer.

[15]Under familiar principles of contract law, a party's rejection terminates its power of acceptance. Restatement (Second) of Contracts § 38 (1981). Once rejected, an offer is terminated and cannot subsequently be accepted without ratification by the other party. *Nodland v. Chirpich*, 240 N.W.2d 513, 307 Minn. 360 (1976).

[16]The critical issue is whether Dataserv rejected Technology's October 1 counteroffer. Dataserv responded to Technology's October 1 counteroffer by agreeing to delete two of the three objectionable clauses, but insisting that the third be included. By refusing to accept according to the terms of the proposal, Dataserv rejected Technology's counteroffer and thus no contract was formed. Moreover, Dataserv's offer to substitute other third party installation

companies, which Technology rejected, operated as a termination of its power to accept Technology's counteroffer. Dataserv's so-called "acceptance," when it offered to delete clause 8 on November 8, 1979, was without any legal effect whatsoever, except to create a new offer which Technology immediately rejected.

[17] Dataserv's November 8 "acceptance" was also ineffective because it was not signed in accordance with the offer's conditions. While it is true that Minn.Stat. §336.2-204 does not require a signed agreement prior to formation of a contract, where the parties know that the execution of a written contract was a condition precedent to their being bound, there can be no binding contract until the written agreement was executed. *Staley Manufacturing Co. v. Northern Cooperatives, Inc.*, 168 F.2d 892 (8th Cir.1948).

[18] Having found that no contract was formed between the parties, it is unnecessary to address the question of mitigation of damages.

DECISION

[19] Technology was subject to the jurisdiction of Minnesota courts. No contract was formed between the parties.

Affirmed in part, reversed in part.

3.4.1 The Mirror Image Rule and the Last Shot Doctrine

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

But what happens if the offeree's response cannot be so easily classified? Suppose that Josh replies with enthusiastic assent to the

bargain but, at the same time, indicates that he expects the deal to include the stylish fleece seat covers and portable GPS unit with which Leslie has equipped her car. As we will shortly learn, the Uniform Commercial Code provision that applies to this sale (recall that a car is unquestionably a “good” within the meaning of the UCC) departs significantly from the traditional common law approach to this situation. Nevertheless, it is instructive to consider how the common law rules would treat this interaction.

Under the so-called “mirror image rule,” an acceptance must manifest assent to all and only the precise terms of the offer. A purported acceptance like Josh’s that proposes different or additional terms would be treated as a counter-offer. The offeree may not add conditions or limitations to his acceptance, and any attempt to vary the terms of the original offer is equivalent to a rejection of that offer. Thus, Josh’s response would terminate his power of acceptance and give rise to a new offer that Leslie may accept or reject as she wishes. Only if the parties agreed to keep the original offer open, for example, by creating an option contract, would Josh retain the ability to form a contract by accepting Leslie’s original offer.

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

The mirror image rule implies that both the second and third communications were counter-offers that rejected the preceding

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

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

3.4.2 Discussion of *Dataserv Equipment, Inc. v. Technology Finance Leasing Corp.*

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

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

4. UCC Section 2-207

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

4.1 Principal Case – Ionics v. Elmwood Sensors, Inc.

Ionics, Inc. v. Elmwood Sensors, Inc.

United States Court of Appeals for the First Circuit
110 F.3d 184 (1997)

TORRUELLA, Chief Judge.

[1] Ionics, Inc. (“Ionics”) purchased thermostats from Elmwood Sensors, Inc. (“Elmwood”) for installation in water dispensers manufactured by the former. Several of the dispensers subsequently caused fires which allegedly resulted from defects in the sensors. Ionics filed suit against Elmwood in order to recover costs incurred in the wake of the fires. Before trial, the district court denied Elmwood's motion for partial summary judgment. The District Court of Massachusetts subsequently certified to this court “the question whether, in the circumstances of this case, § 2-207 of M.G.L. c. 106 has been properly applied.”

I. Standard of Review

[2] We review the grant or denial of summary judgment *de novo*. See *Borschow Hosp. & Medical Supplies v. Cesar Castillo, Inc.*, 96 F.3d 10, 14 (1st Cir.1996).

II. Background

[3] The facts of the case are not in dispute. Elmwood manufactures and sells thermostats. Ionics makes hot and cold water dispensers, which it leases to its customers. On three separate occasions, Ionics purchased thermostats from Elmwood for use in its water dispensers.¹ Every time Ionics made a purchase of thermostats from Elmwood, it sent the latter a purchase order form which contained, in small type, various “conditions.” Of the 20 conditions on the order form, two are of particular relevance:

18. REMEDIES - The remedies provided Buyer herein shall be cumulative, and in

¹ Orders were placed in March, June, and September 1990.

addition to any other remedies provided by law or equity. A waiver of a breach of any provision hereof shall not constitute a waiver of any other breach. The laws of the state shown in Buyer's address printed on the masthead of this order shall apply in the construction hereof.

19. ACCEPTANCE - Acceptance by the Seller of this order shall be upon the terms and conditions set forth in items 1 to 17 inclusive, and elsewhere in this order. Said order can be so accepted only on the exact terms herein and set forth. No terms which are in any manner additional to or different from those herein set forth shall become a part of, alter or in any way control the terms and conditions herein set forth.

[4] Near the time when Ionics placed its first order, it sent Elmwood a letter that it sends to all of its new suppliers. The letter states, in part:

The information preprinted, written and/or typed on our purchase order is especially important to us. Should you take exception to this information, please clearly express any reservations to us in writing. If you do not, we will assume that you have agreed to the specified terms and that you will fulfill your obligations according to our purchase order. If necessary, we will change your invoice and pay your invoice according to our purchase order.

[5] Following receipt of each order, Elmwood prepared and sent an "Acknowledgment" form containing the following language in small type:

THIS WILL ACKNOWLEDGE RECEIPT
OF BUYER'S ORDER AND STATE
SELLER'S WILLINGNESS TO SELL THE

GOODS ORDERED BUT ONLY UPON THE TERMS AND CONDITIONS SET FORTH HEREIN AND ON THE REVERSE SIDE HEREOF AS A COUNTEROFFER. BUYER SHALL BE DEEMED TO HAVE ACCEPTED SUCH COUNTEROFFER UNLESS IT IS REJECTED IN WRITING WITHIN TEN (10) DAYS OF THE RECEIPT HEREOF, AND ALL SUBSEQUENT ACTION SHALL BE PURSUANT TO THE TERMS AND CONDITIONS OF THIS COUNTEROFFER ONLY; ANY ADDITIONAL OR DIFFERENT TERMS ARE HEREBY OBJECTED TO AND SHALL NOT BE BINDING UPON THE PARTIES UNLESS SPECIFICALLY AGREED TO IN WRITING BY SELLER.

[6] Although this passage refers to a “counteroffer,” we wish to emphasize that this language is not controlling. The form on which the language appears is labeled an “Acknowledgment” and the language comes under a heading that reads “Notice of Receipt of Order.” The form, taken as a whole, appears to contemplate an order's confirmation rather than an order's rejection in the form of a counteroffer.

[7] It is undisputed that the Acknowledgment was received prior to the arrival of the shipment of goods. Although the district court, in its ruling on the summary judgment motion, states that “with each shipment of thermostats, Elmwood included an Acknowledgment Form,” this statement cannot reasonably be taken as a finding in support of the claim that the Acknowledgment and the shipment arrived together. First, in its certification order, the court states that “[t]he purchaser, *after* receiving the Acknowledgment, accepted delivery of the goods without objection.” This language is clearer and more precise than the previous statement and suggests that the former was simply a poor choice of phrasing. Furthermore, Ionics has not disputed the arrival

time of the Acknowledgment. In its Memorandum in Support of Defendant's Motion for Partial Summary Judgment Elmwood stated, under the heading of "Statements of Undisputed Facts," that "for each of the three orders, Ionics received the Acknowledgment prior to receiving the shipment of thermostats." In its own memorandum, Ionics argued that there existed disputed issues of material fact, but did not contradict Elmwood's claim regarding the arrival of the Acknowledgment Form. Furthermore, in its appellate brief, Ionics does not argue that the time of arrival of the Acknowledgment Form is in dispute. Ionics repeats language from the district court's summary judgment ruling that "with each shipment of thermostats, Elmwood included an Acknowledgment Form," but does not argue that the issue is in dispute or confront the language in Elmwood's brief which states that "[i]t is undisputed that for each of the three orders, Ionics received the Acknowledgment prior to receiving the shipment of thermostats."

[8] As we have noted, the Acknowledgment Form expressed Elmwood's willingness to sell thermostats on "terms and conditions" that the Form indicated were listed on the reverse side. Among the terms and conditions listed on the back was the following:

WARRANTY. All goods manufactured by Elmwood Sensors, Inc. are guaranteed to be free of defects in material and workmanship for a period of ninety (90) days after receipt of such goods by Buyer or eighteen months from the date of manufacturer [sic] (as evidenced by the manufacturer's date code), whichever shall be longer. THERE IS NO IMPLIED WARRANTY OF MERCHANTABILITY AND NO OTHER WARRANTY, EXPRESSED OR IMPLIED, EXCEPT SUCH AS IS EXPRESSLY SET FORTH HEREIN. SELLER WILL NOT BE LIABLE FOR ANY GENERAL,

CONSEQUENTIAL OR INCIDENTAL DAMAGES, INCLUDING WITHOUT LIMITATION ANY DAMAGES FROM LOSS OF PROFITS, FROM ANY BREACH OF WARRANTY OR FOR NEGLIGENCE, SELLER'S LIABILITY AND BUYER'S EXCLUSIVE REMEDY BEING EXPRESSLY LIMITED TO THE REPAIR OF DEFECTIVE GOODS F.O.B. THE SHIPPING POINT INDICATED ON THE FACE HEREOF OR THE REPAYMENT OF THE PURCHASE PRICE UPON THE RETURN OF THE GOODS OR THE GRANTING OF A REASONABLE ALLOWANCE ON ACCOUNT OF ANY DEFECTS, AS SELLER MAY ELECT.

[9] Neither party disputes that they entered into a valid contract and neither disputes the quantity of thermostats purchased, the price paid, or the manner and time of delivery. The only issue in dispute is the extent of Elmwood's liability.

[10] In summary, Ionics' order included language stating that the contract would be governed exclusively by the terms included on the purchase order and that all remedies available under state law would be available to Ionics. In a subsequent letter, Ionics added that Elmwood must indicate any objections to these conditions in writing. Elmwood, in turn, sent Ionics an Acknowledgment stating that the contract was governed exclusively by the terms in the Acknowledgment, and Ionics was given ten days to reject this "counteroffer." Among the terms included in the Acknowledgment is a limitation on Elmwood's liability. As the district court stated, "the terms are diametrically opposed to each other on the issue of whether all warranties implied by law were reserved or waived."

[11] We face, therefore, a battle of the forms. This is purely a question of law. The dispute turns on whether the contract is

governed by the language after the comma in § 2-207(1) of the Uniform Commercial Code, according to the rule laid down by this court in *Roto-Lith, Ltd. v. F.P. Bartlett & Co.*, 297 F.2d 497 (1st Cir.1962), or whether it is governed by subsection (3) of the Code provision, as enacted by both Massachusetts, Mass. Gen. L. ch. 106, § 2-207 (1990 and 1996 Supp.), and Rhode Island, R.I. Gen. Laws § 6A-2-207 (1992).² We find the rule of *Roto-Lith* to be in conflict with the purposes of section 2-207 and, accordingly, we overrule *Roto-Lith* and find that subsection (3) governs the contract.³ Analyzing the case under section 2-207, we conclude that Ionics defeats Elmwood's motion for partial summary judgment.

III. Legal Analysis

[12]Our analysis begins with the statute. Section 2-207 reads as follows:

§ 2-207. Additional Terms in Acceptance or Confirmation

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms

² There is some uncertainty on the question of whether Massachusetts or Rhode Island law governs. We need not address this issue, however, because the two states have adopted versions of section 2-207 of the Uniform Commercial Code that are virtually equivalent.

³ Although panel decisions of this court are ordinarily binding on newly constituted panels, that rule does not obtain in instances where, as here, a departure is compelled by controlling authority (such as the interpreted statute itself). In such relatively rare instances, we have sometimes chosen to circulate the proposed overruling opinion to all active members of the court prior to publication even though the need to overrule precedent is reasonably clear. *See, e.g., Wright v. Park*, 5 F.3d 586, 591 n. 7 (1st Cir.1993); *Trailer Marine Transport Corp. v. Rivera Vazquez*, 977 F.2d 1, 9 n. 5 (1st Cir.1992). This procedure is, of course, informal, and does not preclude a suggestion of rehearing en banc on any issue. We have followed that praxis here and can report that none of the active judges of this court has objected to the panel's analysis or to its conclusion that *Roto-Lith* has outlived its usefulness as circuit precedent.

additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional or different terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this chapter.

Mass. Gen. L. ch. 106, § 2-207 (1990 and 1996 Supp.).

[13]In *Roto-Lith*, Roto-Lith sent a purchase order to Bartlett, who responded with an acknowledgment that included language purporting to limit Bartlett's liability. Roto-Lith did not object. *Roto-Lith*, 297 F.2d at 498-99. This court held that “a response which states a condition materially altering the obligation solely to the disadvantage of the offeror is an ‘acceptance...expressly...conditional on assent to the additional...terms.’ ” *Id.* at 500. This holding took the case outside of section 2-207 by applying the exception after the comma in subsection (1). The court then reverted to

common law and concluded that Roto-Lith “accepted the goods with knowledge of the conditions specified in the acknowledgment [and thereby] became bound.” *Id.* at 500. In other words, the *Roto-Lith* court concluded that the defendant's acceptance was conditional on assent, by the buyer, to the new terms and, therefore, constituted a counter offer rather than an acceptance. When Roto-Lith accepted the goods with knowledge of Bartlett's conditions, it accepted the counteroffer and Bartlett's terms governed the contract. Elmwood argues that *Roto-Lith* governs the instant appeal, implying that the terms of Elmwood's acknowledgment govern.

[14]Ionics claims that the instant case is distinguishable because in *Roto-Lith* “the seller's language limiting warranties implied at law was proposed as an addition to, but was not in conflict with, the explicit terms of the buyer's form. [In the instant case] the explicit terms of the parties' forms conflict with and reject each other.” Appellee's Brief at 21.

[15]We do not believe that Ionics' position sufficiently distinguishes *Roto-Lith*. It would be artificial to enforce language that conflicts with background legal rules while refusing to enforce language that conflicts with the express terms of the contract. Every contract is assumed to incorporate the existing legal norms that are in place. It is not required that every contract explicitly spell out the governing law of the jurisdiction. Allowing later forms to govern with respect to deviations from the background rules but not deviations from the terms in the contract would imply that only the terms in the contract could be relied upon. Aside from being an artificial and arbitrary distinction, such a standard would, no doubt, lead parties to include more of the background rules in their initial forms, making forms longer and more complicated. Longer forms would be more difficult and time consuming to read-implying that even fewer forms would be read than under the existing rules. It is the failure of firms to read their forms that has brought this case before us,

and we do not wish to engender more of this type of litigation.

[16]Our inquiry, however, is not complete. Having found that we cannot distinguish this case from *Roto-Lith*, we turn to the Uniform Commercial Code, quoted above. A plain language reading of section 2-207 suggests that subsection (3) governs the instant case. Ionics sent an initial offer to which Elmwood responded with its “Acknowledgment.” Thereafter, the conduct of the parties established the existence of a contract as required by section 2-207(3).

[17]Furthermore, the case before us is squarely addressed in comment 6, which states:

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict, each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result, the requirement that there be notice of objection which is found in subsection (2) [of § 2-207] is satisfied and the conflicting terms do not become part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act.

Mass. Gen. L. ch. 106, § 2-207, Uniform Commercial Code Comment 6. This Comment addresses precisely the facts of the instant case. Any attempt at distinguishing the case before us from section 2-207 strikes us as disingenuous.

[18]We are faced, therefore, with a contradiction between a clear precedent of this court, *Roto-Lith*, which suggests that the language after the comma in subsection (1) governs, and the clear dictates of the Uniform Commercial Code, which

indicate that subsection (3) governs. It is our view that the two cannot coexist and the case at bar offers a graphic illustration of the conflict. We have, therefore, no choice but to overrule our previous decision in *Roto-Lith, Ltd. v. F.P. Bartlett & Co.*, 297 F.2d 497 (1st Cir.1962). Our decision brings this circuit in line with the majority view on the subject and puts to rest a case that has provoked considerable criticism from courts and commentators and alike.⁴

[19]We hold, consistent with section 2-207 and Official Comment 6, that where the terms in two forms are contradictory, each party is assumed to object to the other party's conflicting clause. As a result, mere acceptance of the goods by the buyer is insufficient to infer consent to the seller's terms under the language of subsection (1).⁵ Nor do such terms become part of the contract under subsection (2) because notification of objection has been given by the conflicting forms. *See* § 2-207(2)(c).

[20]The alternative result, advocated by Elmwood and consistent with *Roto-Lith*, would undermine the role of section 2-207. Elmwood suggests that “a seller's expressly conditional acknowledgment constitutes a counteroffer where it materially alters the terms proposed by the buyer, and the seller's terms govern the contract between the parties when the buyer accepts and pays for the goods.” Appellant's Brief at 12. Under this view, section 2-207 would no longer apply to cases in which forms have been exchanged and subsequent

⁴ See, e.g., *Step-Saver Data Systems, Inc. v. Wyse Technology*, 939 F.2d 91, 101 (3d Cir.1991); *St. Charles Cable TV, Inc. v. Eagle Comtronics, Inc.*, 687 F.Supp. 820, 828 & n. 19 (S.D.N.Y.1988); *Daitom v. Pennwalt Corp.*, 741 F.2d 1569, 1576-77 (10th Cir.1984); *Luria Bros. v. Piolet Bros. Scrap Iron & Metal*, 600 F.2d 103, 113 (7th Cir.1979); *Dorton v. Collins & Aikman Corp.*, 453 F.2d 1161, 1168 & n. 5 (6th Cir.1972); ; JAMES J. WHITE & ROBERT S. SUMMERS, 1 UNIFORM COMMERCIAL CODE, § 1-3, at 12, 16-17 (1995); Murray, *Intention over Terms: An Exploration of UCC 2-207 & New Section 60*, *Restatement of Contracts*, 37 *FORDHAM L. REV.* 317, 329 (1969).

⁵ *See also* Official Comment 3 (“If [additional or different terms] are such as materially to alter the original bargain, they will not be included unless expressly agreed to by the other party.”).

disputes reveal that the forms are contradictory. That is, the last form would always govern.

[21]The purpose of section 2-207, as stated in *Roto-Lith*, “was to modify the strict principle that a response not precisely in accordance with the offer was a rejection and a counteroffer.” *Roto-Lith*, 297 F.2d at 500; *see also Dorton v. Collins & Aikman Corp.*, 453 F.2d 1161, 1165-66 (6th Cir.1972) (stating that section 2-207 “was intended to alter the ‘ribbon-matching’ or ‘mirror’ rule of common law, under which the terms of an acceptance or confirmation were required to be identical to the terms of the offer”). Under the holding advocated by Elmwood, virtually any response that added to or altered the terms of the offer would be a rejection and a counteroffer. We do not think that such a result is consistent with the intent of section 2-207 and we believe it to be expressly contradicted by Comment 6.

[22]Applied to this case, our holding leads to the conclusion that the contract is governed by section 2-207(3). Section 2-207(1) is inapplicable because Elmwood's acknowledgment is conditional on assent to the additional terms. The additional terms do not become a part of the contract under section 2-207(2) because notification of objection to conflicting terms was given on the order form and because the new terms materially alter those in the offer. Finally, the conduct of the parties demonstrates the existence of a contract, as required by section 2-207(3). Thus, section 2-207(3) applies and the terms of the contract are to be determined in accordance with that subsection.

[23]We conclude, therefore, that section 2-207(3) prevails and “the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this chapter.” Mass. Gen. L. ch. 106, § 2-207(3).

[24]The reality of modern commercial dealings, as this case demonstrates, is that not all participants read their forms. *See*

James J. White & Robert S. Summers, *Uniform Commercial Code* § 1-3 at 6-7 (4th ed.1995). To uphold Elmwood's view would not only fly in the face of Official Comment 6 to section 2-207 of the Uniform Commercial Code, and the overall purpose of that section, it would also fly in the face of good sense. The sender of the last form (in the instant case, the seller) could insert virtually any conditions it chooses into the contract, including conditions contrary to those in the initial form. The final form, therefore, would give its sender the power to re-write the contract. Under our holding today, we at least ensure that a party will not be held to terms that are directly contrary to the terms it has included in its own form. Rather than assuming that a failure to object to the offeree's conflicting terms indicates offeror's assent to those terms, we shall make the more reasonable inference that each party continues to object to the other's contradictory terms. We think it too much to grant the second form the power to contradict and override the terms in the first form.

IV. Conclusion

[25]For the reasons stated herein, the district court's order denying Elmwood's motion for partial summary judgment is *affirmed* and the case is *remanded* to the district court for further proceedings.

4.1.1 The Text of U.C.C. § 2-207

Uniform Commercial Code § 2-207 is one of the most intricate and (arguably) poorly drafted provisions of the code. Here is the current version of the section. Students should also review Official Comments 1-7 from an outside source.

§ 2-207. Additional Terms in Acceptance or Confirmation

- (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered

or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this act.

4.1.2 Additional and Different Terms Under § 2-207

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

Courts have taken three divergent approaches to this question... . In brief the first approach treats “different” terms as a subgroup of

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

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

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

4.1.3 Discussion of Ionics v. Elmwood Sensors, Inc.

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

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

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

5. Frontiers of Contract Formation

When parties negotiate face to face and memorialize their agreement in a signed writing, courts have little difficulty with the issue of contract formation. The previous sections have introduced a variety of complications. In each case, the parties’ communications were incomplete, contradictory, or inconclusive in some significant way. In this final section, we examine cases at the very frontier of traditional notions of contract formation. How should courts respond to so-called “shrink-wrap” or “click-wrap” licenses that purport to bind purchasers when they open a package or click through an online web purchase form? What should courts do to regulate the timing of contract formation? Are sellers free to structure transactions so that the contract is formed and its terms determined some days or weeks after delivery?

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

5.1 Principal Case – Step-Saver Data Systems, Inc. v. Wyse Technology, Inc.

Step-Saver Data Systems, Inc. v. Wyse Technology, Inc.

United States Court of Appeals, Third Circuit
939 F.2d 91 (1991)

WISDOM, Circuit Judge

[1] The “Limited Use License Agreement” printed on a package containing a copy of a computer program raises the central issue in this appeal. The trial judge held that the terms of the Limited Use License Agreement governed the purchase of the package, and, therefore, granted the software producer, The Software Link, Inc. (“TSL”), a directed verdict on claims of breach of warranty brought by a disgruntled purchaser, Step-Saver Data Systems, Inc. We disagree with the district court's determination of the legal effect of the license, and reverse and remand the warranty claims for further consideration.

[2] Step-Saver raises several other issues, but we do not find these issues warrant reversal. We, therefore, affirm in all other respects.

I. FACTUAL AND PROCEDURAL BACKGROUND

[3] The growth in the variety of computer hardware and software has created a strong market for these products. It has also created a difficult choice for consumers, as they must somehow decide which of the many available products will best suit their needs. To assist consumers in this decision process, some companies will evaluate the needs of particular groups of potential computer users, compare those needs with the available technology, and develop a package of hardware and software to satisfy those needs. Beginning in 1981, Step-Saver performed this function as a value added retailer for International Business Machine (IBM) products. It would combine hardware and software to satisfy the word processing, data management, and communications needs for offices of physicians and lawyers. It originally marketed single computer systems, based primarily on the IBM personal computer.

[4] As a result of advances in micro-computer technology, Step-Saver developed and marketed a multi-user system. With a multi-user system, only one computer is required. Terminals are attached, by cable, to the main computer. From these

terminals, a user can access the programs available on the main computer.¹

[5] After evaluating the available technology, Step-Saver selected a program by TSL, entitled Multilink Advanced, as the operating system for the multi-user system. Step-Saver selected WY-60 terminals manufactured by Wyse, and used an IBM AT as the main computer. For applications software, Step-Saver included in the package several off-the-shelf programs, designed to run under Microsoft's Disk Operating System ("MS-DOS"),² as well as several programs written by Step-Saver. Step-Saver began marketing the system in November of 1986, and sold one hundred forty-two systems mostly to law and medical offices before terminating sales of the system in March of 1987. Almost immediately upon installation of the system, Step-Saver began to receive complaints from some of its customers.³

[6] Step-Saver, in addition to conducting its own investigation of the problems, referred these complaints to Wyse and TSL, and requested technical assistance in resolving the problems. After several preliminary attempts to address the problems, the three companies were unable to reach a satisfactory solution, and disputes developed among the three

¹ In essence, the terminals are simply video screens with keyboards that serve as input-output devices for the main computer. The main computer receives data from all of the terminals and processes it appropriately, sending a return signal to the terminal. To someone working on one of the terminals of a properly operating multi-user system, the terminal appears to function as if it were, in fact, a computer. Thus, an operator could work with a word processing program on a terminal, and it would appear to the operator the same as would working with the word processing program on a computer. The difference is that, with a set of computers, the commands of each user are processed within each user's computer, whereas with a multi-user system, the commands of all of the users are sent to the main computer for processing.

² MS-DOS was the standard operating system for IBM and compatible personal computers.

³ According to the testimony of Jeffrey Worthington, an employee of Step-Saver, twenty to twenty-five of the purchasers of the multi-user system had serious problems with the system that were never resolved.

concerning responsibility for the problems. As a result, the problems were never solved. At least twelve of Step-Saver's customers filed suit against Step-Saver because of the problems with the multi-user system.

[7] Once it became apparent that the three companies would not be able to resolve their dispute amicably, Step-Saver filed suit for declaratory judgment, seeking indemnity from either Wyse or TSL, or both, for any costs incurred by Step-Saver in defending and resolving the customers' law suits. The district court dismissed this complaint, finding that the issue was not ripe for judicial resolution. We affirmed the dismissal on appeal.⁴ Step-Saver then filed a second complaint alleging breach of warranties by both TSL and Wyse and intentional misrepresentations by TSL.⁵ The district court's actions during the resolution of this second complaint provide the foundation for this appeal.

[8] On the first day of trial, the district court specifically agreed with the basic contention of TSL that the form language printed on each package containing the Multilink Advanced program ("the box-top license") was the complete and exclusive agreement between Step-Saver and TSL under § 2-202 of the Uniform Commercial Code (UCC).⁶ Based on § 2-316 of the UCC, the district court held that the box-top license disclaimed all express and implied warranties otherwise made by TSL. The court therefore granted TSL's

⁴ See *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 912 F.2d 643 (3d Cir.1990).

⁵ Step-Saver also advanced claims under negligent misrepresentation and breach of contract theories. Step-Saver does not appeal these claims.

⁶ All three parties agree that the terminals and the program are "goods" within the meaning of UCC §§ 2-102 & 2-105. *Cf. Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 674-76 (3d Cir.1991). TSL and Step-Saver have disputed whether Pennsylvania or Georgia law governs the issues of contract formation and modification with regard to the Multilink programs. Because both Pennsylvania and Georgia have adopted, without modification, the relevant portions of Article 2 of the Uniform Commercial Code, *see* Ga. Code Ann. §§ 11-2-101 to 11-2-725 (1990); 13 Pa. Cons. Stat. Ann. §§ 2101-2725 (Purdon 1984), we will simply cite to the relevant UCC provision.

motion in limine to exclude all evidence of the earlier oral and written express warranties allegedly made by TSL. After Step-Saver presented its case, the district court granted a directed verdict in favor of TSL on the intentional misrepresentation claim, holding the evidence insufficient as a matter of law to establish two of the five elements of a prima facie case: (1) fraudulent intent on the part of TSL in making the representations; and (2) reasonable reliance by Step-Saver. The trial judge requested briefing on several issues related to Step-Saver's remaining express warranty claim against TSL. While TSL and Step-Saver prepared briefs on these issues, the trial court permitted Wyse to proceed with its defense. On the third day of Wyse's defense, the trial judge, after considering the additional briefing by Step-Saver and TSL, directed a verdict in favor of TSL on Step-Saver's remaining warranty claims, and dismissed TSL from the case.

[9] The trial proceeded on Step-Saver's breach of warranties claims against Wyse. At the conclusion of Wyse's evidence, the district judge denied Step-Saver's request for rebuttal testimony on the issue of the ordinary uses of the WY-60 terminal. The district court instructed the jury on the issues of express warranty and implied warranty of fitness for a particular purpose. Over Step-Saver's objection, the district court found insufficient evidence to support a finding that Wyse had breached its implied warranty of merchantability, and refused to instruct the jury on such warranty. The jury returned a verdict in favor of Wyse on the two warranty issues submitted.

[10] Step-Saver appeals on four points. (1) Step-Saver and TSL did not intend the box-top license to be a complete and final expression of the terms of their agreement. (2) There was sufficient evidence to support each element of Step-Saver's contention that TSL was guilty of intentional misrepresentation. (3) There was sufficient evidence to submit Step-Saver's implied warranty of merchantability claim against Wyse to the jury. (4) The trial court abused its

discretion by excluding from the evidence a letter addressed to Step-Saver from Wyse, and by refusing to permit Step-Saver to introduce rebuttal testimony on the ordinary uses of the WY-60 terminal.

II. THE EFFECT OF THE BOX-TOP LICENSE

[11]The relationship between Step-Saver and TSL began in the fall of 1984 when Step-Saver asked TSL for information on an early version of the Multilink program. TSL provided Step-Saver with a copy of the early program, known simply as Multilink, without charge to permit Step-Saver to test the program to see what it could accomplish. Step-Saver performed some tests with the early program, but did not market a system based on it.

[12]In the summer of 1985, Step-Saver noticed some advertisements in Byte magazine for a more powerful version of the Multilink program, known as Multilink Advanced. Step-Saver requested information from TSL concerning this new version of the program, and allegedly was assured by sales representatives that the new version was compatible with ninety percent of the programs available “off-the-shelf” for computers using MS-DOS. The sales representatives allegedly made a number of additional specific representations of fact concerning the capabilities of the Multilink Advanced program.

[13]Based on these representations, Step-Saver obtained several copies of the Multilink Advanced program in the spring of 1986, and conducted tests with the program. After these tests, Step-Saver decided to market a multi-user system which used the Multilink Advanced program. From August of 1986 through March of 1987, Step-Saver purchased and resold 142 copies of the Multilink Advanced program. Step-Saver would typically purchase copies of the program in the following manner. First, Step-Saver would telephone TSL and place an order. (Step-Saver would typically order twenty copies of the program at a time.) TSL would accept the order

and promise, while on the telephone, to ship the goods promptly. After the telephone order, Step-Saver would send a purchase order, detailing the items to be purchased, their price, and shipping and payment terms. TSL would ship the order promptly, along with an invoice. The invoice would contain terms essentially identical with those on Step-Saver's purchase order: price, quantity, and shipping and payment terms. No reference was made during the telephone calls, or on either the purchase orders or the invoices with regard to a disclaimer of any warranties.

[14]Printed on the package of each copy of the program, however, would be a copy of the box-top license. The box-top license contains five terms relevant to this action:

- (1) The box-top license provides that the customer has not purchased the software

itself, but has merely obtained a personal, non-transferable license to use the program.⁷

⁷ When these form licenses were first developed for software, it was, in large part, to avoid the federal copyright law first sale doctrine. Under the first sale doctrine, once the copyright holder has sold a copy of the copyrighted work, the owner of the copy could “sell or otherwise dispose of the possession of that copy” without the copyright holder's consent. *See Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350, 28 S.Ct. 722, 726, 52 L.Ed. 1086 (1908); 17 U.S.C.A. § 109(a) (West 1977). Under this doctrine, one could purchase a copy of a computer program, and then lease it or lend it to another without infringing the copyright on the program. Because of the ease of copying software, software producers were justifiably concerned that companies would spring up that would purchase copies of various programs and then lease those to consumers. Typically, the companies, like a videotape rental store, would purchase a number of copies of each program, and then make them available for over-night rental to consumers. Consumers, instead of purchasing their own copy of the program, would simply rent a copy of the program, and duplicate it. This copying by the individual consumers would presumably infringe the copyright, but usually it would be far too expensive for the copyright holder to identify and sue each individual copier. Thus, software producers wanted to sue the companies that were renting the copies of the program to individual consumers, rather than the individual consumers. The first sale doctrine, though, stood as a substantial barrier to successful suit against these software rental companies, even under a theory of contributory infringement. By characterizing the original transaction between the software producer and the software rental company as a license, rather than a sale, and by making the license personal and non-transferable, software producers hoped to avoid the reach of the first sale doctrine and to establish a basis in state contract law for suing the software rental companies directly. Questions remained, however, as to whether the use of state contract law to avoid the first sale doctrine would be preempted either by the federal copyright statute (statutory preemption) or by the exclusive constitutional grant of authority over copyright issues to the federal government (constitutional preemption). *See generally Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989); *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 94 S.Ct. 1879, 40 L.Ed.2d 315 (1974); *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234, 84 S.Ct. 779, 11 L.Ed.2d 669 (1964); *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 84 S.Ct. 784, 11 L.Ed.2d 661 (1964). Congress recognized the problem, and, in 1990, amended the first sale doctrine as it applies to computer programs and phonorecords. *See Computer Software Rental Amendments Act of 1990*, Pub.L. No. 101-650, 104 Stat. 5134 (codified at 17 U.S.C.A. § 109(b) (West Supp.1991)). As amended, the first sale doctrine permits only non-profit libraries and educational institutions to lend or lease copies of software and phonorecords. *See* 17 U.S.C.A. § 109(b)(1)(A) (West Supp.1991). (Under the amended statute, a purchaser of a copy of a copyrighted computer program may still sell his copy to another without the consent of the copyright holder.) This amendment renders the need to characterize the original transaction as a license largely anachronistic. While these transactions took place in 1986-87, before the Computer Software Rental Amendments were enacted, there was no need to characterize the transactions between Step-Saver and TSL as a license to avoid the first sale

(2) The box-top license, in detail and at some length, disclaims all express and implied warranties except for a warranty that the disks contained in the box are free from defects.

(3) The box-top license provides that the sole remedy available to a purchaser of the program is to return a defective disk for replacement; the license excludes any liability for damages, direct or consequential, caused by the use of the program.

(4) The box-top license contains an integration clause, which provides that the box-top license is the final and complete expression of the terms of the parties' agreement.

(5) The box-top license states: "Opening this package indicates your acceptance of these terms and conditions. If you do not agree with them, you should promptly return the package unopened to the person from whom you purchased it within fifteen days from date of purchase and your money will be refunded to you by that person."

[15]The district court, without much discussion, held, as a matter of law, that the box-top license was the final and complete expression of the terms of the parties's agreement. Because the district court decided the questions of contract formation and interpretation as issues of law, we review the district court's resolution of these questions *de novo*.⁸

[16]Step-Saver contends that the contract for each copy of the program was formed when TSL agreed, on the telephone,

doctrine because both Step-Saver and TSL agree that Step-Saver had the right to resell the copies of the Multilink Advanced program.

⁸ See *Diamond Fruit Growers, Inc. v. Krack Corp.*, 794 F.2d 1440, 1442 (9th Cir.1986).

to ship the copy at the agreed price.⁹ The box-top license, argues Step-Saver, was a material alteration to the parties' contract which did not become a part of the contract under UCC § 2-207.¹⁰ Alternatively, Step-Saver argues that the undisputed evidence establishes that the parties did not intend the box-top license as a final and complete expression

⁹ See UCC § 2-206(1)(b) and comment 2. Note that under UCC § 2-201, the oral contract would not be enforceable in the absence of a writing or part performance because each order typically involved more than \$500 in goods. However, courts have typically treated the questions of formation and interpretation as separate from the question of when the contract becomes enforceable. See, e.g., *C. Itoh & Co. v. Jordan Int'l Co.*, 552 F.2d 1228, 1232-33 (7th Cir.1977); *Southeastern Adhesives Co. v. Funder America*, 89 N.C.App. 438, 366 S.E.2d 505, 507-08 (N.C.Ct.App.1988); *United Coal & Commodities Co. v. Hawley Fuel Coal, Inc.*, 363 Pa.Super. 106, 525 A.2d 741, 743 (Pa.Super.Ct.), *app. denied*, 517 Pa. 609, 536 A.2d 1333 (1987).

¹⁰ Section 2-207 provides:

Additional Terms in Acceptance or Confirmation.

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of the Act.

of the terms of their agreement, and, therefore, the parol evidence rule of UCC § 2-202 would not apply.¹¹

[17]TSL argues that the contract between TSL and Step-Saver did not come into existence until Step-Saver received the program, saw the terms of the license, and opened the program packaging. TSL contends that too many material terms were omitted from the telephone discussion for that discussion to establish a contract for the software. Second, TSL contends that its acceptance of Step-Saver's telephone offer was conditioned on Step-Saver's acceptance of the terms of the box-top license. Therefore, TSL argues, it did not accept Step-Saver's telephone offer, but made a counteroffer represented by the terms of the box-top license, which was accepted when Step-Saver opened each package. Third, TSL argues that, however the contract was formed, Step-Saver was aware of the warranty disclaimer, and that Step-Saver, by continuing to order and accept the product with knowledge of the disclaimer, assented to the disclaimer.

[18]In analyzing these competing arguments, we first consider whether the license should be treated as an integrated writing under UCC § 2-202, as a proposed modification under UCC § 2-209, or as a written confirmation under UCC § 2-207. Finding that UCC § 2-207 best governs our resolution of the effect of the box-top license, we then consider whether, under UCC § 2-207, the terms of the box-top license were incorporated into the parties's agreement.

A. Does UCC § 2-207 Govern the Analysis?

¹¹ Two other issues were raised by Step-Saver. First, Step-Saver argued that the box-top disclaimer is either unconscionable or not in good faith. Second, Step-Saver argued that the warranty disclaimer was inconsistent with the express warranties made by TSL in the product specifications. Step-Saver argues that interpreting the form language of the license agreement to override the specific warranties contained in the product specification is unreasonable, citing *Consolidated Data Terminals v. Applied Digital Data Sys.*, 708 F.2d 385 (9th Cir.1983). See also *Northern States Power Co. v. IIT Meyer Indus.*, 777 F.2d 405 (8th Cir.1985). Because of our holding that the terms of the box-top license were not incorporated into the contract, we do not address these issues.

[19]As a basic principle, we agree with Step-Saver that UCC § 2-207 governs our analysis. We see no need to parse the parties's various actions to decide exactly when the parties formed a contract. TSL has shipped the product, and Step-Saver has accepted and paid for each copy of the program. The parties's performance demonstrates the existence of a contract. The dispute is, therefore, not over the existence of a contract, but the nature of its terms.¹² When the parties' conduct establishes a contract, but the parties have failed to adopt expressly a particular writing as the terms of their agreement, and the writings exchanged by the parties do not agree, UCC § 2-207 determines the terms of the contract.

As stated by the official comment to § 2-207:

1. This section is intended to deal with two typical situations. The one is the written confirmation, where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or more of the parties sending formal memoranda embodying the terms so far as agreed upon and adding terms not discussed....

2. Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained in the confirmation or in the acceptance falls within subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional or different terms.

[20]Although UCC § 2-202 permits the parties to reduce an oral agreement to writing, and UCC § 2-209 permits the parties to modify an existing contract without additional

¹² See *McJunkin Corp. v. Mechanicals, Inc.*, 888 F.2d 481, 488 (6th Cir.1989).

consideration, a writing will be a final expression of, or a binding modification to, an earlier agreement only if the parties so intend.¹³ It is undisputed that Step-Saver never expressly agreed to the terms of the box-top license, either as a final expression of, or a modification to, the parties's agreement. In fact, Barry Greebel, the President of Step-Saver, testified without dispute that he objected to the terms of the box-top license as applied to Step-Saver. In the absence of evidence demonstrating an express intent to adopt a writing as a final expression of, or a modification to, an earlier agreement, we find UCC § 2-207 to provide the appropriate legal rules for determining whether such an intent can be inferred from continuing with the contract after receiving a writing containing additional or different terms.¹⁴

[21]To understand why the terms of the license should be considered under § 2-207 in this case, we review briefly the reasons behind § 2-207. Under the common law of sales, and to some extent still for contracts outside the UCC,¹⁵ an acceptance that varied any term of the offer operated as a rejection of the offer, and simultaneously made a counteroffer.¹⁶ This common law formality was known as the mirror image rule, because the terms of the acceptance had to mirror the terms of the offer to be effective.¹⁷ If the offeror proceeded with the contract despite the differing terms of the supposed acceptance, he would, by his performance, constructively accept the terms of the “counteroffer”, and be

¹³ See, e.g., *Sierra Diesel Injection Serv., Inc. v. Burroughs Corp.*, 890 F.2d 108, 112-13 (9th Cir.1989) (UCC § 2-202). By its terms, UCC § 2-209 extends only to “[a]n agreement to modify”.

¹⁴ See *Mead Corp. v. McNally-Pittsburgh Mfg. Corp.*, 654 F.2d 1197, 1206 (6th Cir.1981).

¹⁵ See, e.g., *Learning Works, Inc. v. Learning Annex, Inc.*, 830 F.2d 541, 543 (4th Cir.1987).

¹⁶ See, e.g., *Diamond Fruit Growers, Inc.*, 794 F.2d at 1443; J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code*, § 1-2 at 34 (2d ed. 1980).

¹⁷ See, e.g., *Daitom, Inc. v. Pennwalt Corp.*, 741 F.2d 1569, 1578 (10th Cir.1984).

bound by its terms. As a result of these rules, the terms of the party who sent the last form, typically the seller, would become the terms of the parties's contract. This result was known as the “last shot rule”.

[22]The UCC, in § 2-207, rejected this approach. Instead, it recognized that, while a party may desire the terms detailed in its form if a dispute, in fact, arises, most parties do not expect a dispute to arise when they first enter into a contract. As a result, most parties will proceed with the transaction even if they know that the terms of their form would not be enforced.¹⁸ The insight behind the rejection of the last shot rule is that it would be unfair to bind the buyer of goods to the standard terms of the seller, when neither party cared sufficiently to establish expressly the terms of their agreement, simply because the seller sent the last form. Thus, UCC § 2-207 establishes a legal rule that proceeding with a contract after receiving a writing that purports to define the terms of the parties's contract is not sufficient to establish the party's consent to the terms of the writing to the extent that the terms of the writing either add to, or differ from, the terms detailed in the parties's earlier writings or discussions.¹⁹In the absence of a party's express assent to the

¹⁸ As Judge Engel has written:

Usually, these standard terms mean little, for a contract looks to its fulfillment and rarely anticipates its breach. Hope springs eternal in the commercial world and expectations are usually, but not always, realized.

McJunkin Corp. v. Mechanicals, Inc., 888 F.2d at 482.

¹⁹ As the *Mead* Court explained:

Absent the [UCC], questions of contract formation and intent remain factual issues to be resolved by the trier of fact after careful review of the evidence. However, the [UCC] provides rules of law, and section 2-207 establishes important legal principles to be employed to resolve complex contract disputes arising from the exchange of business forms. Section 2-207 was intended to provide some degree of certainty in this otherwise ambiguous area of contract law. In our view, it is unreasonable and contrary to the policy behind the

additional or different terms of the writing, section 2-207 provides a default rule that the parties intended, as the terms of their agreement, those terms to which both parties have agreed,²⁰ along with any terms implied by the provisions of the UCC.

[23]The reasons that led to the rejection of the last shot rule, and the adoption of section 2-207, apply fully in this case. TSL never mentioned during the parties' negotiations leading to the purchase of the programs, nor did it, at any time, obtain Step-Saver's express assent to, the terms of the box-top license. Instead, TSL contented itself with attaching the terms to the packaging of the software, even though those terms differed substantially from those previously discussed by the parties. Thus, the box-top license, in this case, is best seen as one more form in a battle of forms, and the question of whether Step-Saver has agreed to be bound by the terms of the box-top license is best resolved by applying the legal principles detailed in section 2-207.

B. Application of § 2-207

[24]TSL advances several reasons why the terms of the box-top license should be incorporated into the parties' agreement under a § 2-207 analysis. First, TSL argues that the parties' contract was not formed until Step-Saver received the package, saw the terms of the box-top license, and opened the package, thereby consenting to the terms of the license. TSL argues that a contract defined without reference to the specific terms provided by the box-top license would necessarily fail for indefiniteness. Second, TSL argues that the box-top license was a conditional acceptance and counter-

[UCC] merely to turn the issue over to the uninformed speculation of the jury left to apply its own particular sense of equity.

Mead Corp., 654 F.2d at 1206 (citations omitted).

²⁰ The parties may demonstrate their acceptance of a particular term either “orally or by informal correspondence”, UCC 2-207, comment 1, or by placing the term in their respective form.

offer under § 2-207(1). Third, TSL argues that Step-Saver, by continuing to order and use the product with notice of the terms of the box-top license, consented to the terms of the box-top license.

1. Was the contract sufficiently definite?

[25]TSL argues that the parties intended to license the copies of the program, and that several critical terms could only be determined by referring to the box-top license. Pressing the point, TSL argues that it is impossible to tell, without referring to the box-top license, whether the parties intended a sale of a copy of the program or a license to use a copy. TSL cites *Bethlehem Steel Corp. v. Litton Industries* in support of its position that any contract defined without reference to the terms of the box-top license would fail for indefiniteness.²¹

[26]From the evidence, it appears that the following terms, at the least, were discussed and agreed to, apart from the box-top license: (1) the specific goods involved; (2) the quantity; and (3) the price. TSL argues that the following terms were only defined in the box-top license: (1) the nature of the transaction, sale or license; and (2) the warranties, if any, available. TSL argues that these two terms are essential to creating a sufficiently definite contract. We disagree.

Section 2-204(3) of the UCC provides:

Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

[27]Unlike the terms omitted by the parties in *Bethlehem Steel Corp.*, the two terms cited by TSL are not “gaping holes in a multi-million dollar contract that no one but the parties themselves could fill.”²² First, the rights of the respective

²¹ 488 A.2d 581 (Pa. 1985).

²² 488 A.2d at 591.

parties under the federal copyright law if the transaction is characterized as a sale of a copy of the program are nearly identical to the parties's respective rights under the terms of the box-top license.²³ Second, the UCC provides for express and implied warranties if the seller fails to disclaim expressly those warranties.²⁴ Thus, even though warranties are an important term left blank by the parties, the default rules of the UCC fill in that blank.

[28] We hold that contract was sufficiently definite without the terms provided by the box-top license.²⁵

2. The box-top license as a counter-offer?

[29] TSL advances two reasons why its box-top license should be considered a conditional acceptance under UCC § 2-207(1). First, TSL argues that the express language of the box-top license, including the integration clause and the phrase “opening this product indicates your acceptance of these terms”, made TSL's acceptance “expressly conditional on assent to the additional or different terms”.²⁶ Second, TSL argues that the box-top license, by permitting return of the product within fifteen days if the purchaser²⁷ does not agree to the terms stated in the license (the “refund offer”), establishes that TSL's acceptance was conditioned on Step-

²³ The most significant difference would be that, under the terms of the license, Step-Saver could not transfer the copies without TSL's consent, while Step-Saver could do so under the federal copyright law if it had purchased the copy. Even if we assume that federal law would not preempt state law enforcement of this aspect of the license, this difference is not material to this case in that both parties agree that Step-Saver had the right to transfer the copies to purchasers of the Step-Saver multi-user system.

²⁴ See UCC §§ 2-312, 2-313, 2-314, & 2-315.

²⁵ See, e.g., *City University of New York v. Finalco, Inc.*, 514 N.Y.S.2d 244, 129 A.D.2d 494 (N.Y.App.Div.1987); *URSA Farmers Coop. Co. v. Trent*, 58 Ill.App.3d 930, 16 Ill.Dec. 348, 374 N.E.2d 1123 (Ill. App. Ct. 1978).

²⁶ UCC § 2-207(1).

²⁷ In the remainder of the opinion, we will refer to the transaction as a sale for the sake of simplicity, but, by doing so, do not mean to resolve the sale-license question.

Saver's assent to the terms of the box-top license, citing *Monsanto Agricultural Products Co. v. Edenfield*.²⁸ While we are not certain that a conditional acceptance analysis applies when a contract is established by performance,²⁹ we assume that it does and consider TSL's arguments.

[30]Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained in the confirmation or in the acceptance falls within subsection (2) and must be regarded as a proposal for an added term *unless the acceptance is made conditional on the acceptance of the additional or different terms*.

[31]To determine whether a writing constitutes a conditional acceptance, courts have established three tests. Because neither Georgia nor Pennsylvania has expressly adopted a test to determine when a written confirmation constitutes a conditional acceptance, we consider these three tests to determine which test the state courts would most likely apply.³⁰

[32]Under the first test, an offeree's response is a conditional acceptance to the extent it states a term “materially altering the contractual obligations solely to the disadvantage of the offeror”.³¹ Pennsylvania, at least, has implicitly rejected this test. In *Herzog Oil Field Service, Inc.*,³² a Pennsylvania Superior

²⁸ 426 So.2d 574 (Fla. Dist. Ct. App.1982).

²⁹ Even though a writing sent after performance establishes the existence of a contract, courts have analyzed the effect of such a writing under UCC § 2-207. *See Herzog Oil Field Serv. v. Otto Torpedo Co.*, 391 Pa. Super. 133, 570 A.2d 549, 550 (Pa. Super. Ct. 1990); *McJunkin Corp. v. Mechanicals, Inc.*, 888 F.2d at 487. The official comment to UCC 2-207 suggests that, even though a proposed deal has been closed, the conditional acceptance analysis still applies in determining which writing's terms will define the contract.

³⁰ *See Daitom, Inc.*, 741 F.2d at 1574-75.

³¹ *Daitom, Inc.*, 741 F.2d at 1576. See, e.g., *Roto-Lith Ltd. v. F.P. Bartlett & Co.*, 297 F.2d 497 (1st Cir.1962).

³² 570 A.2d 549 (Pa.Super.Ct.1990).

Court analyzed a term in a written confirmation under UCC § 2-207(2), rather than as a conditional acceptance even though the term materially altered the terms of the agreement to the sole disadvantage of the offeror.³³

[33]Furthermore, we note that adopting this test would conflict with the express provision of UCC § 2-207(2)(b). Under § 2-207(2)(b), additional terms in a written confirmation that “materially alter [the contract]” are construed “as proposals for addition to the contract”, not as conditional acceptances.

[34]A second approach considers an acceptance conditional when certain key words or phrases are used, such as a written confirmation stating that the terms of the confirmation are “the only ones upon which we will accept orders”.³⁴ The third approach requires the offeree to demonstrate an unwillingness to proceed with the transaction unless the additional or different terms are included in the contract.³⁵

³³ The seller/offeree sent a written confirmation that contained a term that provided for attorney's fees of 25 percent of the balance due if the account was turned over for collection. 570 A.2d at 550

³⁴ *Ralph Shrader, Inc. v. Diamond Int'l Corp.*, 833 F.2d 1210, 1214 (6th Cir.1987); see *McJunkin Corp.*, 888 F.2d at 488. Note that even though an acceptance contains the key phrase, and is conditional, these courts typically avoid finding a contract on the terms of the counteroffer by requiring the offeree/counterofferor to establish that the offeror assented to the terms of the counteroffer. Generally, acceptance of the goods, alone, is not sufficient to establish assent by the offeror to the terms of the counteroffer. See, e.g., *Ralph Shrader, Inc.*, 833 F.2d at 1215; *Diamond Fruit Growers, Inc.*, 794 F.2d at 1443-44; *Coastal Indus. v. Automatic Steam Prods. Corp.*, 654 F.2d 375, 379 (5th Cir. Unit B Aug.1981). If the sole evidence of assent to the terms of the counteroffer is from the conduct of the parties in proceeding with the transaction, then the courts generally define the terms of the parties's agreement under § 2-207(3). See, e.g., *Diamond Fruit Growers, Inc.*, 794 F.2d at 1444.

³⁵ See, e.g., *Daitom, Inc.*, 741 F.2d at 1576; *Idaho Power Co. v. Westinghouse Elec. Corp.*, 596 F.2d 924, 926 (9th Cir.1979).

[35] Although we are not certain that these last two approaches would generate differing answers,³⁶ we adopt the third approach for our analysis because it best reflects the understanding of commercial transactions developed in the UCC. Section 2-207 attempts to distinguish between: (1) those standard terms in a form confirmation, which the party would like a court to incorporate into the contract in the event of a dispute; and (2) the actual terms the parties understand to govern their agreement. The third test properly places the burden on the party asking a court to enforce its form to demonstrate that a particular term is a part of the parties' commercial bargain.³⁷

[36] Using this test, it is apparent that the integration clause and the "consent by opening" language is not sufficient to render TSL's acceptance conditional. As other courts have recognized,³⁸ this type of language provides no real indication that the party is willing to forego the transaction if the additional language is not included in the contract.

[37] The second provision provides a more substantial indication that TSL was willing to forego the contract if the terms of the box-top license were not accepted by Step-Saver. On its face, the box-top license states that TSL will refund the purchase price if the purchaser does not agree to the

³⁶ Under the second approach, the box-top license might be considered a conditional acceptance, but Step-Saver, by accepting the product, would not be automatically bound to the terms of the box-top license. *See Diamond Fruit Growers, Inc.*, 794 F.2d at 1444. Instead, courts have applied UCC § 2-207(3) to determine the terms of the parties' agreement. The terms of the agreement would be those "on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act." UCC § 2-207(3). Because the writings of the parties did not agree on the warranty disclaimer and limitation of remedies terms, the box-top license version of those terms would not be included in the parties' contract; rather, the default provisions of the UCC would govern.

³⁷ *See Diamond Fruit Growers, Inc.*, 794 F.2d at 1444-45; cf. *Ralph Shrader, Inc.*, 833 F.2d at 1215.

³⁸ *See, e.g., Idaho Power Co.*, 596 F.2d at 926-27.

terms of the license.³⁹ Even with such a refund term, however, the offeree/counterofferor may be relying on the purchaser's investment in time and energy in reaching this point in the transaction to prevent the purchaser from returning the item. Because a purchaser has made a decision to buy a particular product and has actually obtained the product, the purchaser may use it despite the refund offer, regardless of the additional terms specified after the contract formed. But we need not decide whether such a refund offer could ever amount to a conditional acceptance; the undisputed evidence in this case demonstrates that the terms of the license were not sufficiently important that TSL would forego its sales to Step-Saver if TSL could not obtain Step-Saver's consent to those terms.

[38]As discussed, Mr. Greebel testified that TSL assured him that the box-top license did not apply to Step-Saver, as Step-Saver was not the end user of the Multilink Advanced program. Supporting this testimony, TSL on two occasions asked Step-Saver to sign agreements that would put in formal terms the relationship between Step-Saver and TSL. Both proposed agreements contained warranty disclaimer and limitation of remedy terms similar to those contained in the box-top license. Step-Saver refused to sign the agreements; nevertheless, TSL continued to sell copies of Multilink Advanced to Step-Saver.

[39]Additionally, TSL asks us to infer, based on the refund offer, that it was willing to forego its sales to Step-Saver unless Step-Saver agreed to the terms of the box-top license. Such an inference is inconsistent with the fact that both parties agree that the terms of the box-top license *did not*

³⁹ One Florida Court of Appeals has accepted such an offer as a strong indication of a conditional acceptance. *Monsanto Agricultural Prods. Co.*, 426 So.2d at 575-76. Note that the *Monsanto* warranty label was conspicuous and available to the purchaser before the contract for the sale of the herbicide was formed. When an offeree proceeds with a contract with constructive knowledge of the terms of the offer, the offeree is typically bound by those terms, making the conditional acceptance finding unnecessary to the result reached in *Monsanto*.

represent the parties's agreement with respect to Step-Saver's right to transfer the copies of the Multilink Advanced program. Although the box-top license prohibits the transfer, by Step-Saver, of its copies of the program, both parties agree that Step-Saver was entitled to transfer its copies to the purchasers of the Step-Saver multi-user system. Thus, TSL was willing to proceed with the transaction despite the fact that one of the terms of the box-top license was not included in the contract between TSL and Step-Saver. We see no basis in the terms of the box-top license for inferring that a reasonable offeror would understand from the refund offer that certain terms of the box-top license, such as the warranty disclaimers, were essential to TSL, while others such as the non-transferability provision were not.

[40]Based on these facts, we conclude that TSL did not clearly express its unwillingness to proceed with the transactions unless its additional terms were incorporated into the parties' agreement. The box-top license did not, therefore, constitute a conditional acceptance under UCC § 2-207(1).

3. Did the parties' course of dealing establish that the parties had excluded any express or implied warranties associated with the software program?

[41]TSL argues that because Step-Saver placed its orders for copies of the Multilink Advanced program with notice of the terms of the box-top license, Step-Saver is bound by the terms of the box-top license. Essentially, TSL is arguing that, even if the terms of the box-top license would not become part of the contract if the case involved only a single transaction, the repeated expression of those terms by TSL eventually incorporates them within the contract.

[42]Ordinarily, a “course of dealing” or “course of performance” analysis focuses on the actions of the parties

with respect to a particular issue.⁴⁰ If, for example, a supplier of asphaltic paving material on two occasions gives a paving contractor price protection, a jury may infer that the parties have incorporated such a term in their agreement by their course of performance.⁴¹ Because this is the parties' first serious dispute, the parties have not previously taken any action with respect to the matters addressed by the warranty disclaimer and limitation of liability terms of the box-top license. Nevertheless, TSL seeks to extend the course of dealing analysis to this case where the only action has been the repeated sending of a particular form by TSL. While one court has concluded that terms repeated in a number of written confirmations eventually become part of the contract even though neither party ever takes any action with respect

⁴⁰ A "course of performance" refers to actions with respect to the contract taken after the contract has formed. UCC § 2-208(1). "A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." UCC § 1-205.

⁴¹ See *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772 (9th Cir.1981).

to the issue addressed by those terms,⁴² most courts have rejected such reasoning.⁴³

[43]For two reasons, we hold that the repeated sending of a writing which contains certain standard terms, without any action with respect to the issues addressed by those terms, cannot constitute a course of dealing which would incorporate a term of the writing otherwise excluded under § 2-207. First, the repeated exchange of forms by the parties only tells Step-Saver that TSL *desires* certain terms. Given TSL's failure to obtain Step-Saver's express assent to these terms before it will ship the program, Step-Saver can reasonably believe that, while TSL desires certain terms, it has agreed to do business on other terms—those terms expressly agreed upon by the parties. Thus, even though Step-Saver would not be surprised⁴⁴ to learn that TSL desires the terms of the box-top license, Step-Saver might well be surprised to

⁴² See *Schulze & Burch Biscuit Co. v. Tree Top, Inc.*, 831 F.2d 709, 714-15 (7th Cir.1987). As support for its position, the *Schulze* Court cites *Barliant v. Follett Corp.*, 138 Ill.App.3d 756, 91 Ill.Dec. 677, 483 N.E.2d 1312 (Ill.App.Ct.1985). Yet, the facts and result in *Barliant* do not support the reasoning in *Schulze*. In *Barliant*, the buyer had paid some twenty-four invoices, which included charges for freight and warehousing even though the agreement specified charges were F.O.B. The court found that the buyer had paid the invoices with knowledge of the additional charge for freight and warehousing. Because of this *conduct with respect to the term in question*, the buyer waived any right to complain that the charges should not have been included. 91 Ill.Dec. at 679-80, 483 N.E.2d at 1314-15. In contrast, in *Schulze*, neither party had taken any action with respect to the arbitration provision. Because no disputes had arisen, there was no conduct by either party indicating how disputes were to be resolved. Nevertheless, the *Schulze* Court held that, because the provision had been repeated in nine previous invoices, it became part of the parties's bargain. 831 F.2d at 715. We note that the Seventh Circuit refused to follow *Schulze* in a more recent case raising the same issue. See *Trans-Aire Int'l v. Northern Adhesive Co.*, 882 F.2d 1254, 1262-63 & n. 9 (7th Cir.1989).

⁴³ See, e.g., *Trans-Aire Int'l v. Northern Adhesive Co.*, 882 F.2d at 1262-63 & n. 9; *Diamond Fruit Growers, Inc.*, 794 F.2d at 1445; *Tuck Industries v. Reichhold Chemicals, Inc.*, 542 N.Y.S.2d 676, 678, 151 A.D.2d 566 (N.Y.App.Div.1989); *Southeastern Adhesives Co.*, 366 S.E.2d at 507-08.

⁴⁴ *Cf.* UCC § 2-207, comment 4 (suggesting that terms that “materially alter” a contract are those that would result in “surprise or hardship if incorporated without express awareness by the other party”).

learn that the terms of the box-top license have been incorporated into the parties's agreement.

[44]Second, the seller in these multiple transaction cases will typically have the opportunity to negotiate the precise terms of the parties's agreement, as TSL sought to do in this case. The seller's unwillingness or inability to obtain a negotiated agreement reflecting its terms strongly suggests that, while the seller would like a court to incorporate its terms if a dispute were to arise, those terms are not a part of the parties's commercial bargain. For these reasons, we are not convinced that TSL's unilateral act of repeatedly sending copies of the box-top license with its product can establish a course of dealing between TSL and Step-Saver that resulted in the adoption of the terms of the box-top license.

[45]With regard to more specific evidence as to the parties' course of dealing or performance, it appears that the parties have not incorporated the warranty disclaimer into their agreement. First, there is the evidence that TSL tried to obtain Step-Saver's express consent to the disclaimer and limitation of damages provision of the box-top license. Step-Saver refused to sign the proposed agreements. Second, when first notified of the problems with the program, TSL spent considerable time and energy attempting to solve the problems identified by Step-Saver.

[46]Course of conduct is ordinarily a factual issue. But we hold that the actions of TSL in repeatedly sending a writing, whose terms would otherwise be excluded under UCC § 2-207, cannot establish a course of conduct between TSL and Step-Saver that adopted the terms of the writing.

4. Public policy concerns.

[47]TSL has raised a number of public policy arguments focusing on the effect on the software industry of an adverse holding concerning the enforceability of the box-top license. We are not persuaded that requiring software companies to stand behind representations concerning their products will

inevitably destroy the software industry. We emphasize, however, that we are following the well-established distinction between conspicuous disclaimers made available before the contract is formed and disclaimers made available only after the contract is formed.⁴⁵ When a disclaimer is not expressed until after the contract is formed, UCC § 2-207 governs the interpretation of the contract, and, between merchants, such disclaimers, to the extent they materially alter the parties' agreement, are not incorporated into the parties' agreement.

[48]If TSL wants relief for its business operations from this well-established rule, their arguments are better addressed to a legislature than a court. Indeed, we note that at least two states have enacted statutes that modify the applicable contract rules in this area,⁴⁶ but both Georgia and Pennsylvania have retained the contract rules provided by the UCC.

C. The Terms of the Contract

[49]Under section 2-207, an additional term detailed in the box-top license will not be incorporated into the parties' contract if the term's addition to the contract would materially alter the parties' agreement.⁴⁷ Step-Saver alleges that several representations made by TSL constitute express

⁴⁵ Compare *Hill v. BASF Wyandotte Corp.*, 696 F.2d 287, 290-91 (4th Cir.1982). In that case, a farmer purchased seventy-three five gallon cans of a herbicide from a retailer. Because the disclaimer was printed conspicuously on each can, the farmer had constructive knowledge of the terms of the disclaimer before the contract formed. As a result, when he selected each can of the herbicide from the shelf and purchased it, the law implies his assent to the terms of the disclaimer. See also *Bowdoin v. Showell Growers, Inc.*, 817 F.2d 1543, 1545 (11th Cir.1987) (disclaimers that were conspicuous before the contract for sale has formed are effective; post-sale disclaimers are ineffective); *Monsanto Agricultural Prods. Co. v. Edenfield*, 426 So.2d at 575-76.

⁴⁶ Louisiana Software License Enforcement Act, La.R.S. §§ 51:1961-1966 (1987); Illinois Software Enforcement Act, Ill. Ann. Stat. ch. 29, para. 801-808 (Smith-Hurd 1987).

⁴⁷ UCC § 2-207(2)(b).

warranties, and that valid implied warranties were also a part of the parties' agreement. Because the district court considered the box-top license to exclude all of these warranties, the district court did not consider whether other factors may act to exclude these warranties. The existence and nature of the warranties is primarily a factual question that we leave for the district court,⁴⁸ but assuming that these warranties were included within the parties's original agreement, we must conclude that adding the disclaimer of warranty and limitation of remedies provisions from the box-top license would, as a matter of law, substantially alter the distribution of risk between Step-Saver and TSL.⁴⁹ Therefore, under UCC § 2-207(2)(b), the disclaimer of warranty and limitation of remedies terms of the box-top license did not become a part of the parties' agreement.⁵⁰

[50]Based on these considerations, we reverse the trial court's holding that the parties intended the box-top license to be a final and complete expression of the terms of their agreement. Despite the presence of an integration clause in the box-top license, the box-top license should have been treated as a written confirmation containing additional

⁴⁸ For example, questions exist as to: (1) whether the statements by TSL were representations of fact, or mere statements of opinion; (2) whether the custom in the trade is to exclude warranties and limit remedies in contracts between a software producer and its dealer; (3) whether Step-Saver relied on TSL's alleged representations, or whether these warranties became a basis of the parties's bargain; and (4) whether Step-Saver's testing excluded some or all of these warranties. From the record, it appears that most of these issues are factual determinations that will require a trial, as did the warranty claims against Wyse. But we leave these issues open to the district court on remand.

⁴⁹ See *Valtrol, Inc. v. General Connectors Corp.*, 884 F.2d 149, 155 (4th Cir.1989); *Trans-Aire Int'l v. Northern Adhesive Co.*, 882 F.2d at 1262-63; UCC § 2-207, official comment 4.

⁵⁰ The following recent cases reach a similar conclusion concerning indemnity or warranty disclaimers contained in writings exchanged after the contract had formed: *McJunkin Corp.*, 888 F.2d at 488-89; *Valtrol, Inc. v. General Connectors Corp.*, 884 F.2d at 155; *Trans-Aire Int'l v. Northern Adhesive Co.*, 882 F.2d at 1262-63; *Bowdoin*, 817 F.2d at 1545-46; *Diamond Fruit Growers, Inc.*, 794 F.2d at 1445; *Tuck Industries*, 542 N.Y.S.2d at 678; *Southeastern Adhesives Co.*, 366 S.E.2d at 507-08.

terms.⁵¹ Because the warranty disclaimer and limitation of remedies terms would materially alter the parties' agreement, these terms did not become a part of the parties' agreement. We remand for further consideration the express and implied warranty claims against TSL.

[Students may wish to skim the following material which is not essential to understanding the issue of contract formation.]

III. THE INTENTIONAL MISREPRESENTATION CLAIM AGAINST TSL

[51]We review the trial court's decision to grant a directed verdict on the intentional misrepresentation claim *de novo*.⁵² We ask whether, considering the evidence in the light most favorable to Step-Saver, a reasonable jury could find, by clear and convincing evidence,⁵³ each essential element of Step-Saver's fraud claim: (1) a material misrepresentation; (2) an intention to deceive; (3) an intention to induce reliance; (4) justifiable reliance by the recipient upon the representation; and (5) damage to the recipient proximately caused by the misrepresentation.⁵⁴

[52]To support its intentional misrepresentation claim, Step-Saver argues that TSL made specific claims, in its advertisement and in statements by its sales representatives, that the Multilink Advanced program was compatible with various MS-DOS application programs and with the Wyse terminal. To demonstrate that TSL made these compatibility representations with an intent to deceive, Step-Saver refers to

⁵¹ See *Idaho Power Co.*, 596 F.2d at 925-27 (applying UCC § 2-207 despite presence of integration clause in written confirmation).

⁵² See, e.g., *Indian Coffee Corp. v. Proctor & Gamble Co.*, 752 F.2d 891, 894 (3d Cir.), cert. denied, 474 U.S. 863 (1985).

⁵³ See *Beardshall v. Minuteman Press Int'l, Inc.*, 664 F.2d 23, 26 (3d Cir.1981); *Snell v. State Examining Bd.*, 416 A.2d 468, 470 (Pa. 1980).

⁵⁴ See *Kinnel v. Mid-Atlantic Mausoleums, Inc.*, 850 F.2d 958, 963-64 (3d Cir.1988); *Scaife Co. v. Rockwell-Standard Corp.*, 285 A.2d 451, 454 (Pa. 1971), cert. denied, 407 U.S. 920 (1972).

several statements made in deposition testimony by the co-founders of TSL, and argues that these statements are sufficient to establish that TSL knew these compatibility representations were false at the time they were made. In particular, Step-Saver points to the statement by Mr. Robertson, one of TSL's co-founders, that he did not know of any programs “completely compatible” with Multilink Advanced.

[53]In determining whether Mr. Robertson's testimony will support an inference of fraudulent intent, we, like the experts at trial, distinguish between compatibility, or practical compatibility, and complete, absolute, or theoretical compatibility. If two products are completely compatible, they will work properly together in every possible situation, every time. As Mr. Robertson explained, “complete compatibility is almost virtually impossible to obtain.” On the other hand, two products are compatible, within the standards of the computer industry, if they work together almost every time in almost every possible situation.⁵⁵

[54]It is undisputed that the representations made by the sales representatives referred to practical compatibility, while Mr. Robertson's testimony referred to complete compatibility. Because of the differences between practical and complete compatibility, as those terms are used in the industry, we agree with the district court that Mr. Robertson's testimony about “complete compatibility” will not support a finding, under the clear and convincing standard, that TSL knew its representations concerning practical compatibility were false. In context, Mr. Robertson's statement was simply an expression of technical fact, not an indication that he knew

⁵⁵ We disagree with the holding by the district court that a representation of compatibility is a statement of opinion, rather than fact. Compatibility between two computer products can be tested and determined. While two computer products are not likely to be perfectly compatible, the question of whether the degree of compatibility is consistent with industry standards is a question generally for the jury, not the judge.

that Multilink Advanced failed to satisfy industry standards for practical compatibility.

IV. THE IMPLIED WARRANTY OF MERCHANTABILITY CLAIM AGAINST WYSE

[55]Step-Saver argues that there was sufficient evidence in the record to support a jury finding that the Wyse terminal was not “fit for the ordinary purposes for which such goods are used.”⁵⁶ and that the trial judge should have permitted the jury to decide the implied warranty of merchantability issue.

[56]The only evidence introduced by Step-Saver on this issue was that certain features on the WY-60 terminal were not compatible with the Multilink Advanced operating environment. For example, the WY-60 terminal originally had repeatable, instead of toggle,⁵⁷ NUM LOCK and CAPS LOCK keys. The combination of repeatable keys and the Multilink Advanced program caused the NUM LOCK or CAPS LOCK indicated by the terminal to become out of synchronicity with the actual setting followed by the computer. As a result, a terminal's screen and keyboard might indicate that CAPS LOCK was on, when in fact it was off. Because of this, a user might type an entire document believing that the document was in all capital letters, only to discover upon printing that the document was in all lower case letters.

[57]While this evidence demonstrates some compatibility problems between the WY-60 terminal and the Multilink Advanced program, Wyse introduced undisputed testimony that a user would encounter the same compatibility problems

⁵⁶ UCC § 2-314(2)(c).

⁵⁷ If a user presses and holds a repeatable NUM LOCK key, the terminal will switch back and forth between NUM LOCK on and NUM LOCK off as long as the user holds down the key. In contrast, if a user presses and holds a toggle key, the terminal will switch from the present setting to the other setting. Even if the user continues to hold the key, the setting will not change but once. In order to change the setting back to the prior setting, the user must release the key and press it again.

when using the Multilink Advanced operating environment on either a Kimtron KT-7 terminal, or a Link terminal, the terminals offered by Wyse's two primary competitors. Undisputed testimony also established that Wyse had sold over one million WY-60 terminals since the terminal's introduction in April of 1986, and that the WY-60 was the top-selling terminal in its class.

[58]Furthermore, undisputed testimony by Wyse engineers established that the WY-60 terminals were built to industry-standard specifications for terminals designed to work with a multi-user system based on the IBM AT or XT. It is apparent that when the pieces of a system intended to work together are designed and built independently, each piece must conform to certain specifications if the pieces are to work together properly. Just as a nut and bolt must be built in a certain manner to insure their fit, so too the components of a multi-user system. Just as a bolt, built to industry standards for a certain size and thread, cannot be considered unfit for its ordinary use simply because a particular nut does not fit it, so too the WY-60 terminal.

[59]Under a warranty of merchantability, the seller warrants only that the goods are of acceptable quality "when compared to that generally acceptable in the trade for goods of the kind."⁵⁸ Because the undisputed testimony established that the WY-60 terminal conformed to the industry standard for terminals designed to operate in conjunction with an IBM AT, the evidence of incompatibility with the Multilink Advanced operating system is not sufficient to support a finding that Wyse breached the implied warranty of merchantability.⁵⁹

⁵⁸ Price Bros. Co. v. Philadelphia Gear Corp., 649 F.2d 416, 424 (6th Cir.), cert. denied, 454 U.S. 1099 (1981); see also Dugan & Meyers Constr. Co. v. Worthington Pump Corp. (USA), 746 F.2d 1166, 1176 (6th Cir.1984), cert. denied, 471 U.S. 1135 (1985).

⁵⁹ See *In re Franklin Computer Corp.*, 57 B.R. 155, 157 (Bankr.E.D.Pa.1986).

V. EVIDENTIARY RULINGS

[60]We have carefully reviewed the record regarding the evidentiary rulings. For the reasons given on these two issues in the district court's memorandum opinion rejecting Step-Saver's motion for a new trial,⁶⁰ we hold that the exclusion of the unsent letter and the refusal to permit rebuttal testimony on the issue of the ordinary uses of the WY-60 terminal did not constitute an abuse of discretion.

VI.

[61]We will reverse the holding of the district court that the parties intended to adopt the box-top license as the complete and final expression of the terms of their agreement. We will remand for further consideration of Step-Saver's express and implied warranty claims against TSL. Finding a sufficient basis for the other decisions of the district court, we will affirm in all other respects.

⁶⁰ *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 752 F.Supp. 181, 192-93 (E.D.Pa.1990).

5.2 Principal Case – Hill v. Gateway 2000, Inc.

Hill v. Gateway 2000, Inc.

United States Court of Appeals, Seventh Circuit
105 F.3d 1147 (1997)

EASTERBROOK, Circuit Judge.

[1] A customer picks up the phone, orders a computer, and gives a credit card number. Presently a box arrives, containing the computer and a list of terms, said to govern unless the customer returns the computer within 30 days. Are these terms effective as the parties' contract, or is the contract term-free because the order-taker did not read any terms over the phone and elicit the customer's assent?

[2] One of the terms in the box containing a Gateway 2000 system was an arbitration clause. Rich and Enza Hill, the customers, kept the computer more than 30 days before complaining about its components and performance. They filed suit in federal court arguing, among other things, that the product's shortcomings make Gateway a racketeer (mail and wire fraud are said to be the predicate offenses), leading to treble damages under RICO for the Hills and a class of all other purchasers. Gateway asked the district court to enforce the arbitration clause; the judge refused, writing that “[t]he present record is insufficient to support a finding of a valid arbitration agreement between the parties or that the plaintiffs were given adequate notice of the arbitration clause.” Gateway took an immediate appeal, as is its right. 9 U.S.C. § 16(a)(1)(A).

[3] The Hills say that the arbitration clause did not stand out: they concede noticing the statement of terms but deny reading it closely enough to discover the agreement to arbitrate, and they ask us to conclude that they therefore may go to court. Yet an agreement to arbitrate must be enforced “save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), holds that this provision

of the Federal Arbitration Act is inconsistent with any requirement that an arbitration clause be prominent. A contract need not be read to be effective; people who accept take the risk that the unread terms may in retrospect prove unwelcome. *Carr v. CIGNA Securities, Inc.*, 95 F.3d 544, 547 (7th Cir.1996); *Chicago Pacific Corp. v. Canada Life Assurance Co.*, 850 F.2d 334 (7th Cir.1988). Terms inside Gateway's box stand or fall together. If they constitute the parties' contract because the Hills had an opportunity to return the computer after reading them, then all must be enforced.

[4] *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir.1996), holds that terms inside a box of software bind consumers who use the software after an opportunity to read the terms and to reject them by returning the product. Likewise, *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991), enforces a forum-selection clause that was included among three pages of terms attached to a cruise ship ticket. *ProCD* and *Carnival Cruise Lines* exemplify the many commercial transactions in which people pay for products with terms to follow; *ProCD* discusses others. 86 F.3d at 1451-52. The district court concluded in *ProCD* that the contract is formed when the consumer pays for the software; as a result, the court held, only terms known to the consumer at that moment are part of the contract, and provisos inside the box do not count. Although this is one way a contract could be formed, it is not the only way: "A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance." *Id.* at 1452. Gateway shipped computers with the same sort of accept-or-return offer *ProCD* made to users of its software. *ProCD* relied on the Uniform Commercial Code rather than any peculiarities of Wisconsin law; both Illinois and South Dakota, the two states whose law might govern relations between Gateway and the Hills, have adopted the UCC; neither side has pointed

us to any atypical doctrines in those states that might be pertinent; *ProCD* therefore applies to this dispute.

[5] Plaintiffs ask us to limit *ProCD* to software, but where's the sense in that? *ProCD* is about the law of contract, not the law of software. Payment preceding the revelation of full terms is common for air transportation, insurance, and many other endeavors. Practical considerations support allowing vendors to enclose the full legal terms with their products. Cashiers cannot be expected to read legal documents to customers before ringing up sales. If the staff at the other end of the phone for direct-sales operations such as Gateway's had to read the four-page statement of terms before taking the buyer's credit card number, the droning voice would anesthetize rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time. And oral recitation would not avoid customers' assertions (whether true or feigned) that the clerk did not read term X to them, or that they did not remember or understand it. Writing provides benefits for both sides of commercial transactions. Customers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simple approve-or-return device. Competent adults are bound by such documents, read or unread. For what little it is worth, we add that the box from Gateway was crammed with software. The computer came with an operating system, without which it was useful only as a boat anchor. See *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756, 761 (7th Cir.1996). Gateway also included many application programs. So the Hills' effort to limit *ProCD* to software would not avail them factually, even if it were sound legally—which it is not.

[6] For their second sally, the Hills contend that *ProCD* should be limited to executory contracts (to licenses in particular), and therefore does not apply because both parties' performance of this contract was complete when the box arrived at their home. This is legally and factually wrong:

legally because the question at hand concerns the *formation* of the contract rather than its *performance*, and factually because both contracts were incompletely performed. *ProCD* did not depend on the fact that the seller characterized the transaction as a license rather than as a contract; we treated it as a contract for the sale of goods and reserved the question whether for other purposes a “license” characterization might be preferable. 86 F.3d at 1450. All debates about characterization to one side, the transaction in *ProCD* was no more executory than the one here: Zeidenberg paid for the software and walked out of the store with a box under his arm, so if arrival of the box with the product ends the time for revelation of contractual terms, then the time ended in *ProCD* before Zeidenberg opened the box. But of course *ProCD* had not completed performance with delivery of the box, and neither had Gateway. One element of the transaction was the warranty, which obliges sellers to fix defects in their products. The Hills have invoked Gateway's warranty and are not satisfied with its response, so they are not well positioned to say that Gateway's obligations were fulfilled when the motor carrier unloaded the box. What is more, both *ProCD* and Gateway promised to help customers to use their products. Long-term service and information obligations are common in the computer business, on both hardware and software sides. Gateway offers “lifetime service” and has a round-the-clock telephone hotline to fulfil this promise. Some vendors spend more money helping customers use their products than on developing and manufacturing them. The document in Gateway's box includes promises of future performance that some consumers value highly; these promises bind Gateway just as the arbitration clause binds the Hills.

[7] Next the Hills insist that *ProCD* is irrelevant because Zeidenberg was a “merchant” and they are not. Section 2-207(2) of the UCC, the infamous battle-of-the-forms section, states that “additional terms [following acceptance of an

offer] are to be construed as proposals for addition to a contract. Between merchants such terms become part of the contract unless ...". Plaintiffs tell us that *ProCD* came out as it did only because Zeidenberg was a "merchant" and the terms inside ProCD's box were not excluded by the "unless" clause. This argument pays scant attention to the opinion in *ProCD*, which concluded that, when there is only one form, "sec. 2-207 is irrelevant." 86 F.3d at 1452. The question in *ProCD* was not whether terms were added to a contract after its formation, but how and when the contract was formed—in particular, whether a vendor may propose that a contract of sale be formed, not in the store (or over the phone) with the payment of money or a general "send me the product," but after the customer has had a chance to inspect both the item and the terms. *ProCD* answers "yes," for merchants and consumers alike. Yet again, for what little it is worth we observe that the Hills misunderstand the setting of *ProCD*. A "merchant" under the UCC "means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction", § 2-104(1). Zeidenberg bought the product at a retail store, an uncommon place for merchants to acquire inventory. His corporation put ProCD's database on the Internet for anyone to browse, which led to the litigation but did not make Zeidenberg a software merchant.

[8] At oral argument the Hills propounded still another distinction: the box containing ProCD's software displayed a notice that additional terms were within, while the box containing Gateway's computer did not. The difference is functional, not legal. Consumers browsing the aisles of a store can look at the box, and if they are unwilling to deal with the prospect of additional terms can leave the box alone, avoiding the transactions costs of returning the package after reviewing its contents. Gateway's box, by contrast, is just a shipping carton; it is not on display anywhere. Its function is to protect

the product during transit, and the information on its sides is for the use of handlers (“Fragile!” “This Side Up!”) rather than would-be purchasers.

[9] Perhaps the Hills would have had a better argument if they were first alerted to the bundling of hardware and legal-ware after opening the box and wanted to return the computer in order to avoid disagreeable terms, but were dissuaded by the expense of shipping. What the remedy would be in such a case—could it exceed the shipping charges?—is an interesting question, but one that need not detain us because the Hills knew before they ordered the computer that the carton would include *some* important terms, and they did not seek to discover these in advance. Gateway's ads state that their products come with limited warranties and lifetime support. How limited was the warranty—30 days, with service contingent on shipping the computer back, or five years, with free onsite service? What sort of support was offered? Shoppers have three principal ways to discover these things. First, they can ask the vendor to send a copy before deciding whether to buy. The Magnuson-Moss Warranty Act requires firms to distribute their warranty terms on request, 15 U.S.C. § 2302(b)(1)(A); the Hills do not contend that Gateway would have refused to enclose the remaining terms too. Concealment would be bad for business, scaring some customers away and leading to excess returns from others. Second, shoppers can consult public sources (computer magazines, the Web sites of vendors) that may contain this information. Third, they may inspect the documents after the product's delivery. Like Zeidenberg, the Hills took the third option. By keeping the computer beyond 30 days, the Hills accepted Gateway's offer, including the arbitration clause.

[10]The Hills' remaining arguments, including a contention that the arbitration clause is unenforceable as part of a scheme to defraud, do not require more than a citation to *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967). Whatever may be said

pro and con about the cost and efficacy of arbitration (which the Hills disparage) is for Congress and the contracting parties to consider. Claims based on RICO are no less arbitrable than those founded on the contract or the law of torts. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 238-42, 107 S.Ct. 2332, 2343-46, 96 L.Ed.2d 185 (1987). The decision of the district court is vacated, and this case is remanded with instructions to compel the Hills to submit their dispute to arbitration.

5.2.1 ProCD Inc. v. Zeidenberg

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

Must buyers of computer software obey the terms of shrinkwrap licenses? The district court held not [because] they are not contracts because the licenses are inside the box rather than printed on the outside. [W]e disagree with the district judge's conclusion. Shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable). Because no one argues that the terms of the license at issue here are troublesome, we remand with instructions to enter judgment for the plaintiff.

According to the district court, the UCC does not countenance the sequence of money now, terms later.... To judge by the flux of law review articles discussing shrinkwrap licenses, uncertainty is much in need of reduction—although businesses seem to feel less uncertainty than do scholars, for only three cases (other than ours) touch on the subject,

and none directly addresses it. [T]hese are not consumer transactions. Step-Saver is a battle-of-the-forms case, in which the parties exchange incompatible forms and a court must decide which prevails. Our case has only one form; UCC § 2-207 is irrelevant.

What then does the current version of the UCC have to say? We think that the place to start is § 2-204(1): “A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.” A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance. And that is what happened. ProCD proposed a contract that a buyer would accept by using the software after having an opportunity to read the license at leisure. This Zeidenberg did. He had no choice, because the software splashed the license on the screen and would not let him proceed without indicating acceptance. So although the district judge was right to say that a contract can be, and often is, formed simply by paying the price and walking out of the store, the UCC permits contracts to be formed in other ways. ProCD proposed such a different way, and without protest Zeidenberg agreed. Ours is not a case in which a consumer opens a package to find an insert saying “you owe us an extra \$10,000” and the seller files suit to collect. Any buyer finding such a demand can prevent formation of the contract by returning the package, as can any consumer who concludes that the terms of the license make the software worth less than the purchase price. Nothing in the

UCC requires a seller to maximize the buyer's net gains.

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

5.2.2 Discussion of *Step-Saver* and *Hill v. Gateway*.

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

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

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

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

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

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

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