Volume Two

J.H. Verkerke

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Volume Two

J.H. Verkerke

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Before he received his law degree from Yale in 1990, J. H. (Rip) Verkerke earned a master's of philosophy in economics. Verkerke joined the University of Virginia 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 of Virginia'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

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.

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.

IV. Defining the Obligation to Perform

We have thus far focused on the rules that determine whether the parties have made an enforceable contract. Our attention now shifts to the question of performance. What conduct will be sufficient to fulfill each party's obligation under the contract? Are there circumstances that might excuse performance?

1. Excuse

When we make or receive promises, we understand that there are at least some circumstances that will extinguish the resulting obligation to perform. In social settings, a "good excuse" exists whenever an unexpected contingency prevents someone from fulfilling her promise. If Sharon has agreed to give several friends a ride to a concert, mechanical trouble with her car excuses her from a duty to drive, but not from a duty to tell her friends promptly about her inability to drive. If, however, Sharon is seriously injured in a car accident on the way to pick up her friends, no one would condemn her for failing to call.

What is it about our understanding of Sharon's promise that allows us to make these nuanced judgments about responsibility? Notice first that the words of the promise itself play no role in establishing that mechanical trouble would excuse performance or in distinguishing between the consequences of mechanical trouble and personal injury. Sharon made an unqualified promise to drive her friends to the concert, and no one expects her to recite a litany of circumstances in which she will be unable to perform. Instead, we rely on a shared understanding about what events justify nonperformance.

Commercial agreements ordinarily involve comparatively complex obligations. Their express terms likewise cover a wider array of contingencies. However, no contract can possibly provide for every event that might occur between the execution of the contract and the time for performance. In the two cases that follow, consider carefully the role of contractual language in allocating the risks of unexpected contingencies. Try

to develop a theory that can explain and perhaps justify the results in these cases.

1.1. Principal Case – *Stees v. Leonard*

Stees v. Leonard
Supreme Court of Minnesota
20 Minn. 494 (1874)

[1] Appeal by defendants from an order of the district court, Ramsey county, denying a new trial.

[2] The action was brought to recover damages for a failure of defendants to erect and complete a building on a lot of plaintiffs, on Minnesota street, between Third and Fourth streets, in the city of St. Paul, which, by an agreement under seal between them and plaintiffs, the defendants had agreed to build, erect, and complete, according to plans and specifications annexed to and made part of the agreement. The defendants commenced the construction of the building, and had carried it to the height of three stories, when it fell to the ground. The next year, 1869, they began again and carried it to the same height as before, when it again fell to the ground, whereupon defendants refused to perform the contract. They claimed that in their attempts to erect the building they did the work in all respects according to the plans and specifications, and that the failure to complete the building and its fall on the two occasions was due to the fact that the soil upon which it was to be constructed was composed of quicksand, and when water flowed into it, was incapable of sustaining the building. The offers of proof by defendants, and the character of the allegations in the answer, under which the court held some of the offers inadmissible, are sufficiently indicated in the opinion.

YOUNG, J.

[3] The general principle of law which underlies this case is well established. If a man bind himself, by a positive, express contract, to do an act in itself possible, he must perform his engagement, unless prevented by the act of God, the law, or the other party to the contract. No hardship, no unforeseen hindrance, no difficulty short of absolute impossibility, will excuse him from doing what he has expressly agreed to do. This doctrine may sometimes seem to bear heavily upon contractors; but, in such cases, the hardship is attributable, not to the law, but to the

contractor himself, who has improvidently assumed an absolute, when he might have undertaken only a qualified, liability. The law does no more than enforce the contract as the parties themselves have made it. Many cases illustrating the application of the doctrine to every variety of contract are collected in the note to *Cutter* v. *Powell*, 2 Smith, Lead. Cas. 1.

[4] The rule has been applied in several recent cases, closely analogous to the present in their leading facts. In *Adams* v. *Nichols*, 19 Pick. 275, the defendant, Nichols, contracted to erect a dwelling-house for plaintiff on plaintiff's land. The house was nearly completed, when it was destroyed by accidental fire. It was held that the casualty did not relieve the contractor from his obligation to perform the contract he had deliberately entered into. The court clearly state and illustrate the rule, as laid down in the note to *Walton* v. *Waterhouse*, 2 Wms. Saunders, 422, and add: "In these and similar cases, which seem hard and oppressive, the law does no more than enforce the exact contract entered into. If there be any hardship, it arises from the indiscretion or want of foresight of the suffering party. It is not the province of the law to relieve persons from the improvidence of their own acts."

[5] In *School District* v. *Dauchy*, 25 Conn. 530, the defendant contracted to build and complete a school-house. When nearly finished, the building was struck by lightning, and consumed by the consequent fire, and the defendant refused to rebuild, although plaintiffs offered to allow him such further time as should be necessary. It was held that this non-performance was not excused by the destruction of the building. The court thus state the rule: "If a person promise absolutely, without exception or qualification, that a certain thing shall be done by a given time, or that a certain event shall take place, and the thing to be done, or the event, is neither impossible nor unlawful at the time of the promise, he is bound by his promise, unless the performance, before that time, becomes unlawful."

[6] *School Trustees* v. *Bennett*, 3 Dutcher, 513, is almost identical, in its material facts, with the present case. The contractors agreed to build and complete a school-house, and find all materials therefor, according to specifications annexed to the contract; the building to be located on a lot owned by plaintiff, and designated in the contract. When the building was nearly completed it was blown down by a sudden

and violent gale of wind. The contractors again began to erect the building, when it fell, solely on account of the soil on which it stood having become soft and miry, and unable to sustain the weight of the building; although, when the foundations were laid, the soil was so hard as to be penetrated with difficulty by a pickax, and its defects were latent. The plaintiff had a verdict for the amount of the installments paid under the contract as the work progressed. The verdict was sustained by the supreme court, which held that the loss, although arising solely from a latent defect in the soil, and not from a faulty construction of the building, must fall on the contractor.

[7] In the opinion of the court, the question is fully examined, many cases are cited, and the rule is stated "that where a party by his own contract creates a duty or charge upon himself he is bound to make it good if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract…. If, before the building is completed or accepted, it is destroyed by fire or other casualty, the loss falls upon the builder; he must rebuild. The thing may be done, and he has contracted to do it….No matter how harsh and apparently unjust in its operation the rule may occasionally be, it cannot be denied that it has its foundations in good sense and inflexible honesty. He that agrees to do an act should do it, unless absolutely impossible. He should provide against contingencies in his contract. Where one of two innocent persons must sustain a loss, the law casts it upon him who has agreed to sustain it; or, rather, the law leaves it where the agreement of the parties has put it….Neither the destruction of the incomplete building by a tornado, nor its falling by a latent softness of the soil, which rendered the foundation insecure, *necessarily* prevented the performance of the contract to build, erect, and complete this building for the specified price. It can still be done, for aught that was opened to the jury as a defense, and overruled by the court."

[8] In *Dermott* v. *Jones*, 2 Wall. 1, the foundation of the building sank, owing to a latent defect in the soil, and the owner was compelled to take down and rebuild a portion of the work. The contractor having sued for his pay, it was held that the owner might recoup the damages sustained by his deviation from the contract. The court refer with approval to the cases cited, and say: "The principle

which controlled them rests upon a solid foundation of reason and justice. It regards the sanctity of contracts. It requires a party to do what he has agreed to do. If unexpected impediments lie in the way, and a loss ensue, it leaves the loss where the contract places it. If the parties have made no provision for a dispensation, the rule of law gives none. It does not allow a contract fairly made to be annulled, and it does not permit to be interpolated what the parties themselves have not stipulated."

[9] Nothing can be added to the clear and cogent arguments we have quoted in vindication of the wisdom and justice of the rule which must govern this case, unless it is in some way distinguishable from the cases cited.

[10] It is argued that the spot on which the building is to be erected is not designated with precision in the contract, but is left to be selected by the owner; that, under the contract, the right to designate the particular spot being reserved to plaintiffs, they must select one that will sustain the building described in the specifications, and if the spot they select is not, in its natural state, suitable, they must make it so; that in this respect the present case differs from *School Trustees* v. *Bennett*.

[11] The contract does not, perhaps, designate the site of the proposed building with absolute certainty; but in this particular it is aided by the pleadings. The complaint states that defendants contracted to erect the proposed building on " *a certain piece* of land, of which the plaintiffs then were, and now are, the owners in fee, fronting on Minnesota street, between Third and Fourth streets, in the city of St. Paul." The answer expressly admits that the defendants entered into a contract to erect the building, according to the plans, etc., "on that certain piece of land in said complaint described," and that they "entered upon the performance of said contract, and proceeded with the erection of said building," etc. This is an express admission that the contract was made with reference to the identical piece of land on which the defendants afterwards attempted to perform it, and leaves no foundation in fact for the defendants' argument.

[12] It is no defense to the action that the specifications directed that "footings" should be used as the foundation of the building, and that the defendants, in the construction of these footings, as well as

in all other particulars, conformed to the specifications. The defendants contracted to ""erect and complete the building." Whatever was necessary to be done in order to complete the building, they were bound by the contract to do. If the building could not be completed without other or stronger foundations than the footings specified, they were bound to furnish such other foundations. If the building could not be erected without draining the land, then they must drain the land, "because they have agreed to do everything necessary to erect and complete the building." 3 Dutcher 520; and, see *Dermott* v. *Jones, supra*, where the same point was made by the contractor, but ruled against him by the court.

[13] As the draining of the land was, in fact, necessary to the erection and completion of the building, it was a thing to be done, under the contract, by the defendants. The prior parol agreement that plaintiffs should drain the land, related, therefore, to a matter embraced within the terms of the written contract, and was not, as claimed by defendants' counsel, collateral thereto. It was, accordingly, under the familiar rule, inadmissible in evidence to vary the terms of the written contract, and was properly excluded.

[14] In their second and third offers the defendants proposed to prove that after the making of the written contract, and when the defendants, in the course of their excavation for the cellar and foundation, first discovered that the soil, being porous and spongy, would not sustain the building, unless drained, the plaintiffs proposed and promised to keep the soil well drained during the construction of the building; that, in consequence, the defendants did not drain the same; that plaintiffs for a time kept the soil drained, but afterwards, and just before the fall of the building, they neglected to drain, in consequence of which neglect the soil became saturated with water, and the building fell; and that a like promise was made by defendants at the beginning of the erection of the second building, followed by like part performance and neglect, and subsequent, and consequent, fall of the building.

[15] The rule that a sealed contract cannot be varied by a subsequent parol agreement, is of great antiquity, the maxim on which it rests, *unumquodque dissolvitur eodem modo, quo ligatur*, being one of the most ancient in our law. Broom, Leg. Max. 877; 5 Rep. 26 *a*, citing Bracton, lib.

2, fol. 28; and, see Bracton, fol. 101. In early days the rigor with which it was enforced in the courts of law, led to the interference of chancery to prevent injustice. Per Lord ELLESMERE, *Earl of Oxford's Case*, 2 Lead. Cas. in Eq. 508*; 1 Spence, Eq. Jur. 636. In later times that rigor has become much relaxed, although the English courts of law have refused to permit sealed contracts to be varied by parol in cases of great hardship. *Littler* v. *Holland*, 3 Term R. 590; *Gwynne* v. *Davy*, 1 Man. & Gr. 857; *West* v. *Blakeway*, 2 Man. & Gr. 729; and, see *Albert* v. *Grosvenor Investment Co.* L. R. 3 Q. B. 123.

[16] But, in this country, it has become a well-settled exception to the rule, that a sealed contract may be modified by a subsequent parol agreement, if the latter has been executed, or has been so acted on that the enforcing of the original contract would be inequitable. *Munroe* v. *Perkins*, 9 Pick. 298; *Mill-dam Foundry* v. *Hovey*, 21 Pick. 417; *Blasdell* v. *Souther*, 6 Gray 149; *Foster* v. *Dawber*, 6 Exch. 854, and note; *Thurston* v. *Ludwig*, 6 Ohio St. 1; *Delacroix* v. *Bulkley*, 13 Wend. 71; *Allen* v. *Jaquish*, 21 Wend. 628; *Vicary* v. *Moore*, 2 Watts, 451; *Lawall* v. *Rader*, 24 Pa. St. 283; *Carrier* v. *Dilworth*, 59 Pa. St. 406; *Richardson* v. *Cooper*, 25 Me. 450; *Lawrence* v. *Dole*, 11 Vt. 549; *Patrick* v. *Adams*, 29 Vt. 376; *Seibert* v. *Leonard*, 17 Minn. 436, (Gil. 410;) *Very* v. *Levy*, 13 How. 345; 1 Smith, Lead. Cas. (6th Ed.) 576.

[17] Whether the evidence offered shows a valid consideration for the plaintiff's promise, or whether it shows that such promise, though without consideration, has been so acted on as to inure, by way of estoppel or otherwise, to release defendants from their obligation to drain, are questions that were fully discussed at the bar, but which we are not called upon to determine; for the objection is well taken by counsel for the plaintiffs, that the evidence embraced in the second and third offers is inadmissible under the pleadings.

[18] In their answer, the defendants allege an offer and promise by plaintiffs (made after the defendants had commenced work under the contract) to keep the land drained during the erection of the building. No consideration is alleged for this promise, and, as *nudum pactum*, it could of itself have no effect to vary the obligations imposed on the defendants by the sealed contract. The answer proceeds to allege "that the plaintiffs wholly and wrongfully failed and neglected to drain or

cause to be drained the said piece of land, or any part of the same." It is clear that the defendants would have no right to rely on this naked promise, followed by no acts of plaintiffs in part performance. If the defendants went on with the building, without taking the precaution to drain the land, they proceeded at their own risk. The answer sets up no facts on which an estoppel can be founded, and shows no defense to the action.

[19] But the defendants, at the trial, offered to prove, not only that the plaintiffs offered to drain the land, but also "that the plaintiffs did, for a time, keep the same drained,…but afterwards they neglected to do so," etc. Assuming that the facts offered to be proved would constitute a defense, (and we are not prepared to say they would not,) no such defense is pleaded in the answer.

[20] The tendency of this proof was to establish a new defense, not pleaded, and to contradict, rather than to sustain, the allegations of the answer. For this reason it was inadmissible, even if the facts offered to be proved would, if admissible constitute a defense to the action. If the proof offered would have no such tendency, it was immaterial, and for this reason also was rightly excluded. And as all the evidence embraced in each offer was offered as a whole, and a part thereof was inadmissible, the entire offers were properly rejected.

[21] The objection that the evidence offered was "incompetent, irrelevant, and immaterial," was sufficiently specific. The defendants' counsel must know the contents of the answer, and that evidence inconsistent therewith is inadmissible, if objected to.

[22] There was, therefore, no error in the exclusion of the evidence offered, and the order appealed from is affirmed.

1.1.1. Discussion of *Stees v. Leonard*

The owners allegedly promised but failed to keep the soil drained. Why did the *Stees* court refuse to entertain the argument that the owners' promise had modified the original contract or that the builder had relied on that promise to its detriment?

What exactly did the contract in this case require the builder to do?

Did the parties discuss or negotiate over the possibility that the soil might be unable to support the building?

Try applying the comparative advantage criterion to this situation. Can you think of arguments that would support imposing the risk of poor soil conditions on the owner? On the builder?

1.2. Principal Case – *Taylor v. Caldwell*

Taylor v. Caldwell
King's Bench
3 B. & S. 826, 112 Eng. Rep. 309 (1863)

BLACKBURN J.

[1] In this case the plaintiffs and defendants had, on the 27th May, 1861, entered into a contract by which the defendants agreed to let the plaintiffs have the use of The Surrey Gardens and Music Hall on four days then to come, viz., the 17th June, 15th July, 5th August and 19th August, for the purpose of giving a series of four grand concerts, and day and night fetes at the Gardens and Hall on those days respectively; and the plaintiffs agreed to take the Gardens and Hall on those days, and pay 100£ for each day. The parties inaccurately call this a "letting," and the money to be paid a "rent;" but the whole agreement is such as to shew that the defendants were to retain the possession of the Hall and Gardens so that there was to be no demise of them, and that the contract was merely to give the plaintiffs the use of them on those days. Nothing however, in our opinion, depends on this. The agreement then proceeds to set out various stipulations between the parties as to what each was to supply for these concerts and entertainments, and as to the manner in which they should be carried on. The effect of the whole is to shew that the existence of the Music Hall in the Surrey Gardens in a state fit for a concert was essential for the fulfilment of the contract—such entertainments as the parties contemplated in their agreement could not be given without it. After the making of the agreement, and before the first day on which a concert was to be given, the Hall was destroyed by fire. This destruction, we must take it on the evidence, was without the fault of either party, and was so complete that in consequence the concerts could not be given as intended. And the question we have to decide is whether, under these circumstances, the loss which the plaintiffs

have sustained is to fall upon the defendants. The parties when framing their agreement evidently had not present to their minds the possibility of such a disaster, and have made no express stipulation with reference to it, so that the answer to the question must depend upon the general rules of law applicable to such a contract.

[2] There seems no doubt that where there is a positive contract to do a thing, not in itself unlawful, the contractor must perform it or pay damages for not doing it, although in consequence of unforeseen accidents, the performance of his contract has become unexpectedly burthensome or even impossible. The law is so laid down in 1 Roll. Abr. 450, Condition (G), and in the note (2) to Walton v. Waterhouse (2 Wms. Saund. 421 a. 6th ed.), and is recognised as the general rule by all the Judges in the much discussed case of Hall v. Wright (E. B. & E. 746). But this rule is only applicable when the contract is positive and absolute, and not subject to any condition either express or implied: and there are authorities which, as we think, establish the principle that where, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless when the time for the fulfilment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done; there, in the absence of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor. There seems little doubt that this implication tends to further the great object of making the legal construction such as to fulfil the intention of those who entered into the contract. For in the course of affairs men in making such contracts in general would, if it were brought to their minds, say that there should be such a condition. Accordingly, in the Civil law, such an exception is implied in every obligation of the class which they call obligatio de certo corpore. The rule is laid down in the Digest, lib. xLv., tit. l, de verborum obligationibus, 1. 33. "Si Stichus certo die dari promissus, ante diem moriatur: non tenetur promissor." The principle is more fully developed in l. 23. "Si ex legati

causa, aut ex stipulatii hominem certum mihi debeas: non aliter post mortem ejus tenearis mihi, quam si per te steterit, quominus vivo eo eum mihi dares: quod ita fit, si aut interpellatus non dedisti, aut occidisti eum." The examples are of contracts respecting a slave, which was the common illustration of a certain subject used by the Roman lawyers, just as we are apt to take a horse; and no doubt the propriety, one might almost say necessity, of the implied condition is more obvious when the contract relates to a living animal, whether man or brute, than when it relates to some inanimate thing (such as in the present case a theatre) the existence of which is not so obviously precarious as that of the live animal, but the principle is adopted in the Civil law as applicable to every obligation of which the subject is a certain thing. The general subject is treated of by Pothier, who in his Traite des Obligations, partie 3, chap. 6, art. 3, § 668 states the result to be that the debtor corporis certi is freed from his obligation when the thing has perished, neither by his act, nor his neglect, and before he is in default, unless by some stipulation he has taken on himself the risk of the particular misfortune which has occurred.

[3] Although the Civil law is not of itself authority in an English Court, it affords great assistance in investigating the principles on which the law is grounded. And it seems to us that the common law authorities establish that in such a contract the same condition of the continued existence of the thing is implied by English law.

[4] There is a class of contracts in which a person binds himself to do something which requires to be performed by him in person; and such promises, e.g. promises to marry, or promises to serve for a certain time, are never in practice qualified by an express exception of the death of the party; and therefore in such cases the contract is in terms broken if the promisor dies before fulfilment. Yet it was very early determined that, if the performance is personal, the executors are not liable; *Hyde v. The Dean of Windsor* (Cro. Eliz. 552, 553). See 2 Wms. Exors. 1560, 5th ed., where a very apt illustration is given. "Thus," says the learned author, "if an author undertakes to compose a work, and dies before completing it, his executors are discharged from this contract: for the undertaking is merely personal in its nature, and, by the intervention of the contractor's death, has become impossible to be performed." For this he cites a dictum of Lord Lyndhurst in *Marshall v. Broadhurst* (1 Tyr.

348, 349), and a case mentioned by Patteson J. in Wentworth v. Cock (10 A. & E. 42, 45-46). In *Hall v. Wright* (E. B. & E. 746, 749), Crompton J., in his judgment, puts another case. "Where a contract depends upon personal skill, and the act of God renders it impossible, as, for instance, in the case of a painter employed to paint a picture who is struck blind, it may be that the performance might be excused."

[5] It seems that in those cases the only ground on which the parties or their executors, can be excused from the consequences of the breach of the contract is, that from the nature of the contract there is an implied condition of the continued existence of the life of the contractor, and, perhaps in the case of the painter of his eyesight. In the instances just given, the person, the continued existence of whose life is necessary to the fulfilment of the contract, is himself the contractor, but that does not seem in itself to be necessary to the application of the principle; as is illustrated by the following example. In the ordinary form of an apprentice deed the apprentice binds himself in unqualified terms to "serve until the full end and term of seven years to be fully complete and ended," during which term it is covenanted that the apprentice his master "faithfully shall serve," and the father of the apprentice in equally unqualified terms binds himself for the performance by the apprentice of all and every covenant on his part. (See the form, 2 Chitty on Pleading, 370, 7th ed. by Greening.) It is undeniable that if the apprentice dies within the seven years, the covenant of the father that he shall perform his covenant to serve for seven years is not fulfilled, yet surely it cannot be that an action would lie against the father? Yet the only reason why it would not is that he is excused because of the apprentice's death.

[6] These are instances where the implied condition is of the life of a human being, but there are others in which the same implication is made as to the continued existence of a thing. For example, where a contract of sale is made amounting to a bargain and sale, transferring presently the property in specific chattels, which are to be delivered by the vendor at a future day; there, if the chattels, without the fault of the vendor, perish in the interval, the purchaser must pay the price and the vendor is excused from performing his contract to deliver, which has thus become impossible.

[7] That this is the rule of the English law is established by the case of *Rugg v. Minett* (11 East, 210), where the article that perished before delivery was turpentine, and it was decided that the vendor was bound to refund the price of all those lots in which the property had not passed; but was entitled to retain without deduction the price of those lots in which the property had passed, though they were not delivered, and though in the conditions of sale, which are set out in the report, there was no express qualification of the promise to deliver on payment. It seems in that case rather to have been taken for granted than decided that the destruction of the thing sold before delivery excused the vendor from fulfilling his contract to deliver on payment.

[8] This also is the rule in the Civil law, and it is worth noticing that Pothier, in his celebrated Traite du Contrat de Vente (see Part. 4, § 307, etc.; and Part. 2, ch. 1, sect. 1, art. 4, § 1), treats this as merely an example of the more general rule that every obligation de certo corpore is extinguished when the thing ceases to exist. See Blackburn on the Contract of Sale, p. 173.

[9] The same principle seems to be involved in the decision of *Sparrow v. Sowyate* (W. Jones, 29), where, to an action of debt on an obligation by bail, conditioned for the payment of the debt or the render of the debtor, it was held a good plea that before any default in rendering him the principal debtor died. It is true that was the case of a bond with a condition, and a distinction is sometimes made in this respect between a condition and a contract. But this observation does not apply to *Williams v. Lloyd* (W. Jones, 179). In that case the count, which was in assumpsit, alleged that the plaintiff had delivered a horse to the defendant, who promised to redeliver it on request. Breach, that though requested to redeliver the horse he refused. Plea, that the horse was sick and died, and the plaintiff made the request after its death; and on demurrer it was held a good plea, as the bailee was discharged from his promise by the death of the horse without default or negligence on the part of the defendant. "Let it be admitted," say the Court, "that he promised to deliver it on request, if the horse die before, that is become impossible by the act of God, so the party shall be discharged, as much as if an obligation were made conditioned to deliver the horse on request, and he died before it." And Jones, adds the report, cited 22 Ass. 41, in which it was held that a

ferryman who had promised to carry a horse safe across the ferry was held chargeable for the drowning of the animal only because he had overloaded the boat, and it was agreed, that notwithstanding the promise no action would have lain had there been no neglect or default on his part. It may, we think, be safely asserted to be now English law, that in all contracts of loan of chattels or bailments if the performance of the promise of the borrower or bailee to return the things lent or bailed, becomes impossible because it has perished, this impossibility (if not arising from the fault of the borrower or bailee from some risk which he has taken upon himself) excuses the borrower or bailee from the performance of his promise to redeliver the chattel. The great case of *Coggs v. Bernard* (1 Smith's L. C. 171, 5th ed.; 2 L. Raym. 909) is now the leading case on the law of bailments, and Lord Holt, in that case, referred so much to the Civil law that it might perhaps be thought that this principle was there derived direct from the civilians, and was not generally applicable in English law except in the ease of bailments; but the case of *Williams v. Lloyd* (W. Jones, 179), above cited, shews that the same law had been already adopted by the English law as early as The Book of Assizes. The principle seems to us to be that, in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance. In none of these cases is the promise in words other than positive, nor is there any express stipulation that the destruction of the person or thing shall excuse the performance; but that excuse is by law implied, because from the nature of the contract it is apparent that the parties contracted on the basis of the continued existence of the particular person or chattel. In the present case, looking at the whole contract, we find that the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance.

[10] We think, therefore, that the Music Hall having ceased to exist, without fault of either party, both parties are excused, the plaintiffs from taking the gardens and paying the money, the defendants from performing their promise to give the use of the Hall and Gardens and

other things. Consequently the rule must be absolute to enter the verdict for the defendants.

[11] Rule absolute.

1.2.1. Paradine v. Jane

Suppose that a rich Englishman rents a castle from a neighboring lord. Their brief lease agreement specifies a four-year term and a rental rate. It also makes the lessee responsible for ordinary maintenance during the term of the lease. Imagine now that the armies of Prince Rupert occupy the region and force the lessee to leave the property. Would the lessee be excused from paying rent during the occupation? Or is the lessor entitled to receive rental payments until the end of the lease term?

Here is what one court had to say about these questions:

> [I]f a house be destroyed by tempest, or by enemies, the lessee is excused.… [W]hen the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract. And therefore if the lessee covenant to repair a house, though it be burnt by lightning, or thrown down by enemies, yet he ought to repair it. Dyer 33.a. 40 E.3. 6.h. … Another reason was added, that as the lessee is to have the advantage of casual profits, so he must run the hazard of casual losses, and not lay the whole of the burthen of them upon his lessor; and Dyer 56.6 was cited for this purpose, that though the land be surrounded, or gained by the sea, or made barren by wildfire, yet the lessor shall have his whole rent: and judgment was given for the plaintiff.

Paradine v. Jane, Aleyn 26, 82 Eng. Rep. 897 (K.B. 1647).

1.2.2. Analyzing Risk

Economists and businesspeople often analyze contingencies using the framework of expected value. According to this approach, the magnitude of a risk (R) equals the product of its impact (I) and the probability (P) that the particular risk will materialize. The formula $R = I \cdot P$ summarizes this relationship and suggests the analytic usefulness of identifying these distinct components of risk.

Legal analysis of risk allocation often requires even more detailed attention to each party's relationship with a particular risk. Consider, for example, the risk discussed in *Taylor v. Caldwell* that a shipment of turpentine will be burned at the docks before it reaches the purchaser. It may be helpful to think of three broad factors affecting the optimal allocation of this risk between the parties. First, which one of the parties is best able to *assess* the risk of fire? Who has better access to information or can gather relevant information at lower cost? Second, which party is best positioned to *avoid* the risk? Who can more cheaply take precautions to reduce the impact or probability of harm? Finally, which party could most easily *insure* against the risk?

1.2.3. Discussion of *Taylor v. Caldwell*

On what basis does the *Taylor* court decide to excuse Caldwell from performing his contractual obligation to provide the Surrey Gardens and Music Hall to Taylor? The court must decide how to allocate the risk that the music hall would be burned down before the first concert. Does the contract language play any role in the court's decision? If not the contract language, then what is the source of the court's rule for allocating this risk?

Suppose that one of your talented classmates contracts with you to provide high quality class notes covering each meeting of all of your first-semester courses. Tragically, this classmate dies before she has an opportunity to perform. How might the risk analysis framework outlined above apply to this risk? Are you or your classmate in a better position to assess, avoid or insure against the risk of her untimely demise? Is it helpful to consider separately the impact and probability of her death?

Does a similar analysis shed any light on how to allocate the risk that materialized in *Taylor v. Caldwell*? Can we draw any conclusions from this analysis about how to choose the socially optimal legal rule to govern excuse?

2. Mistake

We have already encountered contract doctrines that excuse performance when certain contingencies arise. In *Stees v. Leonard*, for example, the court observes that performance would have been excused if it were physically impossible to complete the building. Similarly, the court in *Taylor v. Caldwell* finds that the destruction of property necessary for performance excuses both parties' duties under the contract. The doctrine of

commercial impracticability modestly extends these principles to excuse a promisor when performance "has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." U.C.C. § 2-615. *See also* Restatement (Second) of Contracts (1981) § 261 ("Discharge by Supervening Impracticability") [hereinafter Restatement (Second)]. Finally, the common law also excuses performance when "a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made." Restatement (Second) § 265. Taken together, these doctrines establish a set of default rules for allocating the risk of events that make performance more difficult or impair the value of performance. However, the parties remain free to opt out of this default risk allocation by including appropriate language in their contract.

The rules governing unilateral and mutual mistake that we examine in this section are another example of default risk allocations. In these cases, one or both of the parties has made a contract based on a mistaken belief about important facts. As with the excuse doctrines, the parties may opt out with express language allocating the risk. Disputes most often arise, however, when neither party has anticipated the particular mistake and provided for it in the contract. As you read the cases that follow, try to determine what policy concerns affect the structure of these default rules.

The Restatement (Second) describes the mistake doctrines in the following terms:

§ 151 Mistake Defined

A mistake is a belief that is not in accord with the facts.

§ 152 When Mistake of Both Parties Makes a Contract Voidable

(1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the

contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in § 154.

(2) In determining whether the mistake has a material effect on the agreed exchange of performances, account is taken of any relief by way of reformation, restitution, or otherwise.

§ 153 When Mistake of One Party Makes a Contract Voidable

Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake under the rule stated in § 154, and

(a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or

(b) the other party had reason to know of the mistake or his fault caused the mistake.

§ 154 When a Party Bears the Risk of a Mistake

A party bears the risk of a mistake when

(a) the risk is allocated to him by agreement of the parties, or

(b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or

(c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so.

2.1. Principal Case – *Sherwood v. Walker*

Sherwood v. Walker
Supreme Court of Michigan
66 Mich. 568, 33 N.W. 919 (1887)

MORSE, J.

[1] Replevin for a cow. Suit commenced in justice's court; judgment for plaintiff; appealed to circuit court of Wayne county, and verdict and judgment for plaintiff in that court. The defendants bring error, and set out 25 assignments of the same.

[2] The main controversy depends upon the construction of a contract for the sale of the cow. The plaintiff claims that the title passed, and bases his action upon such claim. The defendants contend that the contract was executory, and by its terms no title to the animal was acquired by plaintiff. The defendants reside at Detroit, but are in business at Walkerville, Ontario, and have a farm at Greenfield, in Wayne county, upon which were some blooded cattle supposed to be barren as breeders. The Walkers are importers and breeders of polled Angus cattle. The plaintiff is a banker living at Plymouth, in Wayne county. He called upon the defendants at Walkerville for the purchase of some of their stock, but found none there that suited him. Meeting one of the defendants afterwards, he was informed that they had a few head upon their Greenfield farm. He was asked to go out and look at them, with the statement at the time that they were probably barren, and would not breed. May 5, 1886, plaintiff went out to Greenfield, and saw the cattle. A few days thereafter, he called upon one of the defendants with the view of purchasing a cow, known as "Rose 2d of Aberlone." After considerable talk, it was agreed that defendants would telephone Sherwood at his home in Plymouth in reference to the price. The second morning after this talk he was called up by telephone, and the terms of the sale were finally agreed upon. He was to pay five and one-half cents per pound, live weight, fifty pounds shrinkage. He was asked how he intended to take the cow home, and replied that he might ship her from King's cattle-yard. He requested defendants to confirm the sale in writing, which they did by sending him the following letter:

WALKERVILLE, May 15, 1886.

T.C. Sherwood, President, etc.-DEAR SIR: We confirm sale to you of the cow Rose 2d of Aberlone, lot 56 of our catalogue, at five and half cents per pound, less fifty pounds shrink. We inclose herewith order on Mr. Graham for the cow. You might leave check with him, or mail to us here, as you prefer.

Yours, truly, HIRAM WALKER & SONS.

The order upon Graham inclosed in the letter read as follows:

WALKERVILLE, May 15, 1886.

George Graham: You will please deliver at King's cattle-yard to Mr. T.C. Sherwood, Plymouth, the cow Rose 2d of Aberlone, lot 56 of our catalogue. Send halter with the cow, and have her weighed.

Yours truly, HIRAM WALKER & SONS.

[3] On the twenty-first of the same month the plaintiff went to defendants' farm at Greenfield, and presented the order and letter to Graham, who informed him that the defendants had instructed him not to deliver the cow. Soon after, the plaintiff tendered to Hiram Walker, one of the defendants, $80, and demanded the cow. Walker refused to take the money or deliver the cow. The plaintiff then instituted this suit. After he had secured possession of the cow under the writ of replevin, the plaintiff caused her to be weighed by the constable who served the writ, at a place other than King's cattle-yard. She weighed 1,420 pounds.

[4] When the plaintiff, upon the trial in the circuit court, had submitted his proofs showing the above transaction, defendants moved to strike out and exclude the testimony from the case, for the reason that it was irrelevant and did not tend to show that the title to the cow passed, and that it showed that the contract of sale was merely executory. The court refused the motion, and an exception was taken. The defendants then introduced evidence tending to show that at the time of the alleged sale it was believed by both the plaintiff and themselves that the cow was barren and would not breed; that she cost $850, and if not barren would be worth from $750 to $1,000; that after the date of the letter, and the order to Graham, the defendants were informed by said Graham that in his judgment the cow was with calf, and therefore they instructed him

not to deliver her to plaintiff, and on the twentieth of May, 1886, telegraphed plaintiff what Graham thought about the cow being with calf, and that consequently they could not sell her. The cow had a calf in the month of October following. On the nineteenth of May, the plaintiff wrote Graham as follows:

PLYMOUTH, May 19, 1886.

Mr. George Graham, Greenfield-DEAR SIR: I have bought Rose or Lucy from Mr. Walker, and will be there for her Friday morning, nine or ten o'clock. Do not water her in the morning.

Yours, etc., T.C. SHERWOOD.

[5] Plaintiff explained the mention of the two cows in this letter by testifying that, when he wrote this letter, the order and letter of defendants was at his home, and, writing in a hurry, and being uncertain as to the name of the cow, and not wishing his cow watered, he thought it would do no harm to name them both, as his bill of sale would show which one he had purchased. Plaintiff also testified that he asked defendants to give him a price on the balance of their herd at Greenfield, as a friend thought of buying some, and received a letter dated May 17, 1886, in which they named the price of five cattle, including Lucy, at $90, and Rose 2d at $80. When he received the letter he called defendants up by telephone, and asked them why they put Rose 2d in the list, as he had already purchased her. They replied that they knew he had, but thought it would make no difference if plaintiff and his friend concluded to take the whole herd.

[6] The foregoing is the substance of all the testimony in the case.

[7] The circuit judge instructed the jury that if they believed the defendants, when they sent the order and letter to plaintiff, meant to pass the title to the cow, and that the cow was intended to be delivered to plaintiff, it did not matter whether the cow was weighed at any particular place, or by any particular person; and if the cow was weighed afterwards, as Sherwood testified, such weighing would be a sufficient compliance with the order. If they believed that defendants intended to pass the title by writing, it did not matter whether the cow was weighed before or after

suit brought, and the plaintiff would be entitled to recover. The defendants submitted a number of requests which were refused. The substance of them was that the cow was never delivered to plaintiff, and the title to her did not pass by the letter and order; and that under the contract, as evidenced by these writings, the title did not pass until the cow was weighed and her price thereby determined; and that, if the defendants only agreed to sell a cow that would not breed, then the barrenness of the cow was a condition precedent to passing title, and plaintiff cannot recover. The court also charged the jury that it was immaterial whether the cow was with calf or not. It will therefore be seen that the defendants claim that, as a matter of law, the title of this cow did not pass, and that the circuit judge erred in submitting the case to the jury, to be determined by them, upon the intent of the parties as to whether or not the title passed with the sending of the letter and order by the defendants to the plaintiff.

[Paragraphs 8-13 discuss the comparatively arcane (and now archaic) issue of passing legal title to the cow. This portion of the opinion is not central to understanding mistake doctrine and thus you may feel free to skim until you reach paragraph 14.]

[8] This question as to the passing of title is fraught with difficulties, and not always easy of solution. An examination of the multitude of cases bearing upon this subject, with their infinite variety of facts, and at least apparent conflict of law, ofttimes tends to confuse rather than to enlighten the mind of the inquirer. It is best, therefore, to consider always, in cases of this kind, the general principles of the law, and then apply them as best we may to the facts of the case in hand.

[9] The cow being worth over $50, the contract of sale, in order to be valid, must be one where the purchaser has received or accepted part of the goods, or given something in earnest, or in part payment, or where the seller has signed some note or memorandum in writing. How.St. § 6186. Here there was no actual delivery, nor anything given in payment or in earnest, but there was a sufficient memorandum signed by the defendants to take the case out of the statute, if the matter contained in such memorandum is sufficient to constitute a completed sale. It is evident from the letter that the payment of the purchase price was not intended as a condition precedent to the passing of the title. Mr.

Sherwood is given his choice to pay the money to Graham at King's cattle-yards, or to send check by mail.

[10] Nor can there be any trouble about the delivery. The order instructed Graham to deliver the cow, upon presentation of the order, at such cattle-yards. But the price of the cow was not determined upon to a certainty. Before this could be ascertained, from the terms of the contract, the cow had to be weighed; and, by the order inclosed with the letter, Graham was instructed to have her weighed. If the cow had been weighed, and this letter had stated, upon such weight, the express and exact price of the animal, there can be no doubt but the cow would have passed with the sending and receipt of the letter and order by the plaintiff. Payment was not to be a concurrent act with the delivery, and therein this case differs from *Case v. Dewey*, 55 Mich. 116, 20 N.W.Rep. 817, and 21 N.W.Rep. 911. Also, in that case, there was no written memorandum of the sale, and a delivery was necessary to pass the title of the sheep; and it was held that such delivery could only be made by a surrender of the possession to the vendee, and an acceptance by him. Delivery by an actual transfer of the property from the vendor to the vendee, in a case like the present, where the article can easily be so transferred by a manual act, is usually the most significant fact in the transaction to show the intent of the parties to pass the title, but it never has been held conclusive. Neither the actual delivery, nor the absence of such delivery, will control the case, where the intent of the parties is clear and manifest that the matter of delivery was not a condition precedent to the passing of the title, or that the delivery did not carry with it the absolute title. The title may pass, if the parties so agree, where the statute of frauds does not interpose without delivery, and property may be delivered with the understanding that the title shall not pass until some condition is performed.

[11] And whether the parties intended the title should pass before delivery or not is generally a question of fact to be determined by a jury. In the case at bar the question of the intent of the parties was submitted to the jury. This submission was right, unless from the reading of the letter and the order, and all the facts of the oral bargaining of the parties, it is perfectly clear, as a matter of law, that the intent of the parties was that the cow should be weighed, and the price thereby

accurately determined, before she should become the property of the plaintiff. I do not think that the intent of the parties in this case is a matter of law, but one of fact. The weighing of the cow was not a matter that needed the presence or any act of the defendants, or any agent of theirs, to be well or accurately done. It could make no difference where or when she was weighed, if the same was done upon correct scales, and by a competent person. There is no pretense but what her weight was fairly ascertained by the plaintiff. The cow was specifically designated by this writing, and her delivery ordered, and it cannot be said, in my opinion, that the defendants intended that the weighing of the animal should be done before the delivery even, or the passing of title. The order to Graham is to deliver her, and then follows the instruction, not that he shall weigh her himself, or weigh her, or even have her weighed, before delivery, but simply, "Send halter with the cow, and have her weighed."

[12] It is evident to my mind that they had perfect confidence in the integrity and responsibility of the plaintiff, and that they considered the sale perfected and completed when they mailed the letter and order to plaintiff. They did not intend to place any conditions precedent in the way, either of payment of the price, or the weighing of the cow, before the passing of the title. They cared not whether the money was paid to Graham, or sent to them afterwards, or whether the cow was weighed before or after she passed into the actual manual grasp of the plaintiff. The refusal to deliver the cow grew entirely out of the fact that, before the plaintiff called upon Graham for her, they discovered she was not barren, and therefore of greater value than they had sold her for.

[13] The following cases in this court support the instruction of the court below as to the intent of the parties governing and controlling the question of a completed sale, and the passing of title: *Lingham v. Eggleston*, 27 Mich. 324; *Wilkinson v. Holiday*, 33 Mich. 386; *Grant v. Merchants' & Manufacturers' Bank*, 35 Mich. 527; *Carpenter v. Graham*, 42 Mich. 194, 3 N.W.Rep. 974; *Brewer v. Michigan Salt Ass'n*, 47 Mich. 534, 11 N.W.Rep. 370; *Whitcomb v. Whitney*, 24 Mich. 486; *Byles v. Colier*, 54 Mich. 1, 19 N.W.Rep. 565; *Scotten v. Sutter*, 37 Mich. 527, 532;

Ducey Lumber Co. v. Lane, 58 Mich. 520, 525, 25 N.W.Rep. 568; *Jenkinson v. Monroe*, 28 N.W.Rep. 663.

[14] It appears from the record that both parties supposed this cow was barren and would not breed, and she was sold by the pound for an insignificant sum as compared with her real value if a breeder. She was evidently sold and purchased on the relation of her value for beef, unless the plaintiff had learned of her true condition, and concealed such knowledge from the defendants. Before the plaintiff secured the possession of the animal, the defendants learned that she was with calf, and therefore of great value, and undertook to rescind the sale by refusing to deliver her. The question arises whether they had a right to do so. The circuit judge ruled that this fact did not avoid the sale and it made no difference whether she was barren or not. I am of the opinion that the court erred in this holding. I know that this is a close question, and the dividing line between the adjudicated cases is not easily discerned. But it must be considered as well settled that a party who has given an apparent consent to a contract of sale may refuse to execute it, or he may avoid it after it has been completed, if the assent was founded, or the contract made, upon the mistake of a material fact—such as the subject-matter of the sale, the price, or some collateral fact materially inducing the agreement; and this can be done when the mistake is mutual. 1 Benj. Sales, §§ 605, 606; Leake, Cont. 339; Story, Sales, (4th Ed.) §§ 377, 148. See, also, *Cutts v. Guild*, 57 N.Y. 229; *Harvey v. Harris*, 112 Mass. 32; *Gardner v. Lane*, 9 Allen, 492, 12 Allen, 44; *Huthmacher v. Harris' Adm'rs*, 38 Pa.St. 491; *Byers v. Chapin*, 28 Ohio St. 300; *Gibson v. Pelkie*, 37 Mich. 380, and cases cited; *Allen v. Hammond*, 11 Pet. 63-71.

[15] If there is a difference or misapprehension as to the substance of the thing bargained for; if the thing actually delivered or received is different in substance from the thing bargained for, and intended to be sold—then there is no contract; but if it be only a difference in some quality or accident, even though the mistake may have been the actuating motive to the purchaser or seller, or both of them, yet the contract remains binding. "The difficulty in every case is to determine whether the mistake or misapprehension is as to the substance of the whole contract, going, as it were, to the root of the matter, or only to some point, even though a material point, an error as to which does not

affect the substance of the whole consideration." *Kennedy v. Panama, etc., Mail Co.*, L.R. 2 Q.B. 580, 587. It has been held, in accordance with the principles above stated, that where a horse is bought under the belief that he is sound, and both vendor and vendee honestly believe him to be sound, the purchaser must stand by his bargain, and pay the full price, unless there was a warranty.

[16] It seems to me, however, in the case made by this record, that the mistake or misapprehension of the parties went to the whole substance of the agreement. If the cow was a breeder, she was worth at least $750; if barren, she was worth not over $80. The parties would not have made the contract of sale except upon the understanding and belief that she was incapable of breeding, and of no use as a cow. It is true she is now the identical animal that they thought her to be when the contract was made; there is no mistake as to the identity of the creature. Yet the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them for all purposes of use as there is between an ox and a cow that is capable of breeding and giving milk. If the mutual mistake had simply related to the fact whether she was with calf or not for one season, then it might have been a good sale, but the mistake affected the character of the animal for all time, and for its present and ultimate use. She was not in fact the animal, or the kind of animal, the defendants intended to sell or the plaintiff to buy. She was not a barren cow, and, if this fact had been known, there would have been no contract. The mistake affected the substance of the whole consideration, and it must be considered that there was no contract to sell or sale of the cow as she actually was. The thing sold and bought had in fact no existence. She was sold as a beef creature would be sold; she is in fact a breeding cow, and a valuable one. The court should have instructed the jury that if they found that the cow was sold, or contracted to be sold, upon the understanding of both parties that she was barren, and useless for the purpose of breeding, and that in fact she was not barren, but capable of breeding, then the defendants had a right to rescind, and to refuse to deliver, and the verdict should be in their favor.

[17] The judgment of the court below must be reversed, and a new trial granted, with costs of this court to defendants.

CAMPBELL, C.J., AND CHAMPLIN, J., CONCURRED.

SHERWOOD, J., [WHO, DESPITE HIS NAME, IS UNRELATED TO THE PLAINTIFF] (DISSENTING)

[18] I do not concur in the opinion given by my brethren in this case. I think the judgments before the justice and at the circuit were right. I agree with my Brother MORSE that the contract made was not within the statute of frauds, and the payment for the property was not a condition precedent to the passing of the title from the defendants to the plaintiff. And I further agree with him that the plaintiff was entitled to a delivery of the property to him when the suit was brought, unless there was a mistake made which would invalidate the contract, and I can find no such mistake. There is no pretense there was any fraud or concealment in the case, and an intimation or insinuation that such a thing might have existed on the part of either of the parties would undoubtedly be a greater surprise to them than anything else that has occurred in their dealings or in the case.

[19] As has already been stated by my brethren, the record shows that the plaintiff is a banker and farmer as well, carrying on a farm, and raising the best breeds of stock, and lived in Plymouth, in the county of Wayne, 23 miles from Detroit; that the defendants lived in Detroit, and were also dealers in stock of the higher grades; that they had a farm at Walkerville, in Canada, and also one in Greenfield in said county of Wayne, and upon these farms the defendants kept their stock. The Greenfield farm was about 15 miles from the plaintiff's. In the spring of 1886 the plaintiff, learning that the defendants had some "polled Angus cattle" for sale, was desirous of purchasing some of that breed, and meeting the defendants, or some of them, at Walkerville, inquired about them, and was informed that they had none at Walkerville, "but had a few head left on their farm in Greenfield, and asked the plaintiff to go and see them, stating that in all probability they were sterile and would not breed." In accordance with said request, the plaintiff, on the fifth day of May, went out and looked at the defendants' cattle at Greenfield, and found one called "Rose, Second," which he wished to purchase, and the

terms were finally agreed upon at five and a half cents per pound, live weight, 50 pounds to be deducted for shrinkage. The sale was in writing, and the defendants gave an order to the plaintiff directing the man in charge of the Greenfield farm to deliver the cow to plaintiff. This was done on the fifteenth of May. On the twenty-first of May plaintiff went to get his cow, and the defendants refused to let him have her; claiming at the time that the man in charge at the farm thought the cow was with calf, and, if such was the case, they would not sell her for the price agreed upon. The record further shows that the defendants, when they sold the cow, believed the cow was not with calf, and barren; that from what the plaintiff had been told by defendants (for it does not appear he had any other knowledge or facts from which he could form an opinion) he believed the cow was farrow, but still thought she could be made to breed. The foregoing shows the entire interview and treaty between the parties as to the sterility and qualities of the cow sold to the plaintiff. The cow had a calf in the month of October.

[20] There is no question but that the defendants sold the cow representing her of the breed and quality they believed the cow to be, and that the purchaser so understood it. And the buyer purchased her believing her to be of the breed represented by the sellers, and possessing all the qualities stated, and even more. He believed she would breed. There is no pretense that the plaintiff bought the cow for beef, and there is nothing in the record indicating that he would have bought her at all only that he thought she might be made to breed. Under the foregoing facts—and these are all that are contained in the record material to the contract—it is held that because it turned out that the plaintiff was more correct in his judgment as to one quality of the cow than the defendants, and a quality, too, which could not by any possibility be positively known at the time by either party to exist, the contract may be annulled by the defendants at their pleasure. I know of no law, and have not been referred to any, which will justify any such holding, and I think the circuit judge was right in his construction of the contract between the parties.

[21] It is claimed that a mutual mistake of a material fact was made by the parties when the contract of sale was made. There was no warranty in the case of the quality of the animal. When a mistaken fact is relied upon as ground for rescinding, such fact must not only exist at the

time the contract is made, but must have been known to one or both of the parties. Where there is no warranty, there can be no mistake of fact when no such fact exists, or, if in existence, neither party knew of it, or could know of it; and that is precisely this case. If the owner of a Hambletonian horse had speeded him, and was only able to make him go a mile in three minutes, and should sell him to another, believing that was his greatest speed, for $300, when the purchaser believed he could go much faster, and made the purchase for that sum, and a few days thereafter, under more favorable circumstances, the horse was driven a mile in 2 min. 16 sec., and was found to be worth $20,000, I hardly think it would be held, either at law or in equity, by any one, that the seller in such case could rescind the contract. The same legal principles apply in each case.

[22] In this case neither party knew the actual quality and condition of this cow at the time of the sale. The defendants say, or rather said, to the plaintiff, "they had a few head left on their farm in Greenfield, and asked plaintiff to go and see them, stating to plaintiff that in all probability they were sterile and would not breed." Plaintiff did go as requested, and found there these cows, including the one purchased, with a bull. The cow had been exposed, but neither knew she was with calf or whether she would breed. The defendants thought she would not, but the plaintiff says that he thought she could be made to breed, but believed she was not with calf. The defendants sold the cow for what they believed her to be, and the plaintiff bought her as he believed she was, after the statements made by the defendants. No conditions whatever were attached to the terms of sale by either party. It was in fact as absolute as it could well be made, and I know of no precedent as authority by which this court can alter the contract thus made by these parties in writing—interpolate in it a condition by which, if the defendants should be mistaken in their belief that the cow was barren, she could be returned to them and their contract should be annulled. It is not the duty of courts to destroy contracts when called upon to enforce them, after they have been legally made. There was no mistake of any material fact by either of the parties in the case as would license the vendors to rescind. There was no difference between the parties, nor misapprehension, as to the substance of the thing bargained for, which

was a cow supposed to be barren by one party, and believed not to be by the other. As to the quality of the animal, subsequently developed, both parties were equally ignorant, and as to this each party took his chances. If this were not the law, there would be no safety in purchasing this kind of stock.

[23] I entirely agree with my brethren that the right to rescind occurs whenever "the thing actually delivered or received is different in substance from the thing bargained for, and intended to be sold; but if it be only a difference in some quality or accident, even though the misapprehension may have been the actuating motive" of the parties in making the contract, yet it will remain binding. In this case the cow sold was the one delivered. What might or might not happen to her after the sale formed no element in the contract. The case of *Kennedy v. Panama Mail Co.*, L.R. 2 Q.B. 587, and the extract cited therefrom in the opinion of my brethren, clearly sustains the views I have taken. See, also, *Smith v. Hughes*, L.R. 6 Q.B. 597; *Carter v. Crick*, 4 Hurl. & N. 416.

[24] According to this record, whatever the mistake was, if any, in this case, it was upon the part of the defendants, and while acting upon their own judgment. It is, however, elementary law, and very elementary, too, "that the mistaken party, without any common understanding with the other party in the premises as to the quality of an animal, is remediless if he is injured through his own mistake." Leake, Cont. 338; *Torrance v. Bolton*, L.R. 8 Ch. 118; *Smith v. Hughes,* L.R. 6 Q.B. 597.

[25] The case cited by my brethren from 37 Mich. I do not think sustains the conclusion reached by them. In that case the subject-matter about which the contract was made had no existence, and in such case Mr. Justice GRAVES held there was no contract; and to the same effect are all the authorities cited in the opinion. That is certainly not this case. Here the defendants claim the subject-matter not only existed, but was worth about $800 more than the plaintiff paid for it.

[26] The case of *Huthmacher v. Harris*, 38 Pa. St. 491, is this: A party purchased at an administrator's sale a drill-machine, which had hid away in it by the deceased a quantity of notes, to the amount of $3,000, money to the amount of over $500, and two silver watches and a pocket

compass of the value of $60.25. In an action of trover for the goods, it was held that nothing but the machine was sold or passed to the purchasers, neither party knowing that the machine contained any such articles.

[27] In *Cutts v. Guild*, 57 N.Y. 229, the defendant, as assignee, recovered a judgment against D. & H. He also recovered several judgments in his own name on behalf of the T. Co. The defendant made an assignment of and transferred the first judgment to an assignee of the plaintiff—both parties supposing and intending to transfer one of the T. Co. judgments—and it was held that such contract of assignment was void, because the subject-matter contained in the assignment was not contracted for.

[28] In the case of *Byers v. Chapin*, 28 Ohio St. 300, the defendant sold the plaintiffs 5,000 oil barrels. The plaintiffs paid $5,000 upon their purchase, and took some of the barrels. The barrels proved to be unfit for use, and the contract was rescinded by consent of the parties. The defendant, instead of returning all the money paid to the purchaser, retained a portion and gave plaintiffs his note for the remainder. The plaintiffs brought suit upon this note. The defendant claimed that, under the contract of sale of the barrels, they were to be glued by the plaintiffs, which the plaintiffs properly failed to do, and this fact was not known to defendant when he agreed to rescind, and gave the note, and therefore the note was given upon a mistaken state of facts, falsely represented to the defendant, and which were known to the plaintiffs. On the proofs, the jury found for the defendant, and the verdict was affirmed.

[29] In *Gardner v. Lane*, 9 Mass. 492, it is decided that if, upon a sale of No. 1 mackerel, the vendor delivers No. 3 mackerel, and some barrels of salt, no title to the articles thus delivered passes.

[30] *Allen v. Hammond*, 11 Pet. 63, decides that if a life-estate in land is sold, and at the time of the sale the estate is terminated by the death of the person in whom the right vested, a court of equity will rescind the purchase.

[31] In *Harvey v. Harris*, 112 Mass. 32, at an auction, two different grades of flour were sold, and a purchaser of the second claimed to have bought a quantity of the first grade, under a sale made of

the second, and this he was not allowed to do, because of the mutual mistake; the purchaser had not in fact bought the flour he claimed. In this case, however, it is said it is true that, if there is a mutual agreement of the parties for the sale of particular articles of property, a mistake of misapprehension as to the quality of the articles will not enable the vendor to repudiate the sale.

[32] The foregoing are all the authorities relied on as supporting the positions taken by my brethren in this case. I fail to discover any similarity between them and the present case; and I must say, further, in such examination as I have been able to make, I have found no adjudicated case going to the extent, either in law or equity, that has been held in this case. In this case, if either party had superior knowledge as to the qualities of this animal to the other, certainly the defendants had such advantage. I understand the law to be well settled that "there is no breach of any implied confidence that one party will not profit by his superior knowledge as to facts and circumstances" actually within the knowledge of both, because neither party reposes in any such confidence unless it be specially tendered or required, and that a general sale does not imply warranty of any quality, or the absence of any; and if the seller represents to the purchaser what he himself believes as to the qualities of an animal, and the purchaser buys relying upon his own judgment as to such qualities, there is no warranty in the case, and neither has a cause of action against the other if he finds himself to have been mistaken in judgment.

[33] The only pretense for avoiding this contract by the defendants is that they erred in judgment as to the qualities and value of the animal. I think the principles adopted by Chief Justice CAMPBELL in *Williams v. Spurr* completely cover this case, and should have been allowed to control in its decision. See 24 Mich. 335. See, also, Story, Sales, §§ 174, 175, 382, and Benj. Sales, § 430. The judgment should be affirmed.

2.1.1 The Story of *Sherwood v. Walker*

A recently published law review article provides a wealth of background information about the parties (and the cow) involved in *Sherwood v. Walker*. It appears that Hiram Walker, the seller, was the moving force

behind the famous brand of Canadian Club Whiskey, and the buyer Theodore Clark Sherwood was a prominent banker who went on to found a financial institution that eventually became a part of Bank One. We also learn from the article that after losing in the Michigan Supreme Court, Sherwood purchased Rose the 2d from Walker for an undisclosed price. See Norman Otto Stockmeyer, *To Err Is Human, To Moo Bovine: The Rose of Aberlone Story*, 24 THOMAS COOLEY L. REV. 491 (2007).

2.1.2. Lenawee County Bd. of Health v. Messerly

In a subsequent case, *Lewanee County Bd. of Health v. Messerly*, 331 N.W.2d 203 (Mich. 1982), the Michigan Supreme Court had occasion to revisit the *Sherwood v. Walker* decision and expressed its frustration with the distinction the earlier case had drawn between mistakes that go to the "essence of the consideration" from those affecting merely its "quality or value." The court had this to say about the *Sherwood* opinion:

> [*Sherwood*] arguably distinguishes mistakes affecting the essence of the consideration from those which go to its quality or value, affording relief on a per se basis for the former but not the latte…. However, the distinctions which may be drawn from *Sherwood* … do not provide a satisfactory analysis of the nature of a mistake sufficient to invalidate a contract. Often, a mistake relates to an underlying factual assumption which, when discovered, directly affects value, but simultaneously and materially affects the essence of the contractual consideration. It is disingenuous to label such a mistake collateral…. [The parties in this case] both mistakenly believed that the property which was the subject of their land contract would generate income as rental property. The fact that it could not be used for human habitation deprived the property of its income earning potential and rendered it less valuable. However, this mistake, while directly and dramatically affecting the property's value, cannot accurately be characterized as collateral because it affects the very essence of the consideration…. We find that the inexact and confusing distinction between contractual mistakes running to value and those touching the substance of the consideration serves only as an impediment to a clear and helpful analysis for the equitable resolution of cases in which mistake is alleged and proven. Accordingly, the [holding of *Sherwood* is limited to the facts of that case.]

In *Messerly*, the parties' contract included an express "as is" clause. The following passage shows how such a clause is relevant to analyzing under Restatement (Second) § 154 whether the risk of mistake has been allocated to one of the parties.

> In cases of mistake by two equally blameless parties, we are required, in the exercise of our equitable powers, to determine which blameless party should assume the loss resulting from the misapprehension they shared. Normally that can only be done by drawing upon our "own notions of what is reasonable and just under all the surrounding circumstances…." Equity suggests that, in this case, the risk should be allocated to the purchasers. We are guided to that conclusion, in part, by the standards announced in § 154 of the Restatement of Contracts, [Second], for determining when a party bears the risk of mistake…. Section 154(a) suggests that the court should look first to whether the parties have agreed to the allocation of the risk between themselves. While there is no express assumption in the contract by either party of the risk of the property becoming uninhabitable, there was indeed some agreed allocation of the risk to the vendees by the incorporation of an "as is" clause into the contract…. [The incorporation] of this clause is a persuasive indication that, as between them, such risk as related to the "present condition" of the property should lie with the purchaser. If the "as is" clause is to have any meaning at all, it must be interpreted to refer to those defects which were unknown at the time that contract was executed.

Id. at 31–32.

Despite the *Messerly* court's disapproval of the reasoning in *Sherwood*, Professor Stockmeyer notes that *Sherwood* remains a staple of Contracts casebooks and treatises. He also defends the case's vitality as legal authority in Michigan. Stockmeyer concludes:

> Perhaps most tellingly of all, in a 2006 mutual mistake case, *Ford Motor Co. v. Woodhaven*, a unanimous Michigan Supreme Court discussed *Sherwood* at length, ignored [*Messerly*] completely, and announced that Rose's case was still viable: "Our review of our precedents involving the law of mistake indicates that the peculiar and appropriate meaning that the term 'mutual mistake' has acquired in our law has not changed since *Sherwood*."

Stockmeyer, *supra*, at 501-02.

Although Stockmeyer's account is correct as far as it goes, *Ford Motor Co. v. Woodhaven* may tell us less about the law of mistake in Michigan than he supposes. The *Ford Motor* court relies explicitly on the *Sherwood* majority's understanding of the facts—particularly their highly questionable assertion that neither of the parties to the sale contract thought that Rose could be made to breed. With this important limitation in mind, it is perhaps more accurate to say that *Ford Motor* reaffirmed an uncontroversial proposition—If two parties are both mistaken about a fundamental attribute of the good they are exchanging, then the doctrine of mutual mistake makes it possible to argue for rescission. As our discussion of *Sherwood v. Walker* will reveal, however, the majority's opinion also makes far less defensible claims about the parties' beliefs and about the importance of a distinction between the "substance" and a mere "quality" of the item being exchanged. The *Ford Motor* court has nothing whatsoever to say about these more controversial aspects of *Sherwood*.

2.1.3. Discussion of *Sherwood v. Walker*

What is the best argument that you could make on behalf of Walker (the seller)?

How would you argue the case for Sherwood?

Was this case correctly decided?

2.2. Principal Case – *Anderson v. O'Meara*

Anderson Brothers Corp. v. O'Meara

United States Court of Appeals, Fifth Circuit

306 F.2d 672 (1962)

JONES, CIRCUIT JUDGE.

[1] The appellant, Anderson Brothers Corporation, a Texas corporation engaged in the business of constructing pipelines, sold a barge dredge to the appellee, Robert W. O'Meara, a resident of Illinois who is an oil well driller doing business in several states and Canada. The appellee brought this suit seeking rescission of the sale or, in the alternative, damages. After trial without a jury, the appellee's prayer of rescission was denied, but damages were awarded. The court denied the appellant's counterclaim for the unpaid purchase price of the dredge.

Both parties have appealed.[1] Appellant contends that no relief should have been given to the appellee, and the appellee contends that the damages awarded to him were insufficient.

[2] The dredge which the appellant sold to the appellee was specially designed to perform the submarine trenching necessary for burying a pipeline under water. In particular it was designed to cut a relatively narrow trench in areas where submerged rocks, stumps and logs might be encountered. The dredge could be disassembled into its larger component parts, moved over land by truck, and reassembled at the job site. The appellant built the dredge from new and used parts in its own shop. The design was copied from a dredge which appellant had leased and successfully used in laying a pipeline across the Mississippi River. The appellant began fabrication of the dredge in early 1955, intending to use it in performing a contract for laying a pipeline across the Missouri River. A naval architect testified that the appellant was following customary practice in pipeline operations by designing a dredge for a specific use. Dredges so designed can be modified, if necessary, to meet particular situations. For some reason construction of the dredge was not completed in time for its use on the job for which it was intended, and the dredge was never used by the appellant. After it was completed, the dredge was advertised for sale in a magazine. This advertisement came to the appellee's attention in early December, 1955. The appellee wanted to acquire a dredge capable of digging canals fifty to seventy-five or eighty feet wide and six to twelve feet deep to provide access to off-shore oil well sites in southern Louisiana.

[3] On December 8, 1955, the appellee or someone employed by him contacted the appellant's Houston, Texas, office by telephone and learned that the price of the dredge was $45,000. Terms of sale were discussed, and later that day the appellant sent a telegram to the appellee who was then in Chicago, saying it accepted the appellee's offer of $35,000 for the dredge to be delivered in Houston. The appellee's offer was made subject to an inspection. The next day Kennedy, one of the appellee's employees, went to Houston from New Orleans and

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[1] Anderson Brothers Corporation will be referred to as the appellant and O'Meara as the appellee.

inspected the dredge. Kennedy, it appears, knew nothing about dredges but was familiar with engines. After inspecting the engines of the dredge, Kennedy reported his findings to the appellee by telephone and then signed an agreement with the appellant on behalf of the appellee. In the agreement, the appellant acknowledged receipt of $17,500. The agreement made provision for payment of the remaining $17,500 over a period of seventeen months. The dredge was delivered to the appellee at Houston on December 11, 1955, and from there transported by the appellee to his warehouse in southern Louisiana. The barge was transported by water, and the ladder, that part of the dredge which extends from the barge to the stream bed and to which the cutting devices are attached, was moved by truck. After the dredge arrived at his warehouse the appellee executed a chattel mortgage in favor of the appellant and a promissory note payable to the order of the appellant. A bill of sale dated December 17, 1955, was given the appellee in which the appellant warranted only title and freedom from encumbrances. Both the chattel mortgage and the bill of sale described the dredge and its component parts in detail.

[4] The record contains much testimony concerning the design and capabilities of the dredge including that of a naval architect who, after surveying the dredge, reported "I found that the subject dredge…had been designed for the purpose of dredging a straight trench over a river, lake or other body of water." The testimony shows that a dredge designed to perform sweep dredging, the term used to describe the dredging of a wide channel, must be different in several respects from one used only for trenching operations. The naval architect's report listed at least five major items to be replaced, modified, or added before the dredge would be suited to the appellee's intended use. It is clear that the appellee bought a dredge which, because of its design, was incapable, without modification, of performing sweep dredging.

[5] On July 10, 1956, about seven months after the sale and after the appellee had made seven monthly payments pursuant to the agreement between the parties, the appellee's counsel wrote the appellant stating in part that "Mr. O'Meara has not been able to put this dredge in service and it is doubtful that it will ever be usable in its present condition." After quoting at length from the naval architect's report,

which was dated January 28, 1956, the letter suggested that the differences between the parties could be settled amicably by the appellant's contributing $10,000 toward the estimated $12,000 to $15,000 cost of converting the trenching dredge into a sweep dredge. The appellant rejected this offer and on July 23, 1956, the appellee's counsel wrote the appellant tendering return of the dredge and demanding full restitution of the purchase price. This suit followed the appellant's rejection of the tender and demand.

[6] In his complaint the appellee alleged breaches of expressed and implied warranty and fraudulent representations as to the capabilities of the dredge. By an amendment he alleged as an alternative to the fraud count that the parties had been mistaken in their belief as to the operations of which the dredge was capable, and thus there was a mutual mistake which prevented the formation of a contract. The appellee sought damages of over $29,000, representing the total of principal and interest paid the appellant and expenses incurred in attempting to operate the dredge. In the alternative, the appellee asked for rescission and restitution of all money expended by him in reliance on the contract. The appellant answered denying the claims of the appellee and counterclaiming for the unpaid balance.

[7] The district court found that:

> At the time the dredge was sold by the defendant to the plaintiff, the dredge was not capable for performing sweep dredging operations in shallow water, unless it was modified extensively. Defendant had built the dredge and knew the purpose for which it was designed and adapted. None of the defendant's officers or employees knew that plaintiff intended to use the dredge for shallow sweep dredging operations. Gier (an employee of the appellant who talked with the appellee or one of his employees by telephone) mistakenly assumed that O'Meara intended to use the dredge within its designed capabilities.
>
> At the time the plaintiff purchased this dredge he mistakenly believed that the dredge was capable without modification of performing sweep dredging operations in shallow water.

[8] The court further found that the market value of the dredge on the date of sale was $24,000, and that the unpaid balance on the note given for part of the purchase price was $10,500. Upon its findings the court concluded that:

> The mistake that existed on the part of both plaintiff and defendant with respect to the capabilities of the subject dredge is sufficient to and does constitute mutual mistake, and the plaintiff is entitled to recover the damages he has suffered as a result thereof.

[9] These damages were found to be "equal to the balance due on the purchase price" plus interest, and were assessed by cancellation of the note and chattel mortgage and vesting title to the barge in the appellee free from any encumbrance in favor of the appellant. The court also concluded that the appellee was "not entitled to rescission of this contract." Further findings and conclusions, which are not challenged in this Court, eliminate any considerations of fraud or breach of expressed or implied warranties. The judgment for damages rests entirely upon the conclusion of mutual mistake.[2] The district court's conclusion that the parties were mutually mistaken "with respect to the capabilities of the subject dredge" is not supported by its findings. "A mutual mistake is one common to both parties to the contract, each laboring under the same misconception." *St. Paul Fire & Marine Insurance Co. v. Culwell*, Tex.Com.App., 62 S.W.2d 100; *Hayman v. Dowda*, Tex.Civ.App., 233 S.W.2d 466; *Bryan v. Dallas National Bank*, Tex.Civ.App., 135 S.W.2d 249; 58 C.J.S. Mistake, p. 832. The appellee's mistake in believing that the dredge was capable, without modification, of performing sweep dredging was not a mistake shared by the appellant, who had designed and built the dredge for use in trenching operations and knew its capabilities. The mistake on the part of the appellant's employee in assuming that the appellee intended to use the dredge within its designed capabilities was certainly not one shared by the appellee, who acquired the dredge for use in sweep dredging operations. The appellee

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[2] The disposition of this appeal does not require a review of the district court's action in awarding damages as a remedy for mutual mistake rather than granting rescission and attempting restoration of the *status quo ante*

alone was mistaken in assuming that the dredge was adapted, without modification, to the use he had in mind.

[10] The appellee insists that even if the findings do not support a conclusion of mutual mistake, he is entitled to relief under the well-established doctrine that knowledge by one party to a contract that the other is laboring under a mistake concerning the subject matter of the contract renders it voidable by the mistaken party.[3] See 3 Corbin, Contracts 692, § 610. As a predicate to this contention, the appellee urges that the trial court erred in finding that "None of defendant's officers or employees knew that plaintiff intended to use the dredge for shallow sweep dredging operations." Moreover, the appellee contends that the appellant's knowledge of his intended use of the dredge was conclusively established by the testimony of two of the appellant's employees, because, on the authority of Griffin *v. Superior Insurance Co.*, 161 Tex. 195, 338 S.W.2d 415, this testimony constitutes admissions, conclusive against the appellant. In the *Griffin* case, it was held that a party's testimony must be "deliberate, clear and unequivocal" before it is conclusive against him. The testimony on which the appellee relies falls short of being "clear and unequivocal." If the statement of one witness were taken as conclusive, it would not establish that he knew the appellee intended to use the dredge as a sweep dredge,[4]and the other witness spoke with incertitude.[5] The

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[3] The appellee does not complain of the district court's conclusion that he was not entitled to rescission. He urges, without citation of authority, that the relief to which he is entitled is by way of damages.

[4] Gier, the appellant's shop foreman, testified:

> Q. Did Mr. O'Meara in the telephone conversation tell you what business he was in?
>
> A. No, he didn't.
>
> Q. He didn't. Mr. Gier, I suppose you have already answered this. Did he say what he wanted that dredge for?
>
> Q. Now, did he (Kennedy) discuss with you what the dredge was going to be used for?
>
> A. Other than he just said they was going to pump some channels out for some oil wells. That's all he said. He didn't tell me how deep or how wide or anything

[5] Smith, the appellant's office manager, testified:

> Q. ….Did you all discuss anything about the dredge itself?

testimony is not conclusive and is only one factor to be considered by the finder of facts. See 9 Wigmore, Evidence (3d Ed.) 397, 2594a.

[11] There is a conflict in the evidence on the question of the appellant's knowledge of the appellee's intended use, and it cannot be held that the district court's finding is clearly erroneous. *Smith v. United States*, 5th Cir. 1961, 287 F.2d 299; *Levine v. Johnson*, 5th Cir. 1961, 287 F.2d 623; *Horton v. U.S. Steel Corp.*, 5th Cir. 1961, 286 F.2d 710. It is to be noted that the trial court before whom the appellee testified, did not credit his testimony that he had made a telephone call in which, he said, he personally informed an employee of the appellant of his plans for the use of the dredge.

[12] The appellee makes a further contention that when he purchased the dredge he was laboring under a mistake so grave that allowing the sale to stand would be unconscionable. The ground urged is one which has apparently been recognized in some circumstances. *Edwards v. Trinity & B.V.R. Co.*, 54 Tex. Civ.App. 334, 118 S.W. 572; 13 Tex.Jur.2d 481, Contracts § 257; Annot., 59 A.L.R. 809. However, the Texas courts have held that when unilateral mistake is asserted as a ground for relief, the care which the mistaken complainant exercised or failed to exercise in connection with the transaction sought to be avoided is a factor for consideration. *Wheeler v. Holloway*, Tex.Com.App. 276 S.W.

A. No, not that I recall.

Q. In other words-

A. I do vaguely remember him (Kennedy) mentioning to me that O'Meara had an island over there and had some oil wells on it. He was going to use this dredge to- they had been hiring someone else to do the dredging into well locations, and that's what he intended using this one for, to dredge into his well locations, and I don't remember now how much he said it cost, but as well as I remember, it was rather expensive for a subcontractor just to dredge back to one well location, but by owning their own dredge they would have a considerable saving there.

Q. In other words, he said they had to dredge out a channel so their drilling barge could get by?

A. Yes. So they could get the drilling barge or equipment in there. There wasn't any roads there. That's the impression I got.

653; *Ebberts v. Carpenter Production Co*., Tex.Civ.App., 256 S.W.2d 601; *American Maid Flour Mills v. Lucia*, Tex.Civ.App., 285 S.W. 641; *Cole v. Kjellberg*, Tex.Civ.App., 141 S.W. 120; *Edwards v. Trinity & B.V.R. Co*., supra; 13 Tex.Jur.2d 482, Contracts § 258. It has been stated that "though a court of equity will relieve against mistake, it will not assist a man whose condition is attributable to the want of due diligence which may be fairly expected from a reasonable person." *American Maid Flour Mills v. Lucia*, *supra*. This is consistent with the general rule of equity that when a person does not avail himself of an opportunity to gain knowledge of the facts, he will not be relieved of the consequences of acting upon supposition. Annot., 1 A.L.R.2d 9, 89; see 30 C.J.S. Equity § 47, p. 376. Whether the mistaken party's negligence will preclude relief depends to a great extent upon the circumstances in each instance. *Edwards v. Trinity & B.V.R. Co., supra*.

[13] The appellee saw fit to purchase the dredge subject to inspection, yet he sent an employee to inspect it who he knew had no experience with or knowledge of dredging equipment. It was found that someone familiar with such equipment could have seen that the dredge was then incapable of performing channel type dredging. Although, according to his own testimony, the appellee was conscious of his own lack of knowledge concerning dredges, he took no steps, prior to purchase, to learn if the dredge which he saw pictured and described in some detail in the advertisement, was suited to his purpose. Admittedly he did not even inquire as to the use the appellant had made or intended to make of the dredge, and the district court found that he did not disclose to the appellant the use he intended to make of the dredge. The finding is supported by evidence. The appellee did not attempt to obtain any sort of warranty as to the dredge's capabilities. The only conclusion possible is that the appellee exercised no diligence, prior to the purchase, in determining the uses to which the dredge might be put. Had he sent a qualified person, such as the naval architect whom he later employed, to inspect the dredge he would have learned that it was not what he wanted, or had even made inquiry, he would have been informed as to the truth or have had a cause of action for misrepresentation if he had been given misinformation and relied upon it. The appellee chose to act on assumption rather than upon inquiry or information obtained by

investigation, and, having learned his assumption was wrong, he asks to be released from the resulting consequences on the ground that, because of his mistaken assumption, it would be unconscionable to allow the sale to stand. The appellee seeks this, although the court has found that the appellant was not guilty of any misrepresentation or fault in connection with the transaction.

[14] The appellant is in the same position as the party seeking relief on the grounds of mistake in *Wheeler v. Holloway*, *supra*, and the same result must follow. In the *Wheeler* case it was held that relief should be denied where the mistaken party exercised 'no diligence whatever' in ascertaining the readily accessible facts before he entered into a contract.

[15] The appellee should have taken nothing on his claim; therefore, it is unnecessary to consider the question raised by the cross-appeal. The other questions raised by the appellant need not be considered. The case must be reversed and remanded for further proceeding consistent with what we have here held.

Reversed and remanded.

2.2.1. Discussion of *Anderson v. O'Meara*

What is the best way to frame the case for Anderson (the seller)?

Does the testimony recounted in footnotes 4 and 5 present any problem for your argument?

How might you respond to the buyer's reliance on this testimony?

How do the relevant Restatement (Second) sections apply to this case?

Are there any provisions of the Restatement (Second) that permit a court to use a comparative advantage analysis in this situation?

2.2.2. Hypo of the Sterile Calf

Suppose that Max Backus, a Texas cattle breeder attends an auction in search of promising breeding stock. He purchases one Rob of Aberdeen, a 16-day old bull calf for a price of $5,000. The minimum age at which the fertility of a bull can be determined is about one year. When the calf is 18 months old, veterinary tests establish conclusively that the calf was incurably

sterile at birth. If the parties had known about the calf's condition, Rob would have been worth only $30 at the time of the auction.

Backus now seeks rescission of the sale contract. What arguments would you expect the parties to make and what is the most likely outcome of the case?

3. Substantial Performance

3.1. Principal Case – *Jacob & Youngs v. Kent*

The following case involves a dispute about the brand of pipe installed in the defendant's newly constructed "country residence." As you read the case, consider what the defendant might have done differently to ensure that the court would respect his professed desire for Reading pipe.

Jacob & Youngs v. Kent
Court of Appeals of New York
230 N.Y. 239, 129 N.E. 889 (1921)

CARDOZO, J.

[1] The plaintiff built a country residence for the defendant at a cost of upwards of $77,000, and now sues to recover a balance of $3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that" 'all wrought iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture." The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

[2] The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the

result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract—that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

[3] We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture (*Spence v. Ham*, 163 N. Y. 220; *Woodward v. Fuller*, 80 N. Y. 312; *Glacius v. Black*, 67 N. Y. 563, 566; *Bowen v. Kimbell*, 203 Mass. 364, 370). The distinction is akin to that between dependent and independent promises, or between promises and conditions (Anson on Contracts [Corbin's ed.], sec. 367; 2 Williston on Contracts, sec. 842). Some promises are so plainly independent that they can never by fair construction be conditions of one another. (*Rosenthal Paper Co. v. Nat. Folding Box & Paper Co.*, 226 N. Y. 313; *Bogardus v. N. Y. Life Ins. Co.*, 101 N. Y. 328). Others are so plainly dependent that they must always be conditions. Others, though dependent and thus conditions when there is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant (2 Williston on Contracts, secs. 841, 842; *Eastern Forge Co. v. Corbin*, 182 Mass. 590, 592; *Robinson v. Mollett*, L. R., 7 Eng. & Ir. App. 802, 814; *Miller v. Benjamin*, 142 N. Y. 613). Considerations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another. The simple and the uniform will call for different remedies from the multifarious and the intricate. The margin of departure within the range of normal expectation

upon a sale of common chattels will vary from the margin to be expected upon a contract for the construction of a mansion or a "skyscraper." There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason in the implication of a like condition when the subject-matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.

[4] Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier. The decisions in this state commit us to the liberal view, which is making its way, nowadays, in jurisdictions slow to welcome it (*Dakin & Co. v. Lee*, 1916, 1 K. B. 566, 579). Where the line is to be drawn between the important and the trivial cannot be settled by a formula. "In the nature of the case precise boundaries are impossible" (2 Williston on Contracts, sec. 841). The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract (*Crouch v. Gutmann*, 134 N. Y. 45, 51). There is no general license to install whatever, in the builder's judgment, may be regarded as "just as good" (*Easthampton L. & C. Co., Ltd., v. Worthington*, 186 N. Y. 407, 412). The question is one of degree, to be answered, if there is doubt, by the triers of the facts (*Crouch v. Gutmann*; *Woodward v. Fuller*,

supra), and, if the inferences are certain, by the judges of the law (*Easthampton L. & C. Co., Ltd., v. Worthington*, *supra*). We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfilment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression (*Schultze v. Goodstein*, 180 N. Y. 248, 251; *Desmond-Dunne Co. v. Friedman-Doscher Co.*, 162 N. Y. 486, 490). For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong (Spence v. Ham, supra).

[5] In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure (*Spence v. Ham*, *supra*). The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire.

The measure of allowance is not the cost of reconstruction. "There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable." (*Handy v. Bliss*, 204 Mass. 513, 519. *Cf. Foeller v. Heintz*, 137 Wis. 169, 178; *Oberlies v. Bullinger*, 132 N. Y. 598, 601; 2 Williston on Contracts, sec. 805, p. 1541) The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

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

MCLAUGHLIN, J. (DISSENTING).

[7] I dissent. The plaintiff did not perform its contract. Its failure to do so was either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing, nor did it make any proof of the cost of compliance, where compliance was possible.

[8] Under its contract it obligated itself to use in the plumbing only pipe (between 2,000 and 2,500 feet) made by the Reading Manufacturing Company. The first pipe delivered was about 1,000 feet and the plaintiff's superintendent then called the attention of the foreman of the subcontractor, who was doing the plumbing, to the fact that the specifications annexed to the contract required all pipe used in the plumbing to be of the Reading Manufacturing Company. They then examined it for the purpose of ascertaining whether this delivery was of that manufacture and found it was. Thereafter, as pipe was required in the progress of the work, the foreman of the subcontractor would leave word at its shop that he wanted a specified number of feet of pipe, without in any way indicating of what manufacture. Pipe would thereafter be delivered and installed in the building, without any examination whatever. Indeed, no examination, so far as appears, was made by the

plaintiff, the subcontractor, defendant's architect, or any one else, of any of the pipe except the first delivery, until after the building had been completed. Plaintiff's architect then refused to give the certificate of completion, upon which the final payment depended, because all of the pipe used in the plumbing was not of the kind called for by the contract. After such refusal, the subcontractor removed the covering or insulation from about 900 feet of pipe which was exposed in the basement, cellar and attic, and all but 70 feet was found to have been manufactured, not by the Reading Company, but by other manufacturers, some by the Cohoes Rolling Mill Company, some by the National Steel Works, some by the South Chester Tubing Company, and some which bore no manufacturer's mark at all. The balance of the pipe had been so installed in the building that an inspection of it could not be had without demolishing, in part at least, the building itself.

[9] I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions. (*Woodward v. Fuller*, 80 N. Y. 312; *Nolan v. Whitney*, 88 N. Y. 648.) But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor was any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing

Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either "nominal or nothing." Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been "just as good, better, or done just as well." He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed. (*Schultze v. Goodstein*, 180 N. Y. 248; *Spence v. Ham*, *supra*; *Steel S. & E. C. Co. v. Stock*, 225 N. Y. 173; *Van Clief v. Van Vechten*, 130 N. Y. 571; *Glacius v. Black*, 50 N. Y. 145; *Smith v. Brady*, 17 N. Y. 173, and authorities cited on p. 185.) The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application. (*Crouch v. Gutmann*, 134 N. Y. 45; *Spence v. Ham*, 163 N. Y. 220.)

What was said by this court in *Smith v. Brady* (*supra*) is quite applicable here:

> I suppose it will be conceded that everyone has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. The specifications of the contract become the law between the parties until voluntarily changed. If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian. If the owner, having regard to strength and durability, has contracted for walls of specified materials to be laid in a particular manner, or for a given number of joists and beams, the builder has no right to substitute his own judgment or that of others. Having departed from the agreement, if performance has not been waived by the other party, the law will not allow him to allege that he has made as good a building as the one he engaged to erect. He can demand payment only upon and according to the terms of his contract, and if the conditions on which payment is due have not been performed, then the right to demand it does not exist. To hold a different doctrine would be simply to make another

contract, and would be giving to parties an encouragement to violate their engagements, which the just policy of the law does not permit.

[10] I am of the opinion the trial court did not err in ruling on the admission of evidence or in directing a verdict for the defendant.

[11] For the foregoing reasons I think the judgment of the Appellate Division should be reversed and the judgment of the Trial Term affirmed.

3.1.1. Perfect Tender and Substantial Performance

Under the Uniform Commercial Code, the standard for performance is "perfect tender" rather than "substantial performance."

§ 2-601. Buyer's Rights on Improper Delivery

Subject to the provisions of this Article on installment contracts (Section 2-612) and on shipment by seller (Section 2-504), and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest.

This rule applies to contracts for the sale of "goods" as defined in the UCC. Thus, with the exception of the seller's limited right to "cure" a defective tender under U.C.C. § 2-508, buyers of goods may reject a seller's performance for even a minor failure to conform to the description or quality of the goods specified in the contract.

In contrast, the doctrine enunciated in *Jacob & Youngs v. Kent*, allows a promisor to provide "substantial performance" and pay damages for any "trivial and innocent defects." Courts ordinarily apply this doctrine to complex service and construction contracts.

3.1.2. Motion for Rehearing in *Jacob & Youngs v. Kent*

According to the record on appeal in *Jacob & Youngs v. Kent*, the contract with the builder included the following language:

> Any work furnished by the Contractor, the material or workmanship of which is defective or which is not fully in accordance with the drawings or specifications, in every respect, will be rejected and is to be immediately torn down, removed and remade or replaced in accordance with the drawings and specifications, whenever discovered…. The Owner shall have the option at all times to allow the defective or improper work to stand and to receive from the Contractor a sum of money equivalent to the difference in value of the work as performed and as herein specified.

After losing on appeal, Kent filed a motion for rehearing and called the court's attention to this clause. The New York Court of Appeals responded with a brief *per curiam* opinion:

> The court did not overlook the specification which provides that defective work shall be replaced. The promise to replace, like the promise to install, is to be viewed, not as a condition, but as independent and collateral, when the defect is trivial and innocent. The law does not nullify the covenant, but restricts the remedy to damages.

230 N.Y. 656 (1921).

3.1.3. Discussion of Jacob & Youngs v. Kent

Suppose that, contrary to fact, a rule of perfect tender applied to construction contracts. If you were negotiating an agreement on behalf of a builder, what risks would you anticipate? What contract terms might you propose to the owner in order to protect your client from those risks? How might the owner's willingness to agree to vary the perfect tender rule affect the price the builder should charge for the project?

Now imagine how the same negotiation would proceed under the rule of substantial performance. Suppose that the owner cares deeply about having Reading rather than Cohoes or National pipe. Can you propose contract language that would ensure that the builder must tear out and replace any non-Reading pipe? Are there any additional terms that the parties

could include in their contract to protect the builder from the special risks associated with promising to use only Reading pipe?

Judge Cardozo argues for a rule that permits the builder to avoid the high cost of tearing out and replacing nonconforming pipe because the defect is "both innocent and trivial." The owner must be content with receiving damages for the difference in market value between Reading and other brands of pipe. In his dissent, Judge McLaughlin casts the builder's conduct in a different light and advocates strict application of the contract specifications. What incentives do these competing rules create for builders and owners? Could a court devise what we have called a "compound liability rule" that polices potential misconduct by both parties?

4. Exclusive Dealing Contracts

A number of the contracts we have studied thus far involved a single exchange of payment for an easily defined performance. Thus, for example, Bailey sought to collect for the cost of boarding Bascom's Folly; Lucy wanted Zehmer to convey title to the Ferguson farm; and Lefkowitz sought to enforce the Great Minneapolis Surplus Store's advertised deal on fur pieces. Other cases concerned more complex disputes about whether the promisor completed performance satisfactorily, as in *Stees v. Leonard* and *Jacob & Youngs v. Kent*. Or the circumstances required a court to find an implied term excusing performance, as in *Taylor v. Caldwell*, or to create (and then terminate) an option to accept a subcontractor's bid, as in *Pavel Enterprises v. A.S. Johnson Co.*

In this section, we introduce a new source of complexity to the contracting process. Exclusive dealing contracts are one example of a broader category of "relational contracts" that involve repeated occasions for performance and payment. The familiar employment relationship exemplifies many of the characteristic features of a relational contract. Performance ordinarily occurs over a considerable length of time. Neither party can be certain at the outset exactly what tasks the employee will undertake or what opportunities the employer will be able to offer in exchange. Many unknown contingencies potentially affect both the cost of the parties' performance and the alternative opportunities they have during the term of the contract. Finally, it is impossible to draft specific contract language that will adequately address each of the innumerable contingencies that may arise.

Commercial parties confront these problems in long-term supply contracts, in exclusive distributorship agreements, in some publishing contracts, and in countless other situations. The Uniform Commercial Code provides broad guidelines for certain relational contracts involving the sale of goods. Please read UCC § 2-306 Output, Requirements and Exclusive Dealings.

This UCC section addresses both exclusive dealing and so-called "output or requirements" contracts. An output contract commits the buyer to purchase and the seller to sell the entire output of a particular production facility. A requirements contract similarly obligates one party to purchase the entire quantity of a particular good that it needs from the other party who commits to supply those requirements.

For output and requirements contracts, an initial problem is to establish that the promisors' commitments are sufficiently definite to warrant enforcement. The official comment 2 to U.C.C. § 2-306 expressly rejects cases holding that the quantity term of an output or requirements contract is too indefinite. For exclusive dealing contracts, courts confront an analogous question of whether the recipient of exclusive rights has provided any consideration. As you can see, UCC § 2-306 answers this question in the affirmative. The first of the common law cases that follows, *Wood v. Lucy, Lady Duff-Gordon*, shows how a noted jurist reasoned about consideration in an exclusive dealing contract. The second case, *Bloor v. Falstaff*, interprets specific contractual language establishing a standard of performance quite similar to the implied "best efforts" obligation of U.C.C. § 2-306.

As you read both of these cases, consider first how the court addresses the problem of consideration and then what sort of guidance the decision offers about the applicable performance standard.

4.1. Principal Case – Wood v. Lucy, Lady Duff-Gordon

Wood v. Lucy, Lady Duff-Gordon
Court of Appeals of New York
222 N.Y. 88, 118 N.E. 214 (1917)

CARDOZO, J.

1. The defendant styles herself "a creator of fashions." Her favor helps a sale. Manufacturers of dresses, millinery and like articles are

glad to pay for a certificate of her approval. The things which she designs, fabrics, parasols and what not, have a new value in the public mind when issued in her name. She employed the plaintiff to help her to turn this vogue into money. He was to have the exclusive right, subject always to her approval, to place her indorsements on the designs of others. He was also to have the exclusive right to place her own designs on sale, or to license others to market them. In return, she was to have one-half of "all profits and revenues" derived from any contracts he might make. The exclusive right was to last at least one year from April 1, 1915, and thereafter from year to year unless terminated by notice of ninety days. The plaintiff says that he kept the contract on his part, and that the defendant broke it. She placed her indorsement on fabrics, dresses and millinery without his knowledge, and withheld the profits. He sues her for the damages, and the case comes here on demurrer.

2. The agreement of employment is signed by both parties. It has a wealth of recitals. The defendant insists, however, that it lacks the elements of a contract. She says that the plaintiff does not bind himself to anything. It is true that he does not promise in so many words that he will use reasonable efforts to place the defendant's indorsements and market her designs.

3. We think, however, that such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view to-day. A promise may be lacking, and yet the whole writing may be "instinct with an obligation," imperfectly expressed (SCOTT, J., in *McCall Co. v. Wright*, 133 App. Div. 62; *Moran v. Standard Oil Co.*, 211 N. Y. 187, 198). If that is so, there is a contract.

4. The implication of a promise here finds support in many circumstances. The defendant gave an exclusive privilege. She was to have no right for at least a year to place her own indorsements or market her own designs except through the agency of the plaintiff. The acceptance of the exclusive agency was an assumption of its duties (*Phoenix Hermetic Co. v. Filtrine Mfg. Co.*, 164 App. Div. 424; *W. G. Taylor Co. v. Bannerman*, 120 Wis. 189; *Mueller v. Bethesda Mineral Spring Co.*, 88 Mich. 390). We are not to suppose that one party was to be placed at the mercy of the other (*Hearn v. Stevens & Bro.*, 111 App. Div. 101, 106;

Russell v. Allerton, 108 N. Y. 288). Many other terms of the agreement point the same way. We are told at the outset by way of recital that "the said Otis F. Wood possesses a business organization adapted to the placing of such indorsements as the said Lucy, Lady Duff-Gordon has approved." The implication is that the plaintiff's business organization will be used for the purpose for which it is adapted. But the terms of the defendant's compensation are even more significant. Her sole compensation for the grant of an exclusive agency is to be one-half of all the profits resulting from the plaintiff's efforts. Unless he gave his efforts, she could never get anything. Without an implied promise, the transaction cannot have such business "efficacy as both parties must have intended that at all events it should have" (BOWEN, L. J., in *The Moorcock*, 14 P. D. 64, 68). But the contract does not stop there. The plaintiff goes on to promise that he will account monthly for all moneys received by him, and that he will take out all such patents and copyrights and trademarks as may in his judgment be necessary to protect the rights and articles affected by the agreement. It is true, of course, as the Appellate Division has said, that if he was under no duty to try to market designs or to place certificates of indorsement, his promise to account for profits or take out copyrights would be valueless. But in determining the intention of the parties, the promise has a value. It helps to enforce the conclusion that the plaintiff had some duties. His promise to pay the defendant one-half of the profits and revenues resulting from the exclusive agency and to render accounts monthly, was a promise to use reasonable efforts to bring profits and revenues into existence. For this conclusion, the authorities are ample (*Wilson v. Mechanical Orguinette Co.*, 170 N. Y. 542; *Phoenix Hermetic Co. v. Filtrine Mfg. Co.*, *supra*; *Jacquin v. Boutard*, 89 Hun, 437; 157 N. Y. 686; *Moran v. Standard Oil Co.*, *supra*; *City of N. Y. v. Paoli*, 202 N. Y. 18; *M'Intyre v. Belcher*, 14 C. B. [N. S.] 654; *Devonald v. Rosser & Sons*, 1906, 2 K. B. 728; *W. G. Taylor Co. v. Bannerman*, *supra*; *Mueller v. Bethesda Mineral Spring Co.*, *supra*; *Baker Transfer Co. v. Merchants' R. & I. Mfg. Co.*, 1 App. Div. 507).

5. The judgment of the Appellate Division should be reversed, and the order of the Special Term affirmed, with costs in the Appellate Division and in this court.

CUDDEBACK, MCLAUGHLIN AND ANDREWS, JJ., CONCUR; HISCOCK, CH. J., CHASE AND CRANE, JJ., DISSENT.

4.1.1. The Background of Wood v. Lucy, Lady Duff-Gordon

As her name suggests, Lady Duff-Gordon was a British clothing designer who had considerable success in England before attempting to enter the American market with Wood's promotional assistance. Wood and Lucy hoped that her fame would lead American clothing makers to value her endorsement of their products. The litigation grew out of Lucy's decision to make a separate deal with Sears, Roebuck and Company to sell a line of her dresses through the company's mail order catalogue. Wood objected that the Sears deal violated his exclusive right to market her products in the United States. Adding insult to injury, it appears that the "Lucile" line was too expensive for most Sears customers. The company evidently lost more than $26,000 and dropped the line from its catalogue.

Lucy was quite a celebrity in her day and even tasted some scandal for her conduct as a survivor in the sinking of the *Titanic*. For more on the story of Lucy and her dresses, see Walter Pratt, *American Contract Law at the Turn of the Century*, 39 S.C. L. REV. 415 (1988), and VICTOR GOLDBERG, FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE 57-58 (2007).

4.1.2. Reading Wood v. Lucy, Lady Duff-Gordon

Although judicial opinions often make one outcome appear inevitable, great legal advocates develop a creative ability to imagine how the court could have reached the opposite result. Professor Karl Llewellyn has offered this strikingly different reading of the situation in *Wood*:

> The plaintiff in this action rests his case upon his own carefully prepared form agreement, which has as its first essence his own omission of any expression whatsoever of any obligation of any kind on the part of this same plaintiff. We thus have the familiar situation of a venture in which one party, here the defendant, has an asset, with what is, in advance, purely speculative value. The other party, the present plaintiff, who drew the agreement, is a marketer eager for profit, but chary of risk. The legal question presented is whether the plaintiff, while carefully avoiding all risk in the event of failure, can nevertheless claim full profit in the event that the market may prove favorable

in its response. The law of consideration joins with the principles of business decency in giving the answer. And the answer is no.

Karl Llewellyn, *A Lecture on Appellate Advocacy*, 29 U. CHI. L. REV. 627, 637-38 (1962).

4.1.3. Discussion of Wood v. Lucy, Lady Duff-Gordon

Professor Karl Llewellyn offers a reading of the facts that raises grave doubts about whether the agent, Wood, has provided any consideration for Lady Duff-Gordon's promise to pay him a commission on all U.S. sales of her designs. How does Judge Cardozo avoid this problem and find an enforceable contract? What facts about the relationship of the parties does he use to support this conclusion?

To what standard of performance does Judge Cardozo hold Wood? What exactly is Wood obliged to do under his contract with Lady Duff-Gordon?

4.1.4. Hypo on Real Estate Sales

Suppose that Bob is selling his house. He signs an exclusive listing contract with Kay, a real estate broker. According to the terms of the contract, Bob promises to pay Kay six percent of the selling price of his home if she, or anyone else, sells the house during the next three months.

Is Bob's promise to pay supported by consideration? If so, what is the consideration and what argument justifies us in concluding that it exists?

Now suppose that Kay, the agent, has found a buyer. The buyer, Sue, signs a contract in which she agrees to buy the house for $250,000 but the document provides that "this sale is conditional on the buyer obtaining a mortgage in the amount of $200,000 at an interest rate not to exceed seven (7) percent."

Is Sue's promise illusory? Could she simply sit on her hands and do nothing and then cancel the contract for failure of the financing contingency?

As an attorney for Bob, the seller, what would you tell him about his chances of succeeding in a suit to enforce any duties Sue might have to obtain a mortgage?

Can you think of any measures that Bob or his agent Kay could take to reduce the risk that Sue will avoid the contract by failing to obtain financing?

Finally, suppose that Bob has similar concerns about how much effort Kay will expend promoting the sale of his house. He may worry, for example, that Kay will simply list his property in the Multiple Listing Service (MLS) and then wait passively until another agent brings a prospective buyer to view the house. It is customary in such cases for the listing broker, Kay, to share the sale commission with the other broker. However, Kay might reasonably believe that a low-effort promotional strategy will maximize her net income.

What sort of terms could Bob demand in a future listing contract to address this possibility? Do you foresee any problems that might arise with specific performance standards? Would a simpler contract, promising a commission of six percent of the purchase price to anyone who sells the house, be more likely to achieve Bob's objectives?

4.2. Principal Case – Bloor v. Falstaff Brewing Corp.

Bloor v. Falstaff Brewing Corp

United States Court of Appeals, Second Circuit
601 F.2d 609 (1979)

FRIENDLY, CIRCUIT JUDGE:

[1] This action, wherein federal jurisdiction is predicated on diversity of citizenship, 28 U.S.C. § 1332, was brought in the District Court for the Southern District of New York, by James Bloor, Reorganization Trustee of Balco Properties Corporation, formerly named P. Ballantine & Sons (Ballantine), a venerable and once successful brewery based in Newark, N. J. He sought to recover from Falstaff Brewing Corporation (Falstaff) for breach of a contract dated March 31, 1972, wherein Falstaff bought the Ballantine brewing labels, trademarks, accounts receivable, distribution systems and other property except the brewery. The price was $4,000,000 plus a royalty of fifty cents on each barrel of the Ballantine brands sold between April 1, 1972 and March 31, 1978. Although other issues were tried, the appeals concern only two provisions of the contract. These are:

8. Certain Other Covenants of Buyer. (a) After the Closing Date the (Buyer) will use its best efforts to promote and maintain a high volume of sales under the Proprietary Rights.

2(a)(v) (The Buyer will pay a royalty of $.50 per barrel for a period of 6 years), provided, however, that if during the Royalty Period the Buyer substantially discontinues the distribution of beer under the brand name "Ballantine" (except as the result of a restraining order in effect for 30 days issued by a court of competent jurisdiction at the request of a governmental authority), it will pay to the Seller a cash sum equal to the years and fraction thereof remaining in the Royalty Period times $1,100,000, payable in equal monthly installments on the first day of each month commencing with the first month following the month in which such discontinuation occurs….

[2] Bloor claimed that Falstaff had breached the best efforts clause, 8(a), and indeed that its default amounted to the substantial discontinuance that would trigger the liquidated damage clause, 2(a)(v). In an opinion that interestingly traces the history of beer back to Domesday Book and beyond, Judge Brieant upheld the first claim and awarded damages but dismissed the second. Falstaff appeals from the former ruling, Bloor from the latter. Both sides also dispute the court's measurement of damages for breach of the best efforts clause.

[3] We shall assume familiarity with Judge Brieant's excellent opinion, 454 F. Supp. 258 (S.D.N.Y.1978), from which we have drawn heavily, and will state only the essentials. Ballantine had been a family owned business, producing low-priced beers primarily for the northeast market, particularly New York, New Jersey, Connecticut and Pennsylvania. Its sales began to decline in 1961, and it lost money from 1965 on. On June 1, 1969, Investors Funding Corporation (IFC), a real estate conglomerate with no experience in brewing, acquired substantially all the stock of Ballantine for $16,290,000. IFC increased advertising expenditures, levelling off in 1971 at $1 million a year. This and other promotional practices, some of dubious legality, led to steady growth in Ballantine's sales despite the increased activities in the northeast of the "nationals"[1] which have greatly augmented their market shares at the

[1] Miller's, Schlitz, Anheuser-Busch, Coors and Pabst.

expense of smaller brewers. However, this was a profitless prosperity; there was no month in which Ballantine had earnings and the total loss was $15,500,000 for the 33 months of IFC ownership.

[4] After its acquisition of Ballantine, Falstaff continued the $1 million a year advertising program, IFC's pricing policies, and also its policy of serving smaller accounts not solely through sales to independent distributors, the usual practice in the industry, but by use of its own warehouses and trucks the only change being a shift of the retail distribution system from Newark to North Bergen, N.J., when brewing was concentrated at Falstaff's Rhode Island brewery. However, sales declined and Falstaff claims to have lost $22 million in its Ballantine brand operations from March 31, 1972 to June 1975. Its other activities were also performing indifferently, although with no such losses as were being incurred in the sale of Ballantine products, and it was facing inability to meet payrolls and other debts. In March and April 1975 control of Falstaff passed to Paul Kalmanovitz, a businessman with 40 years experience in the brewing industry. After having first advanced $3 million to enable Falstaff to meet its payrolls and other pressing debts, he later supplied an additional $10 million and made loan guarantees, in return for which he received convertible preferred shares in an amount that endowed him with 35% of the voting power and became the beneficiary of a voting trust that gave him control of the board of directors.

[5] Mr. Kalmanovitz determined to concentrate on making beer and cutting sales costs. He decreased advertising, with the result that the Ballantine advertising budget shrank from $1 million to $115,000 a year.[2] In late 1975 he closed four of Falstaff's six retail distribution centers, including the North Bergen, N.J. depot, which was ultimately replaced by two distributors servicing substantially fewer accounts. He also discontinued various illegal practices that had been used in selling

[2]This was for cooperative advertising with purchasers.

Ballantine products.[3] What happened in terms of sales volume is shown in plaintiff's exhibit 114 J, a chart which we reproduce in the margin.[4] With 1974 as a base, Ballantine declined 29.72% in 1975 and 45.81% in 1976 as compared with a 1975 gain of 2.24% and a 1976 loss of 13.08% for all brewers excluding the top 15. Other comparisons are similarly devastating, at least for 1976.[5] Despite the decline in the sale of its own labels as well as Ballantine's, Falstaff, however, made a substantial financial recovery. In 1976 it had net income of $8.7 million and its year-end working capital had increased from $8.6 million to $20.2 million and its cash and certificates of deposit from $2.2 million to $12.1 million.

[6] Seizing upon remarks made by the judge during the trial that Falstaff's financial standing in 1975 and thereafter "is probably not relevant" and a footnote in the opinion, 454 F. Supp. at 267 n. 7,[6] appellate counsel for Falstaff contend that the judge read the best efforts clause as requiring Falstaff to maintain Ballantine's volume by any sales

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[3] There were two kinds of illegal practices, the testimony on both of which is, unsurprisingly, rather vague. Certain "national accounts", i. e. large draught beer buyers, were gotten or retained by "black bagging", the trade term for commercial bribery. On a smaller scale, sales to taverns were facilitated by the salesman's offering a free round for the house of Ballantine if it was available ("retention"), or the customer's choice ("solicitation"). Both practices seem to have been indulged in by many brewers, including Falstaff before Kalmanovitz took control.

[4][An incomprehensible graph comparing sales volumes is omitted. The text above ably describes the distinctively bad performance of Ballantine brands.]

[5] Falstaff argues that a trend line projecting the declining volume of Ballantine's sales since 1966, before IFC's purchase, would show an even worse picture. We agree with plaintiff that the percentage figures since 1974 are more significant; at least the judge was entitled to think so.

[6] "Even if Falstaff's financial position had been worse in mid-1975 than it actually was, and even if Falstaff had continued in that state of impecuniosity during the term of the contract, performance of the contract is not excused where the difficulty of performance arises from financial difficulty or economic hardship. As the New York Court of Appeals stated in *407 E. 61st St. Garage, Inc. v. Savoy Corp.*, 244 N.E.2d 37, 41 (N.Y. 1968):

'(W)here impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused.' (Citations omitted.)"

methods having a good prospect of increasing or maintaining sales or, at least, to continue lawful methods in use at the time of purchase, no matter what losses they would cause. Starting from this premise, counsel reason that the judge's conclusion was at odds with New York law, stipulated by the contract to be controlling, as last expressed by the Court of Appeals in *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E.2d 320 (N.Y. 1975). The court was there dealing with a contract whereby defendant agreed to sell and plaintiff to purchase all bread crumbs produced by defendant at a certain factory. During the term of the agreement defendant ceased producing bread crumbs because production with existing facilities was "very uneconomical", and the plaintiff sued for breach. The case was governed by § 2-306 of the Uniform Commercial Code which provides:

> § 2-306. Output, Requirements and Exclusive Dealings
>
> (1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.
>
> (2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

[7] Affirming the denial of cross-motions for summary judgment, the court said that, absent a cancellation on six months' notice for which the contract provided:

> [D]efendant was expected to continue to perform in good faith and could cease production of the bread crumbs, a single facet of its operation, only in good faith. Obviously, a bankruptcy or genuine imperiling of the very existence of its entire business caused by the production of the crumbs would warrant cessation of production of that item; the yield of less profit from its sale than expected would not. Since bread crumbs were but a part of defendant's enterprise and since there was a contractual right of

> cancellation, good faith required continued production until cancellation, even if there be no profit. In circumstances such as these and without more, defendant would be justified, in good faith, in ceasing production of the single item prior to cancellation only if its losses from continuance would be more than trivial, which, overall, is a question of fact.

335 N.E.2d 323.[7] Falstaff argues from this that it was not bound to do anything to market Ballantine products that would cause "more than trivial" losses.

[8] Other cases suggest that under New York law a "best efforts" clause imposes an obligation to act with good faith in light of one's own capabilities. In *Van Valkenburgh v. Hayden Publishing Co.*, 30 N.Y.2d 34, 330 N.Y.S.2d 329, 281 N.E.2d 142 (1972), the court held a publisher liable to an author when, in clear bad faith after a contract dispute, he hired another to produce a book very similar to plaintiff's and then promoted it to those who had been buying the latter. On the other hand, a defendant having the exclusive right to sell the plaintiff's product may sell a similar product if necessary to meet outside competition, so long as he accounts for any resulting losses the plaintiff can show in the sales of the licensed product. *Parev Products Co. v. I. Rokeach & Sons*, 124 F.2d 147 (2 Cir. 1941). A summary definition of the best efforts obligation, cited by Judge Brieant, 454 F. Supp. at 266, is given in *Arnold Productions, Inc. v. Favorite Films Corp.*, 176 F.Supp. 862, 866 (S.D.N.Y.1959), *aff'd* 298 F.2d 540 (2 Cir. 1962), to wit, performing as well as "the average prudent comparable" brewer.

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[7]The text of the *Feld* opinion did not refer to the case cited by Judge Brieant in the preceding footnote, *407 East 61st Garage, Inc. v. Savoy Fifth Avenue Corporation*, 244 N.E.2d 37 (N.Y. 1968), which might suggest a more onerous obligation here. The Court of Appeals there reversed a summary judgment in favor of the defendant, which had discontinued operating the Savoy Hilton Hotel because of substantial financial losses, in alleged breach of a five-year contract with plaintiff wherein the defendant had agreed to use all reasonable efforts to provide the garage with exclusive opportunity for storage of the motor vehicles of hotel guests. Although the court did use the language quoted by Judge Brieant, the actual holding was simply that "an issue of fact is presented whether the agreement did import an implied promise by Savoy to fulfill its obligations for an entire five-year period." 244 N.E.2d at 41.

[9] The net of all this is that the New York law is far from clear and it is unfortunate that a federal court must have to apply it.

[10] We do not think the judge imposed on Falstaff a standard as demanding as its appellate counsel argues that he did. Despite his footnote 7, see note 6 *supra*, he did not in fact proceed on the basis that the best efforts clause required Falstaff to bankrupt itself in promoting Ballantine products or even to sell those products at a substantial loss. He relied rather on the fact that Falstaff's obligation to "use its best efforts to promote and maintain a high volume of sales" of Ballantine products was not fulfilled by a policy summarized by Mr. Kalmanovitz as being:

We sell beer and you pay for it….We sell beer, F.O.B. the brewery. You come and get it.

however sensible such a policy may have been with respect to Falstaff's other products. Once the peril of insolvency[8] had been averted, the drastic percentage reductions in Ballantine sales as related to any possible basis of comparison, see fn. 5, required Falstaff at least to explore whether steps not involving substantial losses could have been taken to stop or at least lessen the rate of decline. The judge found that, instead of doing this, Falstaff had engaged in a number of misfeasances and nonfeasances which could have accounted in substantial measure for the catastrophic drop in Ballantine sales shown in the chart, see 454 F. Supp. at 267-72. These included the closing of the North Bergen depot which had serviced "Mom and Pop" stores and bars in the New York metropolitan area; Falstaff's choices of distributors for Ballantine products in the New Jersey and particularly the New York areas, where the chosen distributor was the owner of a competing brand; its failure to take advantage of a proffer from Guinness-Harp Corporation to distribute Ballantine products in New York City through its Metrobeer Division; Falstaff's incentive to put more effort into sales of its own

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[8] The judge may have unduly minimized this. We cannot agree with his statement, 454 F. Supp. at 267, that even in the winter of 1975 Falstaff "had considerable borrowing capacity" and indeed "did borrow successfully from Mr. Kalmanovitz." The latter was not making a commercial loan but was engaged in a program to take control. However, nothing turns on this.

brands which sold at higher prices despite identity of the ingredients and were free from the $0.50 a barrel royalty burden; its failure to treat Ballantine products evenhandedly with Falstaff's; its discontinuing the practice of setting goals for salesmen; and the general Kalmanovitz policy of stressing profit at the expense of volume. In the court's judgment, these misfeasances and nonfeasances warranted a conclusion that, even taking account of Falstaff's right to give reasonable consideration to its own interests, Falstaff had breached its duty to use best efforts as stated in the *Van Valkenburgh* decision, *supra*, 30 N.Y.2d at 46, 330 N.Y.S.2d at 334, 281 N.E.2d at 145.

[11] Falstaff levels a barrage on these findings. The only attack which merits discussion is its criticism of the judge's conclusion that Falstaff did not treat its Ballantine brands evenhandedly with those under the Falstaff name. We agree that the subsidiary findings "that Falstaff but not Ballantine had been advertised extensively in Texas and Missouri" and that "(i)n these same areas Falstaff, although a 'premium' beer, was sold for extended periods below the price of Ballantine," while literally true, did not warrant the inference drawn from them. Texas was Falstaff territory and, with advertising on a cooperative basis, it was natural that advertising expenditures on Falstaff would exceed those on Ballantine. The lower price for Falstaff was a particular promotion of a bicentennial can in Texas, intended to meet a particular competitor.

[12] However, we do not regard this error as undermining the judge's ultimate conclusion of breach of the best efforts clause. While that clause clearly required Falstaff to treat the Ballantine brands as well as its own, it does not follow that it required no more. With respect to its own brands, management was entirely free to exercise its business judgment as to how to maximize profit even if this meant serious loss in volume. Because of the obligation it had assumed under the sales contract, its situation with respect to the Ballantine brands was quite different. The royalty of $.50 a barrel on sales was an essential part of the purchase price. Even without the best efforts clause Falstaff would have been bound to make a good faith effort to see that substantial sales of Ballantine products were made, unless it discontinued under clause 2(a)(v) with consequent liability for liquidated damages. *Cf. Wood v. Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917) (Cardozo, J.). Clause 8

imposed an added obligation to use "best efforts to promote and maintain a *high* volume of sales …." (emphasis supplied). Although we agree that even this did not require Falstaff to spend itself into bankruptcy to promote the sales of Ballantine products, it did prevent the application to them of Kalmanovitz' philosophy of emphasizing profit *uber alles* without fair consideration of the effect on Ballantine volume. Plaintiff was not obliged to show just what steps Falstaff could reasonably have taken to maintain a high volume for Ballantine products. It was sufficient to show that Falstaff simply didn't care about Ballantine's volume and was content to allow this to plummet so long as that course was best for Falstaff's overall profit picture, an inference which the judge permissibly drew. The burden then shifted to Falstaff to prove there was nothing significant it could have done to promote Ballantine sales that would not have been financially disastrous.

[13] Having correctly concluded that Falstaff had breached its best efforts covenant, the judge was faced with a difficult problem in computing what the royalties on the lost sales would have been. There is no need to rehearse the many decisions that, in a situation like this, certainty is not required; "(t)he plaintiff need only show a 'stable foundation for a reasonable estimate of royalties he would have earned had defendant not breached' ". Contemporary *Mission, Inc. v. Famous Music Corp.*, 557 F.2d 918, 926 (2 Cir. 1977), quoting *Freund v. Washington Square Press*, *Inc.*, 34 N.Y.2d 379, 383, 357 N.Y.S.2d 857, 861, 314 N.E.2d 419, 421 (1974). After carefully considering other possible bases, the court arrived at the seemingly sensible conclusion that the most nearly accurate comparison was with the combined sales of Rheingold and Schaefer beers, both, like Ballantine, being "price" beers sold primarily in the northeast, and computed what Ballantine sales would have been if its brands had suffered only the same decline as a composite of Rheingold and Schaefer.

[14] Falstaff's principal criticism of the method of comparison, in addition to that noted in fn. 5, supra, was that the judge erred in saying, 454 F. Supp. at 279, that inclusion of Rheingold made "the comparison a conservative one" since "(t)he brewery was closed in early 1974 and production halted for a time." Falstaff is right that the halt in Rheingold production works the other way since the lowered figure

for the base year made the percentage decline in subsequent years appear to be less than it in fact was. Against this, however, is the fact that the Rheingold 1977 figures do not include sales for the end of 1977 after the sale of Rheingold to Schmidt's Brewery, which counterbalances this error in some degree. In any event the Rheingold sales were only 25.7% of the combined sales in 1974 and 16.8% In 1977. Another criticism is that the deduction from the initial computation of lost royalties of $29,193.50 for the period April 1976 to March 1978 as representing royalties lost through the cessation of illegal practices was insufficient; it may well have been but the judge used the best figures he had. A possible objection, namely, that Schaefer maintained its sales only by incurring large losses, a fact now possibly subject to judicial notice, see *The F. & M. Schaefer Corporation v. C. Schmidt & Sons, Inc.*, 597 F.2d 814, 817 (2d Cir. 1979), was not advanced with sufficient specificity to have required consideration. It is true, more generally, that the award may overcompensate the plaintiff since Falstaff was not necessarily required to do whatever Rheingold and Schaefer did. But that is the kind of uncertainty which is permissible in favor of a plaintiff who has established liability in a case like this. As said in *Wakeman v. Wheeler & Wilson Mfg. Co.*, 101 N.Y. 205, 209, 4 N.E. 264 (1886):

> (W)hen it is certain that damages have been caused by a breach of contract, and the only uncertainty is to their amount, there can rarely be good reason for refusing on account of such uncertainty, any damages whatever for the breach. A person violating his contract should not be permitted entirely to escape liability because the amount of damage which he caused is uncertain.

[15] We also reject plaintiff's complaint on his cross-appeal that the court erred in not taking as its standard for comparison the grouping of all but the top 15 brewers, Ballantine having ranked 16th in 1971. The judge was entirely warranted in believing that the Rheingold-Schaefer combination afforded a better standard of comparison.

[16] We can dispose quite briefly of the portion of the plaintiff's cross-appeal which claims error in the rejection of his contention that Falstaff's actions triggered the liquidated damage clause. One branch of this puts heavy weight on the word "distribution"; the

claim is that the closing of the North Bergen center and Mr. Kalmanovitz' general come-and-get-it philosophy was, without more, a substantial discontinuance of "distribution". On this basis plaintiff would be entitled to invoke the liquidated damage clause even if Falstaff's new methods had succeeded in checking the decline in Ballantine sales. Another fallacy is that, country-wide, Falstaff substantially increased the number of distributors carrying Ballantine labels. Moreover the term "distribution", as used in the brewing industry, does not require distribution by the brewer's own trucks and employees. The norm rather is distribution through independent wholesalers. Falstaff's default under the best efforts clause was not in returning to that method *simpliciter* but in its failure to see to it that wholesale distribution approached in effectiveness what retail distribution had done.

[17] Plaintiff contends more generally that permitting a decline of 63.12% In Ballantine sales from 1974 to 1977 was the equivalent of quitting the game. However, as Judge Brieant correctly pointed out, a large part of this drop was attributable "to the general decline of the market share of the smaller brewers" as against the "nationals", 454 F. Supp. at 266, and even the 518,899 barrels sold in 1977 were not a negligible amount of beer.

[18] The judgment is affirmed. Plaintiff may recover two-thirds of his costs.

4.2.1. "Best Efforts" as Joint Maximization

As you can see from the opinion in *Bloor v. Falstaff*, courts have struggled to define what the vague "best efforts" standard requires. At what level of output does the grantee of exclusive rights satisfy its contractual obligation? How much effort must an exclusive distributor expend to promote the grantor's product? When does promoting a competing product constitute a violation of the best efforts duty?

Professors Charles Goetz and Robert Scott have argued that "best efforts" should be understood to require an exclusive distributor to maximize the joint gains of the parties. See Charles J. Goetz and Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981). They argue that this joint maximization interpretation forces the distributor to choose an efficient level of effort. Goetz and Scott explain that both parties benefit

from maximizing the contractual pie available to be divided between them. The decision rule they propose envisions the parties as a single firm with the manufacturing costs of the principal and the distribution costs of the agent. As a practical matter, the joint maximization standard requires the distributor to undertake any promotional effort that will yield a joint benefit greater than its joint cost.

4.2.2. Discussion of *Bloor v. Falstaff*

How does Judge Friendly resolve Balco's claim for liquidated damages?

If they did not substantially discontinue distribution of Ballantine brands, what exactly did Falstaff do wrong?

What did the "best efforts" clause require?

With the many problems and uncertainties that they face in enforcing best efforts obligations, why do parties enter exclusive dealing arrangements rather than simply selling to all comers?

What is the central problem that parties who grant exclusive rights normally encounter?

4.2.3. Hypo on Joint Maximization

A court is trying to decide whether Falstaff should have to spend an extra $100,000 on advertising Ballantine brands. Suppose that the following table describes the expected returns from this additional investment in advertising:

	Net Gains		
	Falstaff	**Balco**	**Joint**
Case One	($50,000)	$60,000	$10,000
Case Two	($50,000)	$30,000	($20,000)

In each case, what will Falstaff want to do?

What does Balco want Falstaff to do?

What decision satisfies the joint maximization criterion?

The *Bloor v. Falstaff* court emphatically does not analyze the case in these terms. Would joint maximization be an improvement over the method the court employs?

Under the joint maximization criterion, how would a court determine if there has been a breach of the best efforts obligation?

How do parties prove their case?

V. Regulating the Bargaining Process

1. Unconscionability

Consider for a moment what might justify using the coercive power of the state to enforce private promises. From a moral perspective, we might think that choosing to make a promise creates a duty to perform. Imagine that Cheryl promises Albert that she will prepare his tax return in exchange for $200. The promisor Cheryl exercises her autonomy to establish a new relationship in which the promisee Albert can rely on her promise and adjust his plans accordingly. We show respect for the autonomy of both parties by enforcing the promise. Enforcement enables Cheryl to bind herself to perform if she chooses to do so. At the same time, enforcement respects Albert's autonomy by protecting his reliance on Cheryl's promise.

An alternative economic or "instrumental" approach to enforcement also focuses on the parties' choices and reliance. From an economic perspective, one goal of promise making is mutually beneficial trade. People make promises to enable others to rely. Promises also allow parties to trade risks. Thus, Cheryl assumes the risk that the market price for tax preparation will rise or that she will find it inconvenient or difficult to fulfill her promise to complete Albert's tax return by the filing deadline. At the same time, Albert accepts the risk that someone else will offer to do his taxes for less or that he would prefer to prepare the return himself. Each party faces a different bundle of risks than he or she did before making or receiving the promise. On this account, the purpose of promissory enforcement is to maximize the social benefits that flow from these exchanges of risk.

Both justifications for enforcement have in common the assumption that parties make promises and enter into bargains voluntarily. It follows that if Cheryl holds a gun to Albert's head and forces him to contract for her services, then Albert should be free to disavow the deal and use H&R Block instead. More difficult and subtle questions arise when a promisor claims that she lacked essential information about the terms of a bargain or that she was for some other reason unable to exercise a meaningful choice. Even more

controversial are claims that the terms of the deal are so unfavorable that a court should simply refuse to enforce them.

The two opinions in the following case address some of these issues.

1.1. Principal Case – Williams v. Walker-Thomas Furniture Co. I

Williams v. Walker-Thomas Furniture Co. I
District of Columbia Court of Appeals
198 A.2d 914 (1964)

QUINN, ASSOCIATE JUDGE.

[1] Appellant, a person of limited education separated from her husband, is maintaining herself and her seven children by means of public assistance. During the period 1957-1962 she had a continuous course of dealings with appellee from which she purchased many household articles on the installment plan. These included sheets, curtains, rugs, chairs, a chest of drawers, beds, mattresses, a washing machine, and a stereo set. In 1963 appellee filed a complaint in replevin for possession of all the items purchased by appellant, alleging that her payments were in default and that it retained title to the goods according to the sales contracts. By the writ of replevin appellee obtained a bed, chest of drawers, washing machine, and the stereo set. After hearing testimony and examining the contracts, the trial court entered judgment for appellee.

[2] Appellant's principal contentions on appeal are (1) there was a lack of meeting of the minds, and (2) the contracts were against public policy.

[3] Appellant signed fourteen contracts in all. They were approximately six inches in length and each contained a long paragraph in extremely fine print. One of the sentences in this paragraph provided that payments, after the first purchase, were to be prorated on all purchases then outstanding. Mathematically, this had the effect of keeping a balance due on all items until the time balance was completely eliminated. It meant that title to the first purchase, remained in appellee until the fourteenth purchase, made some five years later, was fully paid.

[4] At trial appellant testified that she understood the agreements to mean that when payments on the running account were sufficient to balance the amount due on an individual item, the item became hers. She testified that most of the purchases were made at her home; that the contracts were signed in blank; that she did not read the instruments; and that she was not provided with a copy. She admitted, however, that she did not ask anyone to read or explain the contracts to her.

[5] We have stated that "one who refrains from reading a contract and in conscious ignorance of its terms voluntarily assents thereto will not be relieved from his bad bargain." *Bob Wilson, Inc. v. Swann*, D.C.Mun.App., 168 A.2d 198, 199 (1961). "One who signs a contract has a duty to read it and is obligated according to its terms." *Hollywood Credit Clothing Co. v. Gibson*, D.C.App., 188 A.2d 348, 349 (1963). "It is as much the duty of a person who cannot read the language in which a contract is written to have someone read it to him before he signs it, as it is the duty of one who can read to peruse it himself before signing it." *Stern v. Moneyweight Scale Co.*, 42 App.D.C. 162, 165 (1914).

[6] A careful review of the record shows that appellant's assent was not obtained "by fraud or even misrepresentation falling short of fraud." *Hollywood Credit Clothing Co. v. Gibson*, *supra*. This is not a case of mutual misunderstanding but a unilateral mistake. Under these circumstances, appellant's first contention is without merit.

[7] Appellant's second argument presents a more serious question. The record reveals that prior to the last purchase appellant had reduced the balance in her account to $164. The last purchase, a stereo set, raised the balance due to $678. Significantly, at the time of this and the preceding purchases, appellee was aware of appellant's financial position. The reverse side of the stereo contract listed the name of appellant's social worker and her $218 monthly stipend from the government. Nevertheless, with full knowledge that appellant had to feed, clothe and support both herself and seven children on this amount, appellee sold her a $514 stereo set.

[8] We cannot condemn too strongly appellee's conduct. It raises serious questions of sharp practice and irresponsible business

dealings. A review of the legislation in the District of Columbia affecting retail sales and the pertinent decisions of the highest court in this jurisdiction disclose, however, no ground upon which this court can declare the contracts in question contrary to public policy. We note that were the Maryland Retail Installment Sales Act, Art. 83 §§ 128-153, or its equivalent, in force in the District of Columbia, we could grant appellant appropriate relief. We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar.

1.2. Principal Case – Williams v. Walker-Thomas Furniture Co. II

Williams v. Walker-Thomas Furniture Co. II

United States Court of Appeals, District of Columbia Circuit
121 U.S. App. D.C. 315, 350 F.2d 445 (1965)

WRIGHT, CIRCUIT JUDGE.

[1] Appellee, Walker-Thomas Furniture Company, operates a retail furniture store in the District of Columbia. During the period from 1957 to 1962 each appellant in these cases purchased a number of household items from Walker-Thomas, for which payment was to be made in installments. The terms of each purchase were contained in a printed form contract which set forth the value of the purchased item and purported to lease the item to appellant for a stipulated monthly rent payment. The contract then provided, in substance, that title would remain in Walker-Thomas until the total of all the monthly payments made equaled the stated value of the item, at which time appellants could take title. In the event of a default in the payment of any monthly installment, Walker-Thomas could repossess the item.

[2] The contract further provided that "the amount of each periodical installment payment to be made by (purchaser) to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by (purchaser) under such prior leases, bills or accounts; and all payments now and hereafter made by (purchaser) shall be credited pro rata on all outstanding leases, bills and accounts due the Company by (purchaser) at the time each such payment is made." The effect of this rather obscure

provision was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated. As a result, the debt incurred at the time of purchase of each item was secured by the right to repossess all the items previously purchased by the same purchaser, and each new item purchased automatically became subject to a security interest arising out of the previous dealings.

[3] On May 12, 1962, appellant Thorne purchased an item described as a Daveno, three tables, and two lamps, having total stated value of $391.10. Shortly thereafter, he defaulted on his monthly payments and appellee sought to replevy all the items purchased since the first transaction in 1958. Similarly, on April 17, 1962, appellant Williams bought a stereo set of stated value of $514.95.[1] She too defaulted shortly thereafter, and appellee sought to replevy all the items purchased since December, 1957. The Court of General Sessions granted judgment for appellee. The District of Columbia Court of Appeals affirmed, and we granted appellants' motion for leave to appeal to this court.

[4] Appellants' principal contention, rejected by both the trial and the appellate courts below, is that these contracts, or at least some of them, are unconscionable and, hence, not enforceable. In its opinion in *Williams v. Walker-Thomas Furniture Company*, 198 A.2d 914, 916 (1964), the District of Columbia Court of Appeals explained its rejection of this contention as follows:

> Appellant's second argument presents a more serious question. The record reveals that prior to the last purchase appellant had reduced the balance in her account to $164. The last purchase, a stereo set, raised the balance due to $678. Significantly, at the time of this and the preceding purchases, appellee was aware of appellant's financial position. The reverse side of the stereo contract listed the name of appellant's social worker and her $218 monthly stipend from the government. Nevertheless, with full knowledge that appellant had to feed, clothe and support both herself and seven children on this amount, appellee sold her a $514 stereo set.

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[1] At the time of this purchase her account showed a balance of $164 still owing from her prior purchases. The total of all the purchases made over the years in question came to $1,800. The total payments amounted to $1,400.

We cannot condemn too strongly appellee's conduct. It raises serious questions of sharp practice and irresponsible business dealings. A review of the legislation in the District of Columbia affecting retail sales and the pertinent decisions of the highest court in this jurisdiction disclose, however, no ground upon which this court can declare the contracts in question contrary to public policy. We note that were the Maryland Retail Installment Sales Act, Art. 83 §§ 128-153, or its equivalent, in force in the District of Columbia, we could grant appellant appropriate relief. We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar.

[5] We do not agree that the court lacked the power to refuse enforcement to contracts found to be unconscionable. In other jurisdictions, it has been held as a matter of common law that unconscionable contracts are not enforceable.[2] While no decision of this court so holding has been found, the notion that an unconscionable bargain should not be given full enforcement is by no means novel. In *Scott v. United States*, 79 U.S. (12 Wall.) 443, 445 (1870), the Supreme Court stated:

> …If a contract be unreasonable and unconscionable, but not void for fraud, a court of law will give to the party who sues for its breach damages, not according to its letter, but only such as he is equitably entitled to….[3]

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[2] *Campbell Soup Co. v. Wentz*, 3 Cir., 172 F.2d 80 (1948); Indianapolis Morris Plan Corporation v. Sparks, 132 Ind.App. 145, 172 N.E.2d 899 (1961); *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69, 84-96, 75 A.L.R.2d 1 (1960). Cf. 1 CORBIN, CONTRACTS § 128 (1963).

[3] See *Luing v. Peterson*, 143 Minn. 6, 172 N.W. 692 (1919); *Greer v. Tweed*, N.Y.C.P., 13 Abb.Pr., N.S., 427 (1872); *Schnell v. Nell*, 17 Ind. 29 (1861); and see generally the discussion of the English authorities in *Hume v. United States*, 132 U.S. 406 (1889).

Since we have never adopted or rejected such a rule,[4] the question here presented is actually one of first impression.

[6] Congress has recently enacted the Uniform Commercial Code, which specifically provides that the court may refuse to enforce a contract which it finds to be unconscionable at the time it was made. 28 D.C.CODE § 2-302 (Supp. IV 1965). The enactment of this section, which occurred subsequent to the contracts here in suit, does not mean that the common law of the District of Columbia was otherwise at the time of enactment, nor does it preclude the court from adopting a similar rule in the exercise of its powers to develop the common law for the District of Columbia. In fact, in view of the absence of prior authority on the point, we consider the congressional adoption of § 2-302 persuasive authority for following the rationale of the cases from which the section is explicitly derived.[5] Accordingly, we hold that where the element of unconscionability is present at the time a contract is made, the contract should not be enforced.

[7] Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.[6] Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances

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[4] While some of the statements in the court's opinion in *District of Columbia v. Harlan & Hollingsworth Co.*, 30 App. D.C. 270 (1908), may appear to reject the rule, in reaching its decision upholding the liquidated damages clause in that case the court considered the circumstances existing at the time the contract was made, see 30 App. D.C. at 279, and applied the usual rule on liquidated damages. See 5 CORBIN, CONTRACTS §§ 1054-1075 (1964); Note, 72 YALE L.J. 723, 746-755 (1963). Compare *Jaeger v. O'Donoghue*, 57 App.D.C. 191, 18 F.2d 1013 (1927).

[5] See Comment, § 2-302, Uniform Commercial Code (1962). Compare Note, 45 VA. L. REV. 583, 590 (1959), where it is predicted that the rule of § 2-302 will be followed by analogy in cases which involve contracts not specifically covered by the section. Cf. 1 STATE OF NEW YORK LAW REVISION COMMISSION, REPORT AND RECORD OF HEARINGS ON THE UNIFORM COMMERCIAL CODE 108-110 (1954) (remarks of Professor Llewellyn).

[6] See Henningsen v. Bloomfield Motors, Inc., supra Note 2; Campbell Soup Co. v. Wentz, supra Note 2.

surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power.[7] The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain.[8] But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the

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[7] See *Henningsen v. Bloomfield Motors, Inc.*, *supra* Note 2, 161 A.2d at 86,, and authorities there cited. Inquiry into the relative bargaining power of the two parties is not an inquiry wholly divorced from the general question of unconscionability, since a one-sided bargain is itself evidence of the inequality of the bargaining parties. This fact was vaguely recognized in the common law doctrine of intrinsic fraud, that is, fraud which can be presumed from the grossly unfair nature of the terms of the contract. See the oft-quoted statement of Lord Hardwicke in Earl of Chesterfield v. Janssen, 28 Eng. Rep. 82, 100 (1751): "…(Fraud) may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under delusion would make...." And *cf. Hume v. United States*, supra Note 3, 132 U.S. at 413, where the Court characterized the English cases as 'cases in which one party took advantage of the other's ignorance of arithmetic to impose upon him, and the fraud was apparent from the face of the contracts.' See also *Greer v. Tweed*, *supra* Note 3.

[8] See RESTATEMENT, CONTRACTS § 70 (1932); Note, 63 HARV. L. REV. 494 (1950). See also *Daley v. People's Building, Loan & Savings Ass'n*, 178 Mass. 13, 59 N.E. 452, 453 (1901), in which Mr. Justice Holmes, while sitting on the Supreme Judicial Court of Massachusetts, made this observation: "…Courts are less and less disposed to interfere with parties making such contracts as they choose, so long as they interfere with no one's welfare but their own….It will be understood that we are speaking of parties standing in an equal position where neither has any oppressive advantage or power…."

terms of the agreement are not to be questioned[9] should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.[10]

[8] In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered "in the light of the general commercial background and the commercial needs of the particular trade or case."[11] Corbin suggests the test as being whether the terms are 'so extreme as to appear unconscionable according to the mores and business practices of the time and place."[12] We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.

[9] Because the trial court and the appellate court did not feel that enforcement could be refused, no findings were made on the possible unconscionability of the contracts in these cases. Since the record is not sufficient for our deciding the issue as a matter of law, the cases must be remanded to the trial court for further proceedings.

So ordered.

DANAHER, CIRCUIT JUDGE (DISSENTING):

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[9] This rule has never been without exception. In cases involving merely the transfer of unequal amounts of the same commodity, the courts have held the bargain unenforceable for the reason that "in such a case, it is clear, that the law cannot indulge in the presumption of equivalence between the consideration and the promise." 1 WILLISTON, CONTRACTS § 115 (3d ed. 1957).

[10] See the general discussion of 'Boiler-Plate Agreements' in LLEWELLYN, THE COMMON LAW TRADITION 362-371 (1960).

[11] Comment, Uniform Commercial Code § 2-307.

[12] See *Henningsen v. Bloomfield Motors, Inc.*, *supra* Note 2; *Mandel v. Liebman*, 303 N.Y. 88, 100 N.E.2d 149 (1951). The traditional test as stated in *Greer v. Tweed*, *supra* Note 3, 13 Abb. Pr., N.S., at 429, is "such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept, on the other."

[10] The District of Columbia Court of Appeals obviously was as unhappy about the situation here presented as any of us can possibly be. Its opinion in the *Williams* case, quoted in the majority text, concludes: "We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar."

[11] My view is thus summed up by an able court which made no finding that there had actually been sharp practice. Rather the appellant seems to have known precisely where she stood.

[12] There are many aspects of public policy here involved. What is a luxury to some may seem an outright necessity to others. Is public oversight to be required of the expenditures of relief funds? A washing machine, e.g., in the hands of a relief client might become a fruitful source of income. Many relief clients may well need credit, and certain business establishments will take long chances on the sale of items, expecting their pricing policies will afford a degree of protection commensurate with the risk. Perhaps a remedy when necessary will be found within the provisions of the "Loan Shark" law, D.C.Code §§ 26-601 et seq. (1961).

[13] I mention such matters only to emphasize the desirability of a cautious approach to any such problem, particularly since the law for so long has allowed parties such great latitude in making their own contracts. I dare say there must annually be thousands upon thousands of installment credit transactions in this jurisdiction, and one can only speculate as to the effect the decision in these cases will have.[13]

[14] I join the District of Columbia Court of Appeals in its disposition of the issues.

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[13] However the provision ultimately may be applied or in what circumstances, D.C. Code § 28-2-301 (Supp. IV, 1965) it did not become effective until January 1, 1965.

1.2.1. Procedural and Substantive Unconscionability

Both judges and scholars ordinarily draw a distinction between "substantive" and "procedural" unconscionability. *Substantive* unconscionability focuses on the contract terms themselves. This branch of the doctrine asks whether the terms of the agreement are so unfavorable to one of the parties that we should refuse enforcement. In this vein, courts may find that a manufacturer's clause limiting remedies for breach is contrary to the "essence of the bargain" or that a price or warranty term in a consumer contract is "unreasonable."

In contrast, *procedural* unconscionability focuses on the circumstances surrounding contract formation. Was there something about that process that prevented one party from understanding the agreement? Most courts consider a wide range of "factors related to the bargaining power of each party, including age, education, intelligence, business acumen, experience in similar transactions, whether the terms were explained to the weaker party, who drafted the contract, whether alterations in the printed terms were possible, and whether the party claiming unconscionability was represented by counsel at the time the contract was executed." *Roe v. Rent-A-Center, Inc.*, CA2007-09-224 (Ohio App. 2008). For example, a court might find an agreement procedurally unconscionable because a company's sales practices tended to obscure the true nature of the contract.

Each strand of unconscionability doctrine stands in some tension with other contract doctrines that favor the enforcement of all voluntary bargains. Thus, the "duty to read" doctrine holds that a person who signs a contract without reading it will be bound despite his lack of knowledge of its terms. Courts have even refused to excuse illiterate and non-English-speaking promisors, explaining that they should have asked someone to read and explain the agreement before signing it. See, e.g. *Morales v. Sun Constructors*, Inc., No. 07-3806 (3d Cir. 2008); *Upton v. Tribilcock*, 91 U.S. 45 (1875). As we saw in *Williams I* and *Williams II*, a procedural unconscionability claim must first overcome judicial reluctance to depart from the strict "duty to read" precedents.

Similarly, arguments about substantive unconscionability conflict with the general contractual principle that courts should let the parties' judge for themselves whether to accept a particular bargain. For example, courts do

not scrutinize the adequacy of consideration. Each party is free to make a good bargain or a bad bargain, and judges ordinarily respect the private ordering these agreements seek to create. Finding a contract substantively unconscionable rejects the parties' bargain and prevents them from forming an enforceable agreement on those terms. Perhaps as a result of this fundamental tension, judicial decisions hardly ever invalidate an agreement solely on grounds of substantive unconscionability. And many jurisdictions formally require courts to find an agreement both procedurally and substantively unconscionable before refusing to enforce it. *See, e.g.*, *Roe v. Rent-A-Center, Inc.*, CA2007-09-224 (Ohio App. 2008).

1.2.2. Rent-to-Own Industry and Consumer Protection Laws

In *Williams I*, the court concluded its opinion by calling attention to questionable practices in the rent-to-own industry. Walker-Thomas's conduct evidently raised "serious questions of sharp practice and irresponsible business dealings." The court also issued a plea for "corrective legislation" along the lines of provisions contained in the Maryland Retail Installment Sales Act.

Some years later, *The Wall Street Journal* published a highly critical feature story on the rent-to-own industry. In extensive interviews, former Rent-A-Center managers described high-pressure sales tactics, misleading pricing practices, and coercive methods of repossessing goods from defaulting renters. Repo calls sometimes included demands for "couch payments" – sexual favors extorted in lieu of cash. However, the article also revealed that many renters could not afford to buy the items and had "nowhere else to go." See Alix Freedman, *Peddling Dreams: A Marketing Giant Uses Its Sales Prowess to Profit on Poverty*, THE WALL STREET JOURNAL A1 (Sept. 22, 1993).

More recently the industry has fought off efforts to enact legislation classifying rent-to-own transactions as credit sales. The typical "rental" agreement provides for total payments several times the normal retail value of the goods, and thus an implied annual interest rate of 200-300 percent. Redefining these deals as credit transactions would make state usury laws applicable and prohibit firms from charging such a high implicit interest rate. The industry argues, however, that rent-to-own customers assume no debt and always have an option to return the goods with no further obligation.

Moreover, a 1999 Federal Trade Commission customer survey found that most are satisfied with their rent-to-own transactions. See John Seward, *Tales of the Tape: Rent-To-Owns Seek Definition in Law*, DOW JONES NEWSWIRES (Oct. 17, 2003).

In one respect at least, the *Williams I* court's wish was fulfilled. The District of Columbia Code now contains a provision prohibiting the sort of pro-rata payment arrangement contained in Walker-Thomas Furniture Company's contract. See D.C. Code § 28-3805. Under the statute, payments must be credited towards the first item purchased until that item has been paid off and the seller's security interest in that item is then extinguished.

1.2.3. Uniform Commercial Code Unconscionability Provisions

The Uniform Commercial Code empowers a court to refuse to enforce unconscionable contracts in the following terms:

§ 2-302. Unconscionable Contract or Clause

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Official Comment

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow

the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence on these questions. The principle is one of the prevention of oppression and unfair surprise. (*Cf. Campbell Soup Co. v. Wentz*, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power.

1.2.4. Discussion of Unconscionability

Why does the D.C. Court of Appeals (reluctantly) decide, in *Williams I*, to enforce the pro-rata payment clause in the Walker-Thomas Furniture Company's form contract?

The D.C. Circuit reaches a decidedly different decision about the prevailing legal rule. Does that court hold that the pro-rata-payment clause is unconscionable? If not, then what doctrinal standard will determine whether the clause is unconscionable?

Judge Wright talks extensively about unequal bargaining power. What do you suppose he means by that term?

Consider the following language from the Uniform Commercial Code provision concerning unconscionability: "The principle is one of the prevention of unfair surprise and not of disturbance of risks because of superior bargaining power." U.C.C. § 2-302 Comment 1. Can you reconcile this comment with Judge Wright's discussion of bargaining power in *Williams II*?

The prospective effects of procedural and substantive unconscionability are likely to differ. How would you expect sellers to respond to a ruling that the Walker-Thomas Furniture Company's form contract is procedurally unconscionable? Suppose that a court instead holds that pro-rata-payment clauses and cross-collateral clauses are substantively unconscionable. Will people in Ms. Williams's circumstances be able to obtain furniture on the same payment plan?

2. Modification

In this section, we examine the rules that apply when parties choose to modify existing contractual obligations. The traditional common law approach held that a modification would be ineffective without fresh consideration—some obligation beyond what the promisor was already obliged to perform under the prior contract. This "pre-existing duty rule" established a comparatively precise bright-line rule for evaluating attempted modifications. The *Alaska Packers* case that follows arguably illustrates this traditional approach.

More recent decisions, however, have shown a willingness to enforce modifications even when a promisor assumes no new obligations. The Restatement (Second) embraces a rather open-ended standard incorporating both reliance-based enforcement and general equitable principles.

§ 89 Modification of Executory Contract

A promise modifying a duty under a contract not fully performed on either side is binding

(a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or

(b) to the extent provided by statute; or

(c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise.

The Uniform Commercial Code adopts a very similar standard based on good faith. Please look at UCC § 2-209. Modification, Rescission and Waiver and the related Official Comments 1-4.

Both the Restatement (Second) and this UCC provision abandon the comparatively precise pre-existing duty rule. They instead invite parties to present evidence about the circumstances surrounding their agreement to modify the prior contract and require courts to evaluate modifications under relatively amorphous standards of equity and good faith.

Even under the traditional pre-existing duty rule, one possible alternative was to rescind the existing contract and form a new one. Termed a "substituted contract" or sometimes a "novation," the new contract is enforceable because the parties have terminated the prior contract and discharged any obligations that it imposed. If courts routinely enforced any agreement that parties denominated a substituted contract or novation, the strict pre-existing duty rule would be eviscerated and replaced with an equally clear rule allowing parties to modify existing contractual obligations without any legal constraint. However, this strategy must overcome judges' reluctance to permit a purely formal device to eliminate substantive doctrinal constraints. To prevent parties from elevating form over substance, courts may construe a purported substitution or novation as an attempt to modify the prior contract and then apply the ordinary constraints on modification.

As you read the case that follows, consider whether the court applies the comparatively clear pre-existing duty rule. Or does the opinion examine the surrounding circumstances to determine whether to enforce the modified contract?

2.1. Principal Case – Alaska Packers' Association v. Domenico

Alaska Packers' Ass'n v. Domenico

United States Court of Appeals, Ninth Circuit

117 F. 99 (1902)

ROSS, CIRCUIT JUDGE.

[1] The libel in this case was based upon a contract alleged to have been entered into between the libelants and the appellant corporation on the 22d day of May, 1900, at Pyramid Harbor, Alaska, by which it is claimed the appellant promised to pay each of the libelants, among other things, the sum of $100 for services rendered and to be rendered. In its answer the respondent denied the execution, on its part, of the contract sued upon, averred that it was without consideration, and for a third defense alleged that the work performed by the libelants for it was performed under other and different contracts than that sued on, and that, prior to the filing of the libel, each of the libelants was paid by the respondent the full amount due him thereunder, in consideration of

which each of them executed a full release of all his claims and demands against the respondent.

[2] The evidence shows without conflict that on March 26, 1900, at the city and county of San Francisco, the libelants entered into a written contract with the appellants, whereby they agreed to go from San Francisco to Pyramid Harbor, Alaska, and return, on board such vessel as might be designated by the appellant, and to work for the appellant during the fishing season of 1900, at Pyramid Harbor, as sailors and fishermen, agreeing to do "regular ship's duty, both up and down, discharging and loading; and to do any other work whatsoever when requested to do so by the captain or agent of the Alaska Packers' Association." By the terms of this agreement, the appellant was to pay each of the libelants $50 for the season, and two cents for each red salmon in the catching of which he took part.

[3] On the 15th day of April, 1900, 21 of the libelants signed shipping articles by which they shipped as seamen on the Two Brothers, a vessel chartered by the appellant for the voyage between San Francisco and Pyramid Harbor, and also bound themselves to perform the same work for the appellant provided for by the previous contract of March 26th; the appellant agreeing to pay them therefor the sum of $60 for the season, and two cents each for each red salmon in the catching of which they should respectively take part. Under these contracts, the libelants sailed on board the Two Brothers for Pyramid Harbor, where the appellants had about $150,000 invested in a salmon cannery. The libelants arrived there early in April of the year mentioned, and began to unload the vessel and fit up the cannery. A few days thereafter, to wit, May 19th, they stopped work in a body, and demanded of the company's superintendent there in charge $100 for services in operating the vessel to and from Pyramid Harbor, instead of the sums stipulated for in and by the contracts; stating that unless they were paid this additional wage they would stop work entirely, and return to San Francisco. The evidence showed, and the court below found, that it was impossible for the appellant to get other men to take the places of the libelants, the place being remote, the season short and just opening; so that, after endeavoring for several days without success to induce the libelants to proceed with their work in accordance with their contracts, the

company's superintendent, on the 22d day of May, so far yielded to their demands as to instruct his clerk to copy the contracts executed in San Francisco, including the words ‘Alaska Packers' Association‘ at the end, substituting, for the $50 and $60 payments, respectively, of those contracts, the sum of $100, which document, so prepared, was signed by the libelants before a shipping commissioner whom they had requested to be brought from Northeast Point; the superintendent, however, testifying that he at the time told the libelants that he was without authority to enter into any such contract, or to in any way alter the contracts made between them and the company in San Francisco. Upon the return of the libelants to San Francisco at the close of the fishing season, they demanded pay in accordance with the terms of the alleged contract of May 22d, when the company denied its validity, and refused to pay other than as provided for by the contracts of March 26th and April 5th, respectively. Some of the libelants, at least, consulted counsel, and, after receiving his advice, those of them who had signed the shipping articles before the shipping commissioner at San Francisco went before that officer, and received the amount due them thereunder, executing in consideration thereof a release in full, and the others paid at the office of the company, also receipting in full for their demands.

[4] On the trial in the court below, the libelants undertook to show that the fishing nets provided by the respondent were defective, and that it was on that account that they demanded increased wages. On that point, the evidence was substantially conflicting, and the finding of the court was against the libelants the court saying:

> The contention of libelants that the nets provided them were rotten and unserviceable is not sustained by the evidence. The defendants' interest required that libelants should be provided with every facility necessary to their success as fishermen, for on such success depended the profits defendant would be able to realize that season from its packing plant, and the large capital invested therein. In view of this self-evident fact, it is highly improbable that the defendant gave libelants rotten and unserviceable nets with which to fish. It follows from this finding that libelants were not justified in refusing performance of their original contract.

112 Fed. 554.

[5] The evidence being sharply conflicting in respect to these facts, the conclusions of the court, who heard and saw the witnesses, will not be disturbed. *The Alijandro*, 6 C.C.A. 54, 56 Fed. 621; *The Lucy*, 20 C.C.A. 660, 74 Fed. 572; *The Glendale*, 26 C.C.A. 500, 81 Fed. 633. *The Coquitlam*, 23 C.C.A. 438, 77 Fed. 744; *Gorham Mfg. Co. v. Emery-Bird-Thayer Dry Goods Co.*, 43 C.C.A. 511, 104 Fed. 243.

[6] The real questions in the case as brought here are questions of law, and, in the view that we take of the case, it will be necessary to consider but one of those. Assuming that the appellant's superintendent at Pyramid Harbor was authorized to make the alleged contract of May 22d, and that he executed it on behalf of the appellant, was it supported by a sufficient consideration? From the foregoing statement of the case, it will have been seen that the libelants agreed in writing, for certain stated compensation, to render their services to the appellant in remote waters where the season for conducting fishing operations is extremely short, and in which enterprise the appellant had a large amount of money invested; and, after having entered upon the discharge of their contract, and at a time when it was impossible for the appellant to secure other men in their places, the libelants, without any valid cause, absolutely refused to continue the services they were under contract to perform unless the appellant would consent to pay them more money. Consent to such a demand, under such circumstances, if given, was, in our opinion, without consideration, for the reason that it was based solely upon the libelants' agreement to render the exact services, and none other, that they were already under contract to render. The case shows that they willfully and arbitrarily broke that obligation. As a matter of course, they were liable to the appellant in damages, and it is quite probable, as suggested by the court below in its opinion, that they may have been unable to respond in damages. But we are unable to agree with the conclusions there drawn, from these facts, in these words:

> Under such circumstances, it would be strange, indeed, if the law would not permit the defendant to waive the damages caused by the libelants' breach, and enter into the contract sued upon—a contract mutually beneficial to all the parties thereto, in that it gave to the libelants reasonable compensation for their

labor, and enabled the defendant to employ to advantage the large capital it had invested in its canning and fishing plant.

[7] Certainly, it cannot be justly held, upon the record in this case, that there was any voluntary waiver on the part of the appellant of the breach of the original contract. The company itself knew nothing of such breach until the expedition returned to San Francisco, and the testimony is uncontradicted that its superintendent at Pyramid Harbor, who, it is claimed, made on its behalf the contract sued on, distinctly informed the libelants that he had no power to alter the original or to make a new contract, and it would, of course, follow that, if he had no power to change the original, he would have no authority to waive any rights thereunder. The circumstances of the present case bring it, we think, directly within the sound and just observations of the supreme court of Minnesota in the case of *King v. Railway Co.*, 61 Minn. 482, 63 N.W. 1105:

> No astute reasoning can change the plain fact that the party who refuses to perform, and thereby coerces a promise from the other party to the contract to pay him an increased compensation for doing that which he is legally bound to do, takes an unjustifiable advantage of the necessities of the other party. Surely it would be a travesty on justice to hold that the party so making the promise for extra pay was estopped from asserting that the promise was without consideration. A party cannot lay the foundation of an estoppel by his own wrong, where the promise is simply a repetition of a subsisting legal promise. There can be no consideration for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their contract. The promise cannot be legally enforced, although the other party has completed his contract in reliance upon it.

[8] In *Lingenfelder v. Brewing Co.*, 103 Mo. 578, 15 S.W. 844, the court, in holding void a contract by which the owner of a building agreed to pay its architect an additional sum because of his refusal to otherwise proceed with the contract, said:

> It is urged upon us by respondents that this was a new contract. New in what? Jungenfeld was bound by his contract to design and supervise this building. Under the new promise, he

was not to do anything more or anything different. What benefit was to accrue to Wainwright? He was to receive the same service from Jungenfeld under the new, that Jungenfeld was bound to tender under the original, contract. What loss, trouble, or inconvenience could result to Jungenfeld that he had not already assumed? No amount of metaphysical reasoning can change the plain fact that Jungenfeld took advantage of Wainwright's necessities, and extorted the promise of five per cent. on the refrigerator plant as the condition of his complying with his contract already entered into. Nor had he even the flimsy pretext that Wainwright had violated any of the conditions of the contract on his part. Jungenfeld himself put it upon the simple proposition that "if he, as an architect, put up the brewery, and another company put up the refrigerating machinery, it would be a detriment to the Empire Refrigerating Company," of which Jungenfeld was president.

To permit plaintiff to recover under such circumstances would be to offer a premium upon bad faith, and invite men to violate their most sacred contracts that they may profit by their own wrong. That a promise to pay a man for doing that which he is already under contract to do is without consideration is conceded by respondents. The rule has been so long imbedded in the common law and decisions of the highest courts of the various states that nothing but the most cogent reasons ought to shake it. (Citing a long list of authorities.) But it is "carrying coals to Newcastle" to add authorities on a proposition so universally accepted, and so inherently just and right in itself.

The learned counsel for respondents do not controvert the general proposition. [Their] contention is, and the circuit court agreed with them, that, when Jungenfeld declined to go further on his contract, the defendant then had the right to sue for damages, and not having elected to sue Jungenfeld, but having acceded to his demand for the additional compensation defendant cannot now be heard to say his promise is without consideration. While it is true Jungenfeld became liable in damages for the obvious breach of his contract, we do not think it follows that defendant is estopped from showing its promise was made without consideration. It is true that as eminent a jurist as Judge Cooley, in Goebel v. Linn, 47 Mich. 489, 11 N.W. 284,

41 Am.Rep. 723, held that an ice company which had agreed to furnish a brewery with all the ice they might need for their business from November 8, 1879, until January 1, 1881, at $1.75 per ton, and afterwards in May, 1880, declined to deliver any more ice unless the brewery would give it $3 per ton, could recover on a promissory note given for the increased price.

> Profound as is our respect for the distinguished judge who delivered the opinion, we are still of the opinion that his decision is not in accord with the almost universally accepted doctrine, and is not convincing; and certainly so much of the opinion as holds that the payment, by a debtor, of a part of his debt then due, would constitute a defense to a suit for the remainder, is not the law of this state, nor, do we think, of any other where the common law prevails. … What we hold is that, when a party merely does what he has already obligated himself to do, he cannot demand an additional compensation therefor; and although, by taking advantage of the necessities of his adversary, he obtains a promise for more, the law will regard it as *nudum pactum*, and will not lend its process to aid in the wrong.

[9] The case of *Goebel v. Linn*, 47 Mich. 489, 11 N.W. 284, is one of the eight cases relied upon by the court below in support of its judgment in the present case, five of which are by the supreme court of Massachusetts, one by the supreme court of Vermont, and one other Michigan case, that of *Moore v. Locomotive Works*, 14 Mich. 266. The Vermont case referred to is that of *Lawrence v. Davey*, 28 Vt. 264, which was one of the three cases cited by the court in *Moore v. Locomotive Works*, 14 Mich. 272, 273, as authority for its decision. In that case there was a contract to deliver coal at specified terms and rates. A portion of it was delivered, and plaintiff then informed the defendant that he could not deliver at those rates, and, if the latter intended to take advantage of it, he should not deliver any more; and that he should deliver no more unless the defendant would pay for the coal independent of the contract. The defendant agreed to do so, and the coal was delivered. On suit being brought for the price, the court said:

> Although the promise to waive the contract was after some portion of the coal sought to be recovered had been delivered, and so delivered that probably the plaintiff, if the

defendant had insisted upon strict performance of the contract, could not have recovered anything for it, yet, nevertheless, the agreement to waive the contract, and the promise, and, above all, the delivery of coal after this agreement to waive the contract, and upon the faith of it, will be a sufficient consideration to bind the defendant to pay for the coal already received.

[10] The doctrine of that case was impliedly overruled by the supreme court of Vermont in the subsequent case of *Cobb v. Cowdery*, 40 Vt. 25, where it was held that:

> A promise by a party to do what he is bound in law to do is not an illegal consideration, but is the same as no consideration at all, and is merely void; in other words, it is insufficient, but not illegal. Thus, if the master of a ship promise his crew an addition to their fixed wages in consideration for and as an incitement to, their extraordinary exertions during a storm, or in any other emergency of the voyage, this promise is nudum pactum; the voluntary performance of an act which it was before legally incumbent on the party to perform being in law an insufficient consideration; and so it would be in any other case where the only consideration for the promise of one party was the promise of the other party to do, or his actual doing, something which he was previously bound in law to do. Chit. Cont. (10th Am.Ed.) 51; Smith, Cont. 87; 3 Kent, Com.. 185.

[11] The Massachusetts cases cited by the court below in support of its judgment commence with the case of *Munroe v. Perkins*, 9 Pick. 305, 20 Am. Dec. 475, which really seems to be the foundation of all of the cases in support of that view. In that case, the plaintiff had agreed in writing to erect a building for the defendants. Finding his contract a losing one, he had concluded to abandon it, and resumed work on the oral contract of the defendants that, if he would do so, they would pay him what the work was worth without regard to the terms of the original contract. The court said that whether the oral contract was without consideration:

> [d]epends entirely on the question whether the first contract was waived. The plaintiff having refused to perform that contract, as he might do, subjecting himself to such damages as the other parties might show they were entitled to recover, he

afterward went on, upon the faith of the new promise, and finished the work. This was a sufficient consideration. If Payne and Perkins were willing to accept his relinquishment of the old contract, and proceed on a new agreement, the law, we think, would not prevent it.

[12] The case of *Goebel v. Linn*, 47 Mich. 489, 11 N.W. 284, presented some unusual and extraordinary circumstances. But, taking it as establishing the precise rule adopted in the Massachusetts cases, we think it not only contrary to the weight of authority, but wrong on principle.

[13] In addition to the Minnesota and Missouri cases above cited, the following are some of the numerous authorities holding the contrary doctrine: *Vanderbilt v. Schreyer*, 91 N.Y. 392; *Ayres v. Railroad Co.*, 52 Iowa, 478, 3 N.W. 522; *Harris v. Carter*, 3 Ellis & B. 559; *Frazer v. Hatton*, 2 C.B.(N.S.) 512; *Conover v. Stillwell*, 34 N.J. Law, 54; *Reynolds v. Nugent*, 25 Ind. 328; *Spencer v. McLean* (Ind. App.) 50 N.E. 769, 67 Am.St.Rep. 271; *Harris v. Harris* (Colo. App.) 47 Pac. 841; *Moran v. Peace*, 72 Ill.App. 139; *Carpenter v. Taylor* (N.Y.) 58 N.E. 53; *Westcott v. Mitchell* (Me.) 50 Atl. 21; *Robinson v. Jewett*, 116 N.Y. 40, 22 N.E. 224; *Sullivan v. Sullivan*, 99 Cal. 187, 33 Pac. 862; *Blyth v. Robinson*, 104 Cal. 230, 37 Pac. 904; *Skinner v. Mining Co.* (C.C.) 96 Fed. 735; 1 Beach, Cont. § 166; Langd. Cont. § 54; 1 Pars.Cont. (5th Ed.) 457; *Ferguson v. Harris* (S.C.) 17 S.E. 782.

[14] It results from the views above expressed that the judgment must be reversed, and the cause remanded, with directions to the court below to enter judgment for the respondent, with costs.

[15] It is so ordered.

2.1.1. The Story of Alaska Packers Association v. Domenico

Academic commentary about *Alaska Packers* varies quite considerably. Professor (now Judge) Richard Posner sees a standard holdup story:

> This seems a clear case where the motive for the modification was simply to exploit a monopoly position conferred on the promisors by the circumstances of the contract. It might seem that the promisor would have been in worse shape

> if the men had quit as they threatened to do. However, since their only motive for threatening to quit was to extract a higher wage, there was probably little danger of their actually quitting. The danger would have been truly negligible had they known that they could not extract an enforceable commitment to pay them a higher wage.

Richard Posner, *Gratuitous Promises in Economics and Law*, 6 J. LEGAL STUD. 411 (1977).

Professor Debora Threedy identifies a different motivation entirely. She describes the salmon fishing industry in some detail and points out that the fisherman contended at trial that the company had supplied them with substandard nets, which would have made it more difficult to catch fish and thus to earn the piece rate compensation of $0.02 per salmon caught. Although the trial court ultimately rejected this allegation, Threedy suggests that the fishermen may have believed the nets were substandard. This belief could have justified their demand to renegotiate their contract. See Debora Threedy, *A Fish Story*: *Alaska Packers' Association v. Domenico*, 2000 UTAH L. REV. 185.

2.1.2. Hypo on Modification

Consider a contract under which a farmer promises to deliver 1,000 bushels of wheat to a miller on November 1st at $15 per bushel. Imagine two possible modification scenarios:

Case A – The farmer suffers a drought that diminishes and delays his harvest. He asks for a delay in the delivery date and an increase in the price (to $17/bushel) to cover his added costs.

Case B – The spot price for wheat rises steadily. The farmer waits until just before the scheduled delivery date and then demands that the miller agree to pay the current spot price ($17/bushel) rather than the contract price.

In which of these situations does the modification seem to be in good faith?

2.1.3. Discussion of Alaska Packers Association v. Domenico

Notice that the court in *Alaska Packers* repeatedly refers to the substantial investment that appellant had in its cannery facility. Why is this information relevant to determining whether the modification is enforceable?

Try analyzing the facts of *Alaska Packers* under the standards of the Restatement and the UCC. Can you tell different stories about the case that might lead to enforcement or non-enforcement of the modified contract?

Consider the problem of modification as a game. Could a promisor benefit from being unable to agree to an enforceable modification? Are there any circumstances in which this inability might harm the promisor?

3. Rules Concerning Information

Recall that contractual liability is consensual. We have seen that courts sometimes refuse to enforce agreements because the contracting process deprived one party of the opportunity to understand the nature of the contractual obligations that she or he has assumed. However, courts invoke unconscionability doctrine only rarely because another group of legal rules regulates access to information more directly. In this section, we examine these rules. After a brief introduction to fraud and misrepresentation doctrine, we focus our attention on the subtle problems that arise in cases of non-disclosure and concealment.

3.1. Fraud and Affirmative Misrepresentation

The principal goal of misrepresentation doctrine is to deter people from providing false information. Suppose, for example, that Kathy has offered to sell her BMW Z3 roadster to Josh for $15,000. During a test drive, Josh notices that hard acceleration produces small puffs of white smoke from the car's exhaust. He asks Kathy about the smoke and she responds: "Yes, it's always done that. About six months ago, I took it to the dealer and their shop tested the engine thoroughly. The mechanic said it's just a harmless puff of water vapor from the turbocharger." It turns out, however, that Kathy has never asked the dealer to check this problem. Instead, she used PhotoShop to prepare a fake invoice from the car dealer reporting that the engine is in perfect condition. She hopes that her false statement and the invoice will cause Josh to ignore the smoke and purchase her car.

This hypothetical scenario illustrates how an affirmative misrepresentation can undermine the contracting process. Kathy has invested time and energy in producing a false impression about the condition of her car. There is a real danger that her efforts will mislead Josh and distort his choice among used vehicles. Courts would call Kathy's knowingly false representation "fraudulent" because she knew that what she said was untrue and she intended for it to induce Josh to assent to a contract. A fraudulent misrepresentation of this sort typically will allow its recipient to seek rescission of the resulting contract. See Restatement (Second) § 164(1). Thus, Josh would have the option to void his obligation to purchase the car or he could elect to go through with the deal.

The most practically significant limitation on a party's right to rescind for a fraudulent misrepresentation is the requirement that the misrepresentation actually induced assent to the contract. Imagine now that Josh only asked Kathy about the wisps of smoke after he had already signed a bill of sale and paid for the car. The parties formed a contract when Josh assented to the sale. Kathy's subsequent misrepresentations thus could not have induced his agreement. On this variation of the facts, Josh would be bound by the contract and unable to rescind the deal unless problems with the car violated an express or implied warranty.

Another important doctrinal limitation on the right of rescission arises from the requirement that the recipient of a misrepresentation be justified in relying. Courts occasionally find that even a fraudulent misrepresentation does not warrant rescission because the recipient should have known that the statement was false. Suppose, for example, that Josh is a certified master mechanic and he knows that the BMW Z3 in question doesn't have a turbocharger nor can a turbocharger emit water vapor. In these circumstances, a court might condemn Kathy's untruthfulness but hold that Josh was not justified in relying on her obviously false statements.

This limitation applies even more frequently to cases involving negligent misrepresentations. As with knowingly false representations, a negligent misrepresentation that induces assent will ordinarily warrant rescission. However, if Kathy was merely careless in reassuring Josh about the condition of her car and Josh had good reason to doubt the accuracy of her statement, then courts tend to weigh the parties' relative degree of fault. Decisions often impose the loss on the party who was most negligent.

Finally, courts find even greater doctrinal flexibility when the representation arguably expresses an opinion rather than asserting facts. Suppose that Kathy simply tells Josh that her car is in "great shape." Sometimes courts will interpret such statements as mere puffery without legal significance. In other situations, however, decisions have emphasized a special relationship of trust and confidence between the parties or focused on the expertise of the party making the representation. Thus, if Kathy is the master mechanic and Josh a naïve consumer, some courts may be willing to find in Kathy's statement an implied assertion that she is unaware of any present mechanical problems with the car. If, in fact, she knew at the time that the clutch was failing, her false statement could justify an action for rescission.

There are a number of Restatement (Second) sections (reprinted below) that address the problem of misrepresentations. As you read these sections, notice also how they incorporate rules for cases of concealment and non-disclosure. We will focus most of our class discussion on the subtle issues that arise when one party fails to disclose information that would surely affect the other party's decision about contracting.

§ 160. When Action Is Equivalent to an Assertion (Concealment)

Action intended or known to be likely to prevent another from learning a fact is equivalent to an assertion that the fact does not exist.

§ 161. When Non-Disclosure Is Equivalent To An Assertion

A person's non-disclosure of a fact known to him is equivalent to an assertion that the fact does not exist in the following cases only:

(a) where he knows that disclosure of the fact is necessary to prevent some previous assertion from being a misrepresentation or from being fraudulent or material.

(b) where he knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.

(c) where he knows that disclosure of the fact would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part.

(d) where the other person is entitled to know the fact because of a relation of trust and confidence between them.

§ 162. When A Misrepresentation Is Fraudulent Or Material

(1) A misrepresentation is fraudulent if the maker intends his assertion to induce a party to manifest his assent and the maker

(a) knows or believes that the assertion is not in accord with the facts, or

(b) does not have the confidence that he states or implies in the truth of the assertion, or

(c) knows that he does not have the basis that he states or implies for the assertion.

(2) A misrepresentation is material if it would be likely to induce a reasonable person to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so.

§ 164. When a Misrepresentation Makes a Contract Voidable

(1) If a party's manifestation of assent is induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient is justified in relying, the contract is voidable by the recipient.

(2) If a party's manifestation of assent is induced by either a fraudulent or a material misrepresentation by one who is not a party to the transaction upon which the recipient is justified in relying, the contract is voidable by the recipient, unless the other party to the transaction in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction.

§ 167. When a Misrepresentation Is an Inducing Cause

A misrepresentation induces a party's manifestation of assent if it substantially contributes to his decision to manifest his assent.

§ 168. Reliance on Assertions of Opinion

(1) An assertion is one of opinion if it expresses only a belief, without certainty, as to the existence of a fact or expresses only a judgment as to quality, value, authenticity, or similar matters.

(2) If it is reasonable to do so, the recipient of an assertion of a person's opinion as to facts not disclosed and not otherwise known to the recipient may properly interpret it as an assertion

(a) that the facts known to that person are not incompatible with his opinion, or

(b) that he knows facts sufficient to justify him in forming it.

§ 169. When Reliance on an Assertion of Opinion Is Not Justified

To the extent that an assertion is one of opinion only, the recipient is not justified in relying on it unless the recipient

(a) stands in such a relation of trust and confidence to the person whose opinion is asserted that the recipient is reasonable in relying on it, or

(b) reasonably believes that, as compared with himself, the person whose opinion is asserted has special skill, judgment or objectivity with respect to the subject matter, or

(c) is for some other special reason particularly susceptible to a misrepresentation of the type involved.

3.2. Non-Disclosure and Concealment

Now we turn our attention to several real estate cases involving a failure to disclose material information about the subject matter of the contract. As you read these cases, try to discern the traditional common law rule governing information disclosure in the sale of real estate. Think

carefully about how courts have adjusted the traditional rule and whether you think that the benefits of those changes outweigh their costs.

3.3. Principal Case – *Reed v. King*

Reed v. King
Court of Appeal of California
145 Cal. App. 3d 261 (1983)

BLEASE, J.

[1] In the sale of a house, must the seller disclose it was the site of a multiple murder?

[2] Dorris Reed purchased a house from Robert King. Neither King nor his real estate agents (the other named defendants) told Reed that a woman and her four children were murdered there 10 years earlier. However, it seems "truth will come to light; murder cannot be hid long." (Shakespeare, Merchant of Venice, act II, scene II.) Reed learned of the gruesome episode from a neighbor after the sale. She sues seeking rescission and damages. King and the real estate agent defendants successfully demurred to her first amended complaint for failure to state a cause of action. Reed appeals the ensuing judgment of dismissal. We will reverse the judgment.

Facts

[3] We take all issuable facts pled in Reed's complaint as true. (See 3 WITKIN, CAL. PROCEDURE (2d ed. 1971) Pleading, § 800.) King and his real estate agent knew about the murders and knew the event materially affected the market value of the house when they listed it for sale. They represented to Reed the premises were in good condition and fit for an "elderly lady" living alone. They did not disclose the fact of the murders. At some point King asked a neighbor not to inform Reed of that event. Nonetheless, after Reed moved in neighbors informed her no one was interested in purchasing the house because of the stigma. Reed paid $76,000, but the house is only worth $65,000 because of its past.

[4] The trial court sustained the demurrers to the complaint on the ground it did not state a cause of action. The court concluded a cause of action could only be stated "if the subject property, by reason of

the prior circumstances, were *presently* the object of community notoriety ...." (Original italics.) Reed declined the offer of leave to amend.

Discussion

[5] Does Reed's pleading state a cause of action? Concealed within this question is the nettlesome problem of the duty of disclosure of blemishes on real property which are not physical defects or legal impairments to use.

[6] Reed seeks to state a cause of action sounding in contract, i.e. rescission, or in tort, i.e., deceit. In either event her allegations must reveal a fraud. (See Civ. Code, §§ 1571-1573, 1689, 1709-1710.) "The elements of actual fraud, whether as the basis of the remedy in contract or tort, may be stated as follows: There must be (1) a *false representation* or concealment of a material fact (or, in some cases, an opinion) susceptible of knowledge, (2) made with *knowledge* of its falsity or without sufficient knowledge on the subject to warrant a representation, (3) with the *intent* to induce the person to whom it is made to act upon it; and such person must (4) act in *reliance* upon the representation (5) to his *damage*."[1] (Original italics.) (1 WITKIN, SUMMARY OF CAL. LAW (8th ed. 1973) Contracts, § 315.)

[7] The trial court perceived the defect in Reed's complaint to be a failure to allege concealment of a material fact. "Concealment" and "material" are legal conclusions concerning the effect of the issuable facts pled. As appears, the analytic pathways to these conclusions are intertwined.

[8] Concealment is a term of art which includes mere nondisclosure when a party has a duty to disclose. (See, e.g., *Lingsch v. Savage* (1963) 213 Cal.App.2d 729, 738 [29 Cal.Rptr. 201, 8 A.L.R.3d 537]; Rest.2d Contracts, § 161; Rest.2d Torts, § 551; Rest., Restitution, § 8, esp. com. b.) Reed's complaint reveals only nondisclosure despite the allegation King asked a neighbor to hold his peace. There is no allegation

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[1] Proof of damage, i.e. specific pecuniary loss, is not essential to obtain rescission alone. (See 1 WITKIN, *op. cit. supra.*, §§ 324-325; see also *Earl v. Saks & Co.* (1951) 36 Cal.2d 602 [226 P.2d 340].)

the attempt at suppression was a cause in fact of Reed's ignorance.[2] (See Rest.2d Contracts, §§ 160, 162-164; Rest.2d Torts, § 550; Rest., Restitution, § 9.) Accordingly, the critical question is: does the seller have a duty to disclose here? Resolution of this question depends on the materiality of the fact of the murders.

[9] Similarly we do not view the statement the house was fit for Reed to inhabit as transmuting her case from one of nondisclosure to one of false representation. To view the representation as patently false is to find "elderly ladies" uniformly susceptible to squeamishness. We decline to indulge this stereotypical assumption. To view the representation as misleading because it conflicts with a duty to disclose is to beg that question.

[10] In general, a seller of real property has a duty to disclose: "where the seller knows of facts *materially* affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer.[3] [Italics added, citations omitted.]" (*Lingsch v. Savage*, *supra.*, 213 Cal. App. 2d at p. 735.) This broad statement of duty has led one commentator to conclude: "The ancient maxim *caveat emptor* ('let the buyer beware.') has little or no application to California real estate transactions." (1 Miller & Starr, Current Law of Cal. Real Estate (rev. ed. 1975) § 1:80.)

[11] Whether information "is of sufficient materiality to affect the value or desirability of the property ... depends on the facts of the particular case." (*Lingsch*, *supra.*, 213 Cal. App. 2d at p. 737.) Materiality "is a question of law, and is part of the concept of right to rely or justifiable reliance." (3 WITKIN, CAL. PROCEDURE (2d ed. 1971) Pleading,

[2] Reed elsewhere in the complaint asserts defendants "actively concealed" the fact of the murders and this in part misled her. However, no connection is made or apparent between the legal conclusion of active concealment and any issuable fact pled by Reed. Accordingly, the assertion is insufficient. (See *Bacon v. Soule* (1912) 19 Cal. App. 428, 438 [126 P. 384].)

[3] The real estate agent or broker representing the seller is under the same duty of disclosure. (*Lingsch v. Savage*, *supra.*, 213 Cal.App.2d at p. 736.)

§ 578, p. 2217.) Accordingly, the term is essentially a label affixed to a normative conclusion.[4] Three considerations bear on this legal conclusion: the gravity of the harm inflicted by nondisclosure; the fairness of imposing a duty of discovery on the buyer as an alternative to compelling disclosure, and the impact on the stability of contracts if rescission is permitted.

[12] Numerous cases have found nondisclosure of physical defects and legal impediments to use of real property are material. (See 1 Miller & Starr, *supra.*, § 181.)[5] However, to our knowledge, no prior real estate sale case has faced an issue of nondisclosure of the kind presented here. (Compare *Earl v. Saks & Co.*, *supra.*, 36 Cal.2d 602; *Kuhn v. Gottfried* (1951) 103 Cal.App.2d 80, 85-86 [229 P.2d 137].) Should this variety of ill-repute be required to be disclosed? Is this a circumstance where "non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing[?]" (Rest. 2d Contracts, § 161, subd. (b).)

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[4] This often subsumes a policy analysis of the effect of permitting rescission on the stability of contracts. (See fn. 6, *ante.*) "In the case law of fraud, the word 'material' has become a sort of talisman. It is suggested that it has no meaning when undefined other than to the user since the word actually means no more than that the fraud is the sort which will justify rescission or damages in deceit. However, courts continue to use materiality as a test without explanatory reference to the varying standards of reliance, damage, etc. they are following." (Note, *Rescission: Fraud as Ground: Contracts* (1951) 39 Cal. L. Rev. 309, 310-311, fn. 4.)

[5] For example, the following have been held of sufficient materiality to require disclosure: the home sold was constructed on filled land (*Burkett v. J.A. Thompson & Son* (1957) 150 Cal.App.2d 523, 526 [310 P.2d 56]); improvements were added without a building permit and in violation of zoning regulations (*Barder v. McClung* (1949) 93 Cal.App.2d 692, 697 [209 P.2d 808]) or in violation of building codes (*Curran v. Heslop* (1953) 115 Cal.App.2d 476, 480-481 [252 P.2d 378]); the structure was condemned (*Katz v. Department of Real Estate* (1979) 96 Cal.App.3d 895, 900 [158 Cal.Rptr. 766]); the structure was termite-infested (*Godfrey v. Steinpress* (1982) 128 Cal.App.3d 154 [180 Cal.Rptr. 95]); there was water infiltration in the soil (*Barnhouse v. City of Pinole* (1982) 133 Cal.App.3d 171, 187-188 [183 Cal.Rptr. 881]); the amount of net income a piece of property would yield was overstated (*Ford v. Cournale* (1973) 36 Cal.App.3d 172, 179-180 [111 Cal.Rptr. 334, 81 A.L.R.3d 704].)

[13] The paramount argument against an affirmative conclusion is it permits the camel's nose of unrestrained irrationality admission to the tent. If such an "irrational" consideration is permitted as a basis of rescission the stability of all conveyances will be seriously undermined. Any fact that might disquiet the enjoyment of some segment of the buying public may be seized upon by a disgruntled purchaser to void a bargain.[6] In our view, keeping this genie in the bottle is not as difficult a task as these arguments assume. We do not view a decision allowing Reed to survive a demurrer in these unusual circumstances as indorsing the materiality of facts predicating peripheral, insubstantial, or fancied harms.

[14] The murder of innocents is highly unusual in its potential for so disturbing buyers they may be unable to reside in a home where it has occurred. This fact may foreseeably deprive a buyer of the intended use of the purchase. Murder is not such a common occurrence that *buyers* should be charged with anticipating and discovering this disquieting possibility. Accordingly, the fact is not one for which a duty of inquiry and discovery can sensibly be imposed upon the buyer.

[15] Reed alleges the fact of the murders has a quantifiable effect on the market value of the premises.[7] We cannot say this allegation is inherently wrong and, in the pleading posture of the case, we assume it to be true. If information known or accessible only to the seller has a significant and measurable effect on market value and, as is alleged here,

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[6] Concern for the effects of an overly indulgent rescission policy on the stability of bargains is not new. Our Supreme Court early on quoted with approval the sentiment: "'The power to cancel a contract is a most extraordinary power. It is one which should be exercised with great caution—nay, I may say, with great reluctance—unless in a clear case. A too free use of this power would render all business uncertain, and, as has been said, make the length of a chancellor's foot the measure of individual rights. The greatest liberty of making contracts is essential to the business interests of the country. In general, the parties must look out for themselves.'" (*Colton v. Stanford* (1980) 82 Cal. 351, 398 [23 P. 16].)

[7] See Evidence Code section 810 et seq. We note the traditional formulation of market value assumes a buyer "with knowledge of all the issues and purposes to which [the realty] is adapted." (See e.g. *South Bay Irr. Dist. v. California-American Water Co.* (1976) 61 Cal. App. 3d 944, 961 and 970 [133 Cal. Rptr. 166].)

the seller is aware of this effect, we see no principled basis for making the duty to disclose turn upon the character of the information. Physical usefulness is not and never has been the sole criterion of valuation. Stamp collections and gold speculation would be insane activities if utilitarian considerations were the sole measure of value. (See also Civ. Code, § 3355 [deprivation of property of peculiar value to owner]; Annot. (1950) 12 A.L.R.2d 902 [Measure of Damages for Conversion or Loss of, or Damage to, Personal Property Having No Market Value].)

[16] Reputation and history can have a significant effect on the value of realty. "George Washington slept here" is worth something, however physically inconsequential that consideration may be. Ill-repute or "bad will" conversely may depress the value of property. Failure to disclose such a negative fact where it will have a foreseeably depressing effect on income expected to be generated by a business is tortious. (See Rest.2d Torts, § 551, illus. 11.) Some cases have held that *unreasonable* fears of the potential buying public that a gas or oil pipeline may rupture may depress the market value of land and entitle the owner to incremental compensation in eminent domain. (See Annot., Eminent Domain: Elements and Measure of Compensation for Oil or Gas Pipeline Through Private Property (1954) 38 A.L.R.2d 788, 801-804.)

[17] Whether Reed will be able to prove her allegation the decade-old multiple murder has a significant effect on market value we cannot determine.[8] If she is able to do so by competent evidence she is entitled to a favorable ruling on the issues of materiality and duty to

[8] [In]determining what factors would motivate [buyers and sellers] in reaching an agreement as to price, and in weighing the effect of their motivation, [the trier of fact] may rely upon the opinion of experts in the field and also upon its knowledge and experience shared in common with people in general." (*South Bay Irr. Dist.*, *supra.*, 61 Cal.App.3d at p. 970; see also 3 Wigmore, Evidence (Chadbourn rev.ed. 1970) § 711 et seq.)

disclose.[9] Her demonstration of objective tangible harm would still the concern that permitting her to go forward will open the floodgates to rescission on subjective and idiosyncratic grounds.

[18] A more troublesome question would arise if a buyer in similar circumstances were unable to plead or establish a significant and quantifiable effect on market value. However, this question is not presented in the posture of this case. Reed has not alleged the fact of the murders has rendered the premises useless to her as a residence. As currently pled, the gravamen of her case is pecuniary harm. We decline to speculate on the abstract alternative.

[19] The judgment is reversed.

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[9] The ruling of the trial court requiring the additional element of notoriety, i.e. widespread public knowledge, is unpersuasive. Lack of notoriety may facilitate resale to yet another unsuspecting buyer at the "market price" of a house with no ill-repute. However, it appears the buyer will learn of the possibly unsettling history of the house soon after moving in. Those who suffer no discomfort from the specter of residing in such quarters per se, will nonetheless be discomforted by the prospect they have bought a house that may be difficult to sell to less hardy souls. Nondisclosure must be evaluated as fair or unfair regardless of the ease with which a buyer may escape this discomfort by foisting it upon another.

3.4. Principal Case – *Stambovsky v. Ackley*

Stambovsky v. Ackley

New York Supreme Court, Appellate Division

169 A.D.2d 254 (1991)

RUBIN, JUSTICE.

[1] Plaintiff, to his horror, discovered that the house he had recently contracted to purchase was widely reputed to be possessed by poltergeists, reportedly seen by defendant seller and members of her family on numerous occasions over the last nine years. Plaintiff promptly commenced this action seeking rescission of the contract of sale. Supreme Court reluctantly dismissed the complaint, holding that plaintiff has no remedy at law in this jurisdiction.

[2] The unusual facts of this case, as disclosed by the record, clearly warrant a grant of equitable relief to the buyer who, as a resident of New York City, cannot be expected to have any familiarity with the folklore of the Village of Nyack. Not being a "local," plaintiff could not readily learn that the home he had contracted to purchase is haunted. Whether the source of the spectral apparitions seen by defendant seller are parapsychic or psychogenic, having reported their presence in both a national publication ("Readers' Digest") and the local press (in 1977 and 1982, respectively), defendant is estopped to deny their existence and, as a matter of law, the house is haunted. More to the point, however, no divination is required to conclude that it is defendant's promotional efforts in publicizing her close encounters with these spirits which fostered the home's reputation in the community. In 1989, the house was included in a five-home walking tour of Nyack and described in a November 27th newspaper article as "a riverfront Victorian (with ghost)." The impact of the reputation thus created goes to the very essence of the bargain between the parties, greatly impairing both the value of the property and its potential for resale. The extent of this impairment may be presumed for the purpose of reviewing the disposition of this motion to dismiss the cause of action for rescission (*Harris v. City of New York*, 147 A.D.2d 186, 188-189, 542 N.Y.S.2d 550) and represents merely an issue of fact for resolution at trial.

[3] While I agree with Supreme Court that the real estate broker, as agent for the seller, is under no duty to disclose to a potential buyer the phantasmal reputation of the premises and that, in his pursuit of a legal remedy for fraudulent misrepresentation against the seller, plaintiff hasn't a ghost of a chance, I am nevertheless moved by the spirit of equity to allow the buyer to seek rescission of the contract of sale and recovery of his downpayment. New York law fails to recognize any remedy for damages incurred as a result of the seller's mere silence, applying instead the strict rule of caveat emptor. Therefore, the theoretical basis for granting relief, even under the extraordinary facts of this case, is elusive if not ephemeral.

[4] "Pity me not but lend thy serious hearing to what I shall unfold" (WILLIAM SHAKESPEARE, HAMLET, Act I, Scene V [Ghost]).

[5] From the perspective of a person in the position of plaintiff herein, a very practical problem arises with respect to the discovery of a paranormal phenomenon: "Who you gonna' call?" as the title song to the movie "Ghostbusters" asks. Applying the strict rule of caveat emptor to a contract involving a house possessed by poltergeists conjures up visions of a psychic or medium routinely accompanying the structural engineer and Terminix man on an inspection of every home subject to a contract of sale. It portends that the prudent attorney will establish an escrow account lest the subject of the transaction come back to haunt him and his client—or pray that his malpractice insurance coverage extends to supernatural disasters. In the interest of avoiding such untenable consequences, the notion that a haunting is a condition which can and should be ascertained upon reasonable inspection of the premises is a hobgoblin which should be exorcised from the body of legal precedent and laid quietly to rest.

[6] It has been suggested by a leading authority that the ancient rule which holds that mere non-disclosure does not constitute actionable misrepresentation "finds proper application in cases where the fact undisclosed is patent, or the plaintiff has equal opportunities for obtaining information which he may be expected to utilize, or the defendant has no reason to think that he is acting under any misapprehension" (PROSSER, LAW OF TORTS § 106, at 696 [4th ed., 1971]). However, with respect to transactions in real estate, New York adheres

to the doctrine of caveat emptor and imposes no duty upon the vendor to disclose any information concerning the premises (*London v. Courduff*, 141 A.D.2d 803, 529 N.Y.S.2d 874) unless there is a confidential or fiduciary relationship between the parties (*Moser v. Spizzirro*, 31 A.D.2d 537, 295 N.Y.S.2d 188, *affd.*, 25 N.Y.2d 941, 305 N.Y.S.2d 153, 252 N.E.2d 632; *IBM Credit Fin. Corp. v. Mazda Motor Mfg. (USA) Corp.*, 152 A.D.2d 451, 542 N.Y.S.2d 649) or some conduct on the part of the seller which constitutes "active concealment" (see, *17 East 80th Realty Corp. v. 68th Associates*, 173 A.D.2d 245, 569 N.Y.S.2d 647 [dummy ventilation system constructed by seller]; *Haberman v. Greenspan*, 82 Misc.2d 263, 368 N.Y.S.2d 717 [foundation cracks covered by seller]). Normally, some affirmative misrepresentation (e.g., *Tahini Invs., Ltd. v. Bobrowsky*, 99 A.D.2d 489, 470 N.Y.S.2d 431 [industrial waste on land allegedly used only as farm]; *Jansen v. Kelly*, 11 A.D.2d 587, 200 N.Y.S.2d 561 [land containing valuable minerals allegedly acquired for use as campsite]) or partial disclosure (*Junius Constr. Corp. v. Cohen*, 257 N.Y. 393, 178 N.E. 672 [existence of third unopened street concealed]; *Noved Realty Corp. v. A.A.P. Co.*, 250 App.Div. 1, 293 N.Y.S. 336 [escrow agreements securing lien concealed]) is required to impose upon the seller a duty to communicate undisclosed conditions affecting the premises (contra, *Young v. Keith*, 112 A.D.2d 625, 492 N.Y.S.2d 489 [defective water and sewer systems concealed]).

[7] Caveat emptor is not so all-encompassing a doctrine of common law as to render every act of non-disclosure immune from redress, whether legal or equitable. "In regard to the necessity of giving information which has not been asked, the rule differs somewhat at law and in equity, and while the law courts would permit no recovery of damages against a vendor, because of mere concealment of facts under certain circumstances, yet if the vendee refused to complete the contract because of the concealment of a material fact on the part of the other, equity would refuse to compel him so to do, because equity only compels the specific performance of a contract which is fair and open, and in regard to which all material matters known to each have been communicated to the other" (*Rothmiller v. Stein*, 143 N.Y. 581, 591-592, 38 N.E. 718 [emphasis added]). Even as a principle of law, long before exceptions were embodied in statute law (see, e.g., UCC §§ 2-312, 2-313,

2-314, 2-315; 3-417[2][e]), the doctrine was held inapplicable to contagion among animals, adulteration of food, and insolvency of a maker of a promissory note and of a tenant substituted for another under a lease (see, *Rothmiller v. Stein*, *supra*, at 592-593, 38 N.E. 718 and cases cited therein). Common law is not moribund. Ex facto jus oritur (law arises out of facts). Where fairness and common sense dictate that an exception should be created, the evolution of the law should not be stifled by rigid application of a legal maxim.

[8] The doctrine of caveat emptor requires that a buyer act prudently to assess the fitness and value of his purchase and operates to bar the purchaser who fails to exercise due care from seeking the equitable remedy of rescission (see, e.g., *Rodas v. Manitaras*, 159 A.D.2d 341, 552 N.Y.S.2d 618). For the purposes of the instant motion to dismiss the action pursuant to CPLR 3211(a)(7), plaintiff is entitled to every favorable inference which may reasonably be drawn from the pleadings (*Arrington v. New York Times Co.*, 55 N.Y.2d 433, 442, 449 N.Y.S.2d 941, 434 N.E.2d 1319; *Rovello v. Orofino Realty Co.*, 40 N.Y.2d 633, 634, 389 N.Y.S.2d 314, 357 N.E.2d 970), specifically, in this instance, that he met his obligation to conduct an inspection of the premises and a search of available public records with respect to title. It should be apparent, however, that the most meticulous inspection and the search would not reveal the presence of poltergeists at the premises or unearth the property's ghoulish reputation in the community. Therefore, there is no sound policy reason to deny plaintiff relief for failing to discover a state of affairs which the most prudent purchaser would not be expected to even contemplate (see, *Da Silva v. Musso*, 53 N.Y.2d 543, 551, 444 N.Y.S.2d 50, 428 N.E.2d 382).

[9] The case law in this jurisdiction dealing with the duty of a vendor of real property to disclose information to the buyer is distinguishable from the matter under review. The most salient distinction is that existing cases invariably deal with the physical condition of the premises (e.g., *London v. Courduff*, supra [use as a landfill]; *Perin v. Mardine Realty Co.*, 5 A.D.2d 685, 168 N.Y.S.2d 647 *aff'd.* 6 N.Y.2d 920, 190 N.Y.S.2d 995, 161 N.E.2d 210 [sewer line crossing adjoining property without owner's consent]), defects in title (e.g., *Sands v. Kissane*, 282 App. Div. 140, 121 N.Y.S.2d 634 [remainderman]), liens against the

property (e.g., *Noved Realty Corp. v. A.A.P. Co.*, *supra*), expenses or income (e.g., *Rodas v. Manitaras*, *supra* [gross receipts]) and other factors affecting its operation. No case has been brought to this court's attention in which the property value was impaired as the result of the reputation created by information disseminated to the public by the seller (or, for that matter, as a result of possession by poltergeists).

[10] Where a condition which has been created by the seller materially impairs the value of the contract and is peculiarly within the knowledge of the seller or unlikely to be discovered by a prudent purchaser exercising due care with respect to the subject transaction, nondisclosure constitutes a basis for rescission as a matter of equity. Any other outcome places upon the buyer not merely the obligation to exercise care in his purchase but rather to be omniscient with respect to any fact which may affect the bargain. No practical purpose is served by imposing such a burden upon a purchaser. To the contrary, it encourages predatory business practice and offends the principle that equity will suffer no wrong to be without a remedy.

[11] Defendant's contention that the contract of sale, particularly the merger or "as is" clause, bars recovery of the buyer's deposit is unavailing. Even an express disclaimer will not be given effect where the facts are peculiarly within the knowledge of the party invoking it (*Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 322, 184 N.Y.S.2d 599, 157 N.E.2d 597; *Tahini Invs., Ltd. v. Bobrowsky*, *supra*). Moreover, a fair reading of the merger clause reveals that it expressly disclaims only representations made with respect to the physical condition of the premises and merely makes general reference to representations concerning "any other matter or things affecting or relating to the aforesaid premises". As broad as this language may be, a reasonable interpretation is that its effect is limited to tangible or physical matters and does not extend to paranormal phenomena. Finally, if the language of the contract is to be construed as broadly as defendant urges to encompass the presence of poltergeists in the house, it cannot be said that she has delivered the premises "vacant" in accordance with her obligation under the provisions of the contract rider.

[12] To the extent New York law may be said to require something more than "mere concealment" to apply even the equitable

remedy of rescission, the case of *Junius Construction Corporation v. Cohen*, 257 N.Y. 393, 178 N.E. 672, *supra*, while not precisely on point, provides some guidance. In that case, the seller disclosed that an official map indicated two as yet unopened streets which were planned for construction at the edges of the parcel. What was not disclosed was that the same map indicated a third street which, if opened, would divide the plot in half. The court held that, while the seller was under no duty to mention the planned streets at all, having undertaken to disclose two of them, he was obliged to reveal the third (*see also*, *Rosenschein v. McNally*, 17 A.D.2d 834, 233 N.Y.S.2d 254).

[13] In the case at bar, defendant seller deliberately fostered the public belief that her home was possessed. Having undertaken to inform the public at large, to whom she has no legal relationship, about the supernatural occurrences on her property, she may be said to owe no less a duty to her contract vendee. It has been remarked that the occasional modern cases which permit a seller to take unfair advantage of a buyer's ignorance so long as he is not actively misled are "singularly unappetizing" (PROSSER, LAW OF TORTS § 106, at 696 [4th ed. 1971]). Where, as here, the seller not only takes unfair advantage of the buyer's ignorance but has created and perpetuated a condition about which he is unlikely to even inquire, enforcement of the contract (in whole or in part) is offensive to the court's sense of equity. Application of the remedy of rescission, within the bounds of the narrow exception to the doctrine of caveat emptor set forth herein, is entirely appropriate to relieve the unwitting purchaser from the consequences of a most unnatural bargain.

[14] Accordingly, the judgment of the Supreme Court, New York County (Edward H. Lehner, J.), entered April 9, 1990, which dismissed the complaint pursuant to CPLR 3211(a)(7), should be modified, on the law and the facts and in the exercise of discretion, and the first cause of action seeking rescission of the contract reinstated, without costs.

All concur except MILONAS, J.P. and SMITH, J., who dissent in an opinion by SMITH, J.

SMITH, JUSTICE (DISSENTING).

[15] I would affirm the dismissal of the complaint by the motion court.

[16] Plaintiff seeks to rescind his contract to purchase defendant Ackley's residential property and recover his down payment. Plaintiff alleges that Ackley and her real estate broker, defendant Ellis Realty, made material misrepresentations of the property in that they failed to disclose that Ackley believed that the house was haunted by poltergeists. Moreover, Ackley shared this belief with her community and the general public through articles published in Reader's Digest (1977) and the local newspaper (1982). In November 1989, approximately two months after the parties entered into the contract of sale but subsequent to the scheduled October 2, 1989 closing, the house was included in a five-house walking tour and again described in the local newspaper as being haunted.

[17] Prior to closing, plaintiff learned of this reputation and unsuccessfully sought to rescind the $650,000 contract of sale and obtain return of his $32,500 down payment without resort to litigation. The plaintiff then commenced this action for that relief and alleged that he would not have entered into the contract had he been so advised and that as a result of the alleged poltergeist activity, the market value and resaleability of the property was greatly diminished. Defendant Ackley has counterclaimed for specific performance.

[18] "It is settled law in New York that the seller of real property is under no duty to speak when the parties deal at arm's length. The mere silence of the seller, without some act or conduct which deceived the purchaser, does not amount to a concealment that is actionable as a fraud (see *Perin v. Mardine Realty Co., Inc.*, 5 A.D.2d 685, 168 N.Y.S.2d 647, *aff'd.*, 6 N.Y.2d 920, 190 N.Y.S.2d 995, 161 N.E.2d 210; *Moser v. Spizzirro*, 31 A.D.2d 537, 295 N.Y.S.2d 188, *aff'd.*, 25 N.Y.2d 941, 305 N.Y.S.2d 153, 252 N.E.2d 632). The buyer has the duty to satisfy himself as to the quality of his bargain pursuant to the doctrine of *caveat emptor*, which in New York State still applies to real estate transactions." *London v. Courduff*, 141 A.D.2d 803, 804, 529 N.Y.S.2d 874, *app. dism'd.*, 73 N.Y.2d 809, 537 N.Y.S.2d 494, 534 N.E.2d 332 (1988).

[19] The parties herein were represented by counsel and dealt at arm's length. This is evidenced by the contract of sale which, inter alia, contained various riders and a specific provision that all prior understandings and agreements between the parties were merged into the contract, that the contract completely expressed their full agreement and that neither had relied upon any statement by anyone else not set forth in the contract. There is no allegation that defendants, by some specific act, other than the failure to speak, deceived the plaintiff. Nevertheless, a cause of action may be sufficiently stated where there is a confidential or fiduciary relationship creating a duty to disclose and there was a failure to disclose a material fact, calculated to induce a false belief. *County of Westchester v. Welton Becket Assoc.*, 102 A.D.2d 34, 50-51, 478 N.Y.S.2d 305, *aff'd.*, 66 N.Y.2d 642, 495 N.Y.S.2d 364, 485 N.E.2d 1029 (1985). However, plaintiff herein has not alleged and there is no basis for concluding that a confidential or fiduciary relationship existed between these parties to an arm's length transaction such as to give rise to a duty to disclose. In addition, there is no allegation that defendants thwarted plaintiff's efforts to fulfill his responsibilities fixed by the doctrine of *caveat emptor*. See *London v. Courduff*, *supra*, 141 A.D.2d at 804, 529 N.Y.S.2d 874.

[20] Finally, if the doctrine of *caveat emptor* is to be discarded, it should be for a reason more substantive than a poltergeist. The existence of a poltergeist is no more binding upon the defendants than it is upon this court.

[21] Based upon the foregoing, the motion court properly dismissed the complaint.

3.4.1. Discussion of Reed v. King and Stambovsky v. Ackley

What is the traditional common law rule governing the disclosure of information in connection with real estate sales?

How have the California courts sought to protect buyers?

Compare the *Stambovsky* court's statement of New York law. Can you specify precisely under what circumstances New York sellers of real estate have a duty to disclose information to prospective buyers?

Is there any reason to believe that the rules announced in *Reed* and *Stambovsky* might increase the costs associated with real estate transactions?

For an amusing take on *Reed v. King*, view THE SIMPSONS, episode #909, "Reality Bites."

3.4.2. Kronman's Theory of Deliberately Acquired Information

Before we examine several more real estate cases, it will be helpful to think more systematically about how disclosure obligations are likely to affect parties' incentives to obtain and use information. One of the most frequently cited approaches to this problem is Professor Anthony Kronman's theory distinguishing deliberately and casually acquired information.

The centerpiece of Kronman's article is his discussion of a US Supreme Court decision concerning non-disclosure. In *Laidlaw v. Organ*, 15 U.S. (2 Wheat.) 178 (1817), the Court confronted a case in which two parties had been negotiating the purchase and sale of a large quantity of tobacco. On the morning of the sale, news was publicly announced in a handbill that the War of 1812 had ended, thus reopening the foreign tobacco market and increasing by 30 to 50 percent the price of US tobacco. Organ, the buyer, somehow learned this news before he went to close the deal, but Girault, the seller, was unaware of the change in market conditions. Girault even asked Organ whether he had heard any news that might affect the price of tobacco. Organ evidently declined to answer this question, and Girault decided to go ahead with the contract anyhow. The Court ruled without much analysis or explanation that Organ had no legal duty to inform Girault of such a change in "extrinsic circumstances" but also held that whether Organ had affirmatively misrepresented any facts was a jury question. The following excerpt describes Kronman's analysis in greater detail:

> One effective way of insuring that an individual will benefit from the possession of information (or anything else for that matter) is to assign him a property right in the information itself — a right or entitlement to invoke the coercive machinery of the state in order to exclude others from its use and enjoyment. The benefits of possession become secure only when the state transforms the possessor of information into an owner by investing him with a legally enforceable property right of some sort or other. The assignment of property rights in information is a familiar feature of our legal system. The legal protection

accorded patented inventions and certain trade secrets rights are two obvious examples.

One (seldom noticed) way in which the legal system can establish property rights in information is by permitting an informed party to enter — and enforce — contracts which his information suggests are profitable, without disclosing the information to the other party. Imposing a duty to disclose upon the knowledgeable party deprives him of a private advantage which the information would otherwise afford. A duty to disclose is tantamount to a requirement that the benefit of the information be publicly shared and is thus antithetical to the notion of a property right which — whatever else it may entail — always requires the legal protection of private appropriation.

Of course, different sorts of property rights may be better suited for protecting possessory interests in different sorts of information. It is unlikely, for example, that information of the kind involved in *Laidlaw v. Organ* could be effectively protected by a patent system. The only feasible way of assigning property rights in short-lived market information is to permit those with such information to contract freely without disclosing what they know.

It is unclear, from the report of the case, whether the buyer in *Laidlaw* casually acquired his information or made a deliberate investment in seeking it out (for example, by cultivating a network of valuable commercial "friendships"). If we assume the buyer casually acquired his knowledge of the treaty, requiring him to disclose the information to his seller (that is, denying him a property right in the information) will have no significant effect on his future behavior. Since one who casually acquires information makes no investment in its acquisition, subjecting him to a duty to disclose is not likely to reduce the amount of socially useful information which he actually generates. Of course, if the buyer in *Laidlaw* acquired his knowledge of the treaty as the result of a deliberate and costly search, a disclosure requirement will deprive him of any private benefit which he might otherwise realize from possession of the information and should discourage him from making similar investments in the future.

In addition, since it would enable the seller to appropriate the buyer's information without cost and would eliminate the danger of his being lured unwittingly into a losing contract by one possessing superior knowledge, a disclosure requirement will also reduce the seller's incentive to search. Denying the buyer a property right in deliberately acquired information will therefore discourage both buyers and sellers from investing in the development of expertise and in the actual search for information. The assignment of such a right will not only protect the investment of the party possessing the special knowledge, it will also impose an opportunity cost on the other party and thus give him an incentive to undertake a (cost-justified) search of his own.

If we assume that courts can easily discriminate between those who have acquired information casually and those who have acquired it deliberately, plausible economic considerations might well justify imposing a duty to disclose on a case-by-case basis (imposing it where the information has been casually acquired, refusing to impose it where the information is the fruit of a deliberate search). A party who has casually acquired information is, at the time of the transaction, likely to be a better (cheaper) mistake-preventer than the mistaken party with whom he deals — regardless of the fact that both parties initially had equal access to the information in question. One who has deliberately acquired information is also in a position to prevent the other party's error. But in determining the cost to the knowledgeable party of preventing the mistake (by disclosure), we must include whatever investment he has made in acquiring the information in the first place. This investment will represent a loss to him if the other party can avoid the contract on the grounds that the party with the information owes him a duty of disclosure.

If we take this cost into account, it is no longer clear that the party with knowledge is the cheaper mistake-preventer when his knowledge has been deliberately acquired. Indeed, the opposite conclusion seems more plausible. In this case, therefore, a rule permitting nondisclosure (which has the effect of imposing the risk of a mistake on the mistaken party) corresponds to the arrangement the parties themselves would have been likely to

adopt if they had negotiated an explicit allocation of the risk at the time they entered the contract. The parties to a contract are always free to allocate this particular risk by including an appropriate disclaimer in the terms of their agreement. Where they have failed to do so, however, the object of the law of contracts should be (as it is elsewhere) to reduce transaction costs by providing a legal rule which approximates the arrangement the parties would have chosen for themselves if they had deliberately addressed the problem. This consideration, coupled with the reduction in the production of socially useful information which is likely to follow from subjecting him to a disclosure requirement, suggests that allocative efficiency is best served by permitting one who possesses deliberately acquired information to enter and enforce favorable bargains without disclosing what he knows.

A rule which calls for case-by-case application of a disclosure requirement is likely, however, to involve factual issues that will be difficult (and expensive) to resolve. *Laidlaw* itself illustrates this point nicely. On the facts of the case, as we have them, it is impossible to determine whether the buyer actually made a deliberate investment in acquiring information regarding the treaty. The cost of administering a disclosure requirement on a case-by-case basis is likely to be substantial.

As an alternative, one might uniformly apply a blanket rule (of disclosure or nondisclosure) across each class of cases involving the same sort of information (for example, information about market conditions or about defects in property held for sale). In determining the appropriate blanket rule for a particular class of cases, it would first be necessary to decide whether the kind of information involved is (on the whole) more likely to be generated by chance or by deliberate searching. The greater the likelihood that such information will be deliberately produced rather than casually discovered, the more plausible the assumption becomes that a blanket rule permitting nondisclosure will have benefits that outweigh its costs.

In *Laidlaw*, for example, the information involved concerned changing market conditions. The results in that case may be justified (from the more general perspective just described) on the grounds that information regarding the state of

> the market is typically (although not in every case) the product of a deliberate search. The large number of individuals who are actually engaged in the production of such information lends some empirical support to this proposition.

Anthony Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. (1978).

What does Kronman's analysis imply about situations in which someone responds untruthfully to a question or takes other measures to conceal deliberately acquired information? In a footnote, Kronman appears to suggest that such a variation on the facts of *Laidlaw* would dictate an opposite result:

> If Organ denied that he had heard any news of this sort [the treaty], he would have committed a fraud. It may even be, in light of Laidlaw's direct question, that silence on Organ's part was fraudulent…. In my discussion of the case, …I have put aside any question of fraud on Organ's part.

Id. at note 27.

You should bear Kronman's approach in mind as you read the remaining cases on non-disclosure and concealment.

3.5. Principal Case – *Obde v. Schlemeyer*

Obde v. Schlemeyer
Supreme Court of Washington
56 Wash. 2d 449, 353 P.2d 672

FINLEY, JUDGE.

[1] Plaintiffs, Mr. and Mrs. Fred Obde, brought this action to recover damages for the alleged fraudulent concealment of termite infestation in an apartment house purchased by them from the defendants, Mr. and Mrs. Robert Schlemeyer. Plaintiffs assert that the building was infested at the time of the purchase; that defendants were well apprised of the termite condition, but fraudulently concealed it from the plaintiffs.

[2] After a trial on the merits, the trial court entered findings of fact and conclusions of law sustaining the plaintiffs' claim, and awarded them a judgment for damages in the amount of $3,950. The

defendants appealed. Their assignments of error may be compartmentalized, roughly, into two categories: (1) those going to the question of liability, and (2) those relating to the amount of damages to be awarded if liability is established.

[3] First, as to the question of liability: The Schlemeyers concede that, shortly after they purchased the property from a Mr. Ayars on an installment contract in April 1954, they discovered substantial termite infestation in the premises. The Schlemeyers contend, however, that they immediately took steps to eradicate the termites, and that, at the time of the sale to the Obdes in November 1954, they had no reason to believe that these steps had not completely remedied the situation. We are not convinced of the merit of this contention.

[4] The record reveals that when the Schlemeyers discovered the termite condition they engaged the services of a Mr. Senske, a specialist in pest control. He effected some measures to eradicate the termites, and made some repairs in the apartment house. Thereafter, there was no easily apparent or surface evidence of termite damage. However, portions of the findings of fact entered by the trial court read as follows:

> Senske had advised Schlemeyer that in order to obtain a complete job it would be necessary to drill the holes and pump the fluid into all parts of the basement floors as well as the basement walls. Part of the basement was used as a basement apartment. Senske informed Schlemeyer that the floors should be taken up in the apartment and the cement flooring under the wood floors should be treated in the same manner as the remainder of the basement. Schlemeyer did not care to go to the expense of tearing up the floors to do this and therefore this portion of the basement was not treated.
>
> Senske also told Schlemeyer even though the job were done completely, including treating the portion of the basement which was occupied by the apartment, to be sure of success, it would be necessary to make inspections regularly for a period of a year. Until these inspections were made for this period of time the success of the process could not be determined. Considering the job was not completed as mentioned, Senske would give

Schlemeyer no assurance of success and advised him that he would make no guarantee under the circumstances.

[5] No error has been assigned to the above findings of fact. Consequently, they will be considered as the established facts of the case, *Lewis v. Scott*, 1959, 154 Wash. Dec. 509, 341 P.2d 488. The pattern thus established is hardly compatible with the Schlemeyers' claim that they had no reason to believe that their efforts to remedy the termite condition were not completely successful.

[6] The Schlemeyers urge that, in any event, as sellers, they had no duty to inform the Obdes of the termite condition. They emphasize that it is undisputed that the purchasers asked no questions respecting the possibility of termites. They rely on a Massachusetts case involving a substantially similar factual situation, *Swinton v. Whitinsville Savings Bank*, 1942, 311 Mass. 677, 42 N.E.2d 808, 141 A.L.R. 965. Applying the traditional doctrine of *caveat emptor*—namely, that, as between parties dealing at arms length (as vendor and purchaser), there is no duty to speak, in the absence of a request for information—the Massachusetts court held that a vendor of real property has no duty to disclose to a prospective purchaser the fact of a latent termite condition in the premises.

[7] Without doubt, the parties in the instant case were dealing at arms length. Nevertheless, and notwithstanding the reasoning of the Massachusetts court above noted, we are convinced that the defendants had a duty to inform the plaintiffs of the termite condition. In *Perkins v. Marsh*, 1934, 179 Wash. 362, 37 P.2d 689, 690, a case involving parties dealing at arm's length as landlord and tenant, we held that,

> Where there are concealed defects in demised premises, dangerous to the property, health, or life of the tenant, which defects are known to the landlord when the lease is made, but unknown to the tenant, and which a careful examination on his part would not disclose, it is the landlord's duty to disclose them to the tenant before leasing, and his failure to do so amounts to a fraud.

[8] We deem this rule to be equally applicable to the vendor-purchaser relationship. See Keeton, *Fraud-Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 14-16 (1936). In this article Professor Keeton also

aptly summarized the modern judicial trend away from a strict application of *caveat emptor* by saying:

> It is of course apparent that the content of the maxim "caveat emptor," used in its broader meaning of imposing risks on both parties to a transaction, has been greatly limited since its origin. When Lord Cairns stated in *Peek v. Gurney* that there was no duty to disclose facts, however morally censurable their non-disclosure may be, he was stating the law as shaped by an individualistic philosophy based upon freedom of contract. It was not concerned with morals. In the present stage of the law, the decisions show a drawing away from this idea, and there can be seen an attempt by many courts to reach a just result in so far as possible, but yet maintaining the degree of certainty which the law must have. The statement may often be found that if either party to a contract of sale conceals or suppresses a material fact which he is in good faith bound to disclose then his silence is fraudulent.
>
> The attitude of the courts toward non-disclosure is undergoing a change and contrary to Lord Cairns' famous remark it would seem that the object of the law in these cases should be to impose on parties to the transaction a duty to speak whenever justice, equity, and fair dealing demand it.

[9] A termite infestation of a frame building, such as that involved in the instant case, is manifestly a serious and dangerous condition. One of the Schlemeyers' own witnesses, Mr. Hoefer, who at the time was a building inspector for the city of Spokane, testified that "…if termites are not checked in their damage, they can cause a complete collapse of a building, … they would simply eat up the wood." Further, at the time of the sale of the premises, the condition was clearly latent—not readily observable upon reasonable inspection. As we have noted, all superficial or surface evidence of the condition had been removed by reason of the efforts of Senske, the pest control specialist. Under the circumstances, we are satisfied that "justice, equity, and fair dealing," to use Professor Keeton's language, demanded that the Schlemeyers speak-that they inform prospective purchasers, such as the Obdes, of the condition, regardless of the latter's failure to ask any questions relative to the possibility of termites.

[10] Error has been assigned to the trial court's finding that Mrs. Schlemeyer knew of the termite condition and participated with her husband in the sale to the Obdes. However, this assignment of error has not been argued in the appeal brief. Thus, it must be deemed to have been abandoned. *Winslow v. Mell*, 1956, 48 Wash.2d 581, 295 P.2d 319, and cases cited therein.

[11] Schlemeyers' final contentions, relating to the issue of liability, emphasize the Obdes' conduct after they discovered the termite condition. Under the purchase agreement with the Schlemeyers, the Obdes paid $5,000 in cash, and gave their promissory note for $2,250 to the Schlemeyers. In addition, they assumed the balance due on the installment contract, under which the Schlemeyers had previously acquired the property from Ayars. This amounted to $34,750. After they discovered the termites (some six weeks subsequent to taking possession of the premises in November 1954), the Obdes continued for a time to make payments on the Ayars contract. They then called in Senske to examine the condition—not knowing that he had previously worked on the premises at the instance of the Schlemeyers. From Senske the Obdes learned for the first time that the Schlemeyers had known of the termite infestation prior to the sale. Obdes then ceased performance of the Ayars contract, and allowed the property to revert to Ayars under a forfeiture provision in the installment contract.

[12] The Schlemeyers contend that by continuing to make payments on the Ayars contract after they discovered the termites the Obdes waived any right to recovery for fraud. This argument might have some merit if the Obdes were seeking to rescind the purchase contract. *Salter v. Heiser*, 1951, 39 Wash. 2d 826, 239 P.2d 327. However, this is not an action for rescission; it is a suit for damages, and thus is not barred by conduct constituting an affirmance of the contract. *Salter v. Heiser*, *supra*.

[13] Contrary to the Schlemeyers final argument relative to the question of liability, the Obdes' ultimate default and forfeiture on the Ayars contract does not constitute a bar to the present action. The rule governing this issue is well stated in 24 Am.Jur. 39, Fraud and Deceit, § 212, as follows:

Since the action of fraud or deceit in inducing the entering into a contract or procuring its execution is not based upon the contract, but is independent thereof, although it is regarded as an affirmance of the contract, it is a general rule that a vendee is entitled to maintain an action against the vendor for fraud or deceit in the transaction even though he has not complied with all the duties imposed upon him by the contract. His default is not a bar to an action by him for fraud or deceit practiced by the vendor in regard to some matter relative to the contract.

See, also, Annotation, 74 A.L.R. 169; *cf. Conaway v. Co-Operative Homebuilders*, 1911, 65 Wash. 39, 117 P. 716.

[14] For the reasons hereinbefore set forth, we hold that the trial court committed no error in determining that the respondents (Obdes) were entitled to recover damages against the appellants (Schlemeyers) upon the theory of fraudulent concealment. However, there remains the question of the proper amount of damages to be awarded. The trial court found that,

…because of the termite condition the value [of the premises] has been reduced to the extent of $3950.00 and the plaintiffs have been damaged to that extent, and in that amount.

[15] As hereinbefore noted, judgment was thereupon entered for the respondents in that amount.

[16] The appellants concede that the measure of damages in a case of this type is the difference between the actual value of the property and what the property would have been worth had the misrepresentations been true. *Salter v. Heiser, supra*, and cases cited therein. However, they urge that the only evidence introduced to show the diminution in value of the premises on account of the termite condition—namely, the testimony of one Joseph P. Wieber—was incompetent. Wieber qualified as an expert witness on the basis of substantial experience as a realtor and appraiser. He examined the premises in question, and estimated that the termite condition had reduced the value of the property by some thirty per cent. Applying this estimate to an assumption (as posed in a hypothetical question propounded by respondents' counsel) that the property had been

purchased twice during the year 1954 by persons who were unaware of the termite condition for approximately $40,000, Wieber rendered an opinion that the actual value of the premises (taking into account the termite condition) was about $25,000.

[17] Appellants' sole objection to Wieber's testimony is based upon a claim that the facts (two purchases in 1954 for approximately $40,000, by persons who were unaware of the termite condition) supporting the hypothetical question were never supplied. We find no merit in this claim. The record fully discloses the two purchases in question: namely, the Obdes' purchase from the Schlemeyers in November 1954; and the Schlemeyers' purchase from Ayars in April 1954.

[18] The judgment awarding damages of $3,950 is well within the limits of the testimony in the record relating to damages. The Obdes have not cross-appealed. The judgment of the trial court should be affirmed in all respects. It is so ordered.

WEAVER, C. J., AND ROSELLINI AND FOSTER, JJ., CONCUR. HILL, J., CONCURS IN THE RESULT.

3.5.1. Discussion of *Obde v. Schlemeyer*

In *Obde*, who has the comparative advantage in avoiding this mistake about the existence of termites?

What sort of investments would buyers need to make if they could not rescind a contract in cases of concealment?

3.6. Principal Case – L & N Grove, Inc. v. Chapman

L&N Grove v. Chapman
District Court of Appeal of Florida
291 So. 2d 217 (1974)

BOARDMAN, JUDGE.

[1] Appellants/defendants, Paul L. Curtis and his wife and L & N Grove, Inc. (hereinafter Curtis) seeks this timely review of an adverse final judgment of the trial judge in which Curtis was declared to be constructive trustee of the real property in question for appellees/plaintiffs, Robert L. Chapman, Jr., et al. (hereinafter Chapman).

[2] The second amended complaint was filed by Chapman on November 5, 1970, to rescind the contract and deed and to impose a constructive trust on the property in favor of Chapman, alleging therein, *inter alia*, that Curtis was the real estate broker for Chapman and that he breached the fiduciary relationship by failing to disclose certain material facts, principally the impact of Walt Disney World on the value of the property involved here.

[3] The basic facts are not in serious dispute. During the summer of 1966 Curtis, who was an active real estate broker with offices in Orlando, contacted Chapman concerning the purchase of a 10-acre tract of land located in Lake County and legally described as:

> That part West of U.S. #27 of the South Half of the NE 1/4 of the SE 1/4 of Section 35, Township 24 South Range 26 East, less the northerly 15 feet thereof, being 10 acres more or less.

The property is situated north of and contiguous to a 22-acre tract that Curtis had purchased previously. Both parcels of land are located on U.S. Highway 27 near what was designated as State Road #530, now U.S. Highway 192.

[4] Chapman is also a real estate broker with offices in St. Petersburg and was a member of the partnership that owned the subject property and spokesman for the partnership in this transaction.

[5] After a period of negotiations between the parties concerning the purchase of the real property, on or about August 1, 1966, an agreement was reached and Chapman agreed, after submitting Curtis' offer to the other members of the partnership, to sell the land involved to Curtis. The said agreement was confirmed by letter dated August 3, 1966, from Curtis to Dr. Pollard, a member of the partnership, with copy of said letter being mailed to Chapman. In addition, the letter advised that Curtis was acting "…as a Broker and a principal and would look to (his) group for a commission compensation." The contract for sale and purchase of the land was subsequently prepared and, in due course, executed by Chapman on August 23, 1966, and by Curtis on August 16, 1966. We call attention at this point to the fact that the buyer designated in the contract was Paul L. Curtis, or assigns.

[6] The purchase price agreed upon was $47,500, which appears to have been one and one half times the then market value of the land for grove purposes. The contract provided that Chapman would maintain the grove and be entitled to the fruit crop under the conditions set forth in 'SCHEDULE A' which was attached to the said contract.

[7] In August, 1966, Curtis had formed L & N Grove, Inc., with one other person named Odell Warren, each owning 50% of the corporation. The corporation was organized for the purpose of acquiring title to the real property involved here and the 22-acre tract of land referred to above. The corporation was dissolved on August 20, 1970. The warranty deed, mortgage and note were recorded among the public records of Lake County on December 14, 1966. L & N Grove, Inc. was the grantee named in the deed. The mortgage and note were signed by Curtis as president of the corporation.

[8] The complete terms and conditions of the sale are not necessarily pertinent. We mention that the mortgage was payable annually, covering a period of seven years. The mortgage payments due in June of 1967, 1968, 1969, and 1970, were paid to Chapman or his assignee. The payment due in June of 1971 was refused by Chapman's assignee.

[9] This is the third appearance of this cause before this court.[1] This appeal followed from entry of the final judgment.

[10] It is, of course, necessary to prove the existence of a constructive trust by clear and convincing evidence. *Carberry v. Foley*,

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[1]This court reversed the trial court's holding that a bond was required in connection with the lis pendens because plaintiffs/appellees were claiming against their own deed stating that the claim was 'founded on a duly recorded instrument.' 244 So.2d 154. After trial, final judgment in favor of appellees was entered and appellants filed several post-trial motions, including a motion to vacate and set aside judgment for want of indispensible parties, which the trial court granted. This holding resulted in another interlocutory appeal wherein this court held that L & N Grove, Inc., was not dissolved until August 20, 1970, that the cause did not abate, and that the trustees of the corporation were not indispensible parties and ordered the trial court to reinstate the final judgment and to hear and rule on the pending post-decretal motions. 265 So.2d 725. Thereafter, final judgment was entered and the post-decretal motions denied.

Fla.App.3rd, 1968, 213 So.2d 635. The doctrine of constructive trust is well established in Florida law and the courts of this state will impose the same where … through actual fraud, abuse of confidence reposed and accepted, to through other questionable means gains something for himself which in equity and good conscience he should not be permitted to hold….' *Quinn v. Phipps*, 93 Fla. 805, 113 So. 419, 422 (1927). We also are aware that it is not within the province of this court to substitute its judgment for that of the trier of the facts unless the record clearly reflects that the findings and conclusions by the trial court are erroneous. *Old Equity Life Insurance Co. v. Levenson*, Fla.App.3rd, 1965, 177 So.2d 50; *In re Estate of Hobein*, Fla.App.1st, 1970, 238 So.2d 497; *Griffith Services, Inc. v. Walter Kidde Constructors, Inc.*, Fla.App.1st, 1972, 262 So.2d 240. Against this background of general and accepted principles, we turn then to the particular situation presented in the case sub judice.

[11] We have carefully considered the records, briefs, the authorities cited and discussed therein and arguments of respective counsel and conclude, for reasons delineated hereinafter, that reversible error has been demonstrated.

[12] The trial court made a finding of fact in the final judgment as follows:

> It is beyond question that Paul Curtis had knowledge of the impact which Walt Disney World would have on the value of this property…

The trial court further found that Curtis failed to disclose that fact to Chapman. This is the finding of fact that has caused us great concern. We submit that after many readings of the record this finding of fact is not supported by substantial competent evidence.

[13] The central and perhaps the sole question for our decision is what inside information does the record disclose that Curtis had that he did not disclose to Chapman and that he had a duty to disclose to him. There is not a scintilla of evidence in the record that we have been able to find that shows Curtis knew in 1966 what effect the Disney project would have on the value of the property. It is, of course, Chapman's contention that Curtis knew said property was immediately adjacent to the proposed widening and reconstruction of U.S. Highway

27 and that a cloverleaf exchange was to be constructed on said highway with its intersection with State Road #530.

[14] In 1966 it is extremely doubtful that anyone knew if Walt Disney World would ever be developed into a reality. It was only on the drawing boards at that particular time. There can be no serious doubt that the Walt Disney World project was announced sometime in the fall of 1965, many months prior to the sale of the property involved here. Perhaps it is not significant that Curtis testified that the Disney announcement was the biggest announcement in the history of Florida real estate and resounded around the world. We believe it highly plausible and reasonable to glean from the record that Chapman likewise had this knowledge, or by the exercise of reasonable diligence could have acquired it. We believe the announcement was one of general public knowledge. The alleged information that Curtis is charged with having withheld was speculative in nature and clearly available to the parties involved here.

[15] It was not until 1970 that construction of Walt Disney World had actually been commenced and the Central Florida real estate boom hit with full impact that this present action was filed by Chapman. In the interim period of time the record shows that Chapman accepted the terms of the mortgage and payments made thereon.

[16] Notwithstanding the above-recited matters, the trial judge found breach of duty even if the broker-employer relationship did not exist. In this connection, the trial court found that that relationship at one time did exist between the parties. As Curtis concedes, this finding is not assailable. We submit that the record definitely shows that at the time the contract of sale was executed Chapman was advised of the fact that Curtis was acting as a principal in the transaction. The trial judge found, however:

> Irrespective of any technical brokerage relationship, defendant Curtis, as a registered real estate broker, owed plaintiffs the duty of acting honestly and fairly in his dealings with them.

[17] It is agreed that there is an abundance of case law supporting this finding, as well as learned treatises, but, the question is, is the finding supported by competent evidence. We cannot find wherein Curtis failed to act honestly and fairly with Chapman. Here the

transaction from its conception to its consummation was negotiated between Curtis and Chapman. Both parties, as stated, are real estate brokers and must be considered as being fully aware of the duties, responsibilities and ethics of their time-honored profession.

[18] Lest it be overlooked, Chapman cannot be thought of as a stranger to this area of the state. It would be naiveté to reach such a conclusion. The record shows that he has an interest in over 600 acres of land in the immediate vicinity of the subject property—433 acres on the west side of U.S. Highway 27, which lands had been in possession of Chapman and relatives for approximately 20 years, about 180 acres of which have been used for citrus purposes and, additionally, had an interest in approximately 178 acres immediately across the highway and west of the 433 acres. The latter tract was purchased by the partnership, of which Chapman was a member, in 1962. Furthermore, Chapman is a real estate broker and a housing consultant accredited by the U.S. Department of Housing and Urban Development.

[19] The remedy of rescisson requires that the reliance be justified. A representee who has expert knowledge of the general subject matter, and is peculiarly fitted and qualified, by knowledge and experience, to evaluate that which he sees and appreciate the obvious falsity of the claimed representation does not have the right to rely on a representation. *Puget Sound National Bank v. McMahon*, 53 Wash.2d 51, 330 P.2d 559 (1958).

[20] In view of this fact, perhaps standing alone, it is difficult to reconcile the trial judge's finding that Curtis had all the alleged information and withheld it from Chapman, who is depicted as being completely ignorant and innocent of the land market in this area.

[21] Chapman asserts that he believed that Curtis purchased the land for grove purposes. The testimony of the parties and the documentary evidence indicate to us that the land in issue was purchased for speculative purposes and it is not unreasonable for us to conclude that Chapman was aware of this fact. We point out again that the contract documents provide that Chapman was to retain possession of the fruit under the conditions provided in the contract.

[22] Now, it is true that during the negotiations for the purchase of this land Curtis had hoped that State Road #530 would be the entrance to Walt Disney World and that he attempted to ascertain this information. He had a dream and some five years later it became a reality. This case appears to be a classic example of the old cliche that hindsight is better than foresight. As Chapman testified on cross-examination:

> … If I had fully realized the effect of Disney World on that property, I would not have sold it. If I had had adequate information to make a judgment, we-I would not have been a party to its sale.

[23] Chapman further testified that in 1968 he attempted to make inquiries of the State Road Department, "…Smith, Reynolds & Hill," (sic) engineers, concerning a certain configuration taking place on the highway and he got enough conflicting stories as to what was and wasn't planned to be at a loss to understand or even if anything was definite. It appears that Chapman was negotiating an option with Humble Oil Company for a lease on some other property Chapman owned and was attempting to find out if U.S. Highway 27 would be widened and four-laned and the interchange constructed in the area. The property Chapman owned abutting U.S. Highway 27 is a relatively short distance from the intersection of U.S. Highway 27 and State road #530.

[24] The case of *Chisman v. Moylan*, Fla. App. 2d, 1958, 105 So. 2d 186, is cited in the final judgment and by both parties in their briefs. We agree with that decision and the cases cited therein. We are impressed by the language in the court's opinion where it is held:

> … Neither a judgment nor a decree, however, should be entered in favor of an employer or a principal who complains that he has been injured by breach of duty by a broker where the complaint appears to be founded on conjecture, suspicion, or speculation. (105 So. 2d 186, 189).

[25] Chapman's testimony amounts to just that, for he does not testify or prove by other witnesses or documentary evidence that Curtis had specific inside information that State Road #530 would either be four-laned or become the entrance to Walt Disney World. His

testimony in this regard is based purely on conjecture, suspicion, or speculation.

[26] In the light of our decision we do not think it necessary to discuss the remaining points raised by Curtis on appeal. We do mention that it is quite apparent from the record that cancellation and rescission, returning the parties to their original position, due to the passage of time, intervening probable equities, would make a just settlement of the transaction a very difficult, if not an impossible task.

[27] Lastly, but importantly, the court truly expresses its appreciation to the trial judge and attorneys representing the parties litigant for the exemplary manner in which this case was litigated in the trial court. The briefs of counsel filed in support of their respective contentions were superbly presented and oral argument to this court was presented most ably and was of invaluable assistance.

[28] Accordingly, for the reasons above stated, the order appealed from is reversed and the trial court directed to enter judgment in favor of Curtis. Each party is required to bear his own cost and expenses incurred in this litigation.

Reversed.

3.6.1. Discussion of *L&N Grove v. Chapman*

How would you defend Curtis?

What facts about the interaction between Curtis and Chapman make Chapman's claim for rescission legally implausible?

3.6.2. Hypo of Ivy Diamonds

Suppose that an international diamond conglomerate uses satellite imaging to do a geological survey of some farmland that I own near my home in Ivy, Virginia. The survey shows that there is a high likelihood (about 90%) that diamonds (really big ones) lie under the farmland.

What, if anything, should the diamond conglomerate have to disclose to me before they purchase the land?

Suppose that the company also wishes to purchase similar farmland from my neighbor, an 85-year-old blind grandmother. Would you expect courts to treat these two transactions in the same way?

3.6.3. Further Discussion of *L&N Grove v. Chapman*

Suppose that Curtis tries subtly to conceal the purpose for which he is buying the land from Chapman (e.g., he talks about his interest in raising oranges, or he buys under the name of "L&N Grove"). How would you expect a court to react to this conduct?

What if Chapman (and every other seller of property) asks the buyer: "Do you know anything about my property that could affect its value?" What can the buyer say in response?

4. The Statute of Frauds

The Statute of Frauds was originally enacted by Parliament in 1677 under the title "An Act for Prevention of Frauds and Perjuries." Section four provided:

> And be it further enacted by the authority aforesaid, That from and after, the said four and twentieth day of June no action shall be brought (1) whereby to charge any executor or administrator upon any special promise, to answer damages out of his own estate, (2) or whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriages of another person; (3) or to charge any person upon any agreement made upon consideration of marriage; (4) or upon any contract for sale of lands, tenements, or hereditaments, or any interest in or concerning them; (5) or upon any agreement that is not to be performed within the space of one year from the making thereof; (6) unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized.

Section seventeen provided:

> And be it further enacted by the authority aforesaid, That from and after the said four and twentieth day of June no contract for the sale of any goods, wares and merchandizes, for the price of ten pounds sterling or upwards, shall be allowed to be good, except the buyer shall accept part of the good so sold, and actually receive the same, or give something in earnest to bind the bargain, or in part payment, or that some note or memorandum in writing of the said bargain be made and signed

by the parties to be charged by such contract, or their agents thereto lawfully authorized.

The legislatures of most U.S. states have enacted legislation that roughly duplicates the provisions of section four of the original Statute of Frauds. Similarly, U.C.C. § 2-201 establishes a writing requirement for the sale of goods that parallels section seventeen. There has been some scholarly debate about the precise historical circumstances that gave rise to the original statute. However, most contemporary commentary condemns the Statute's writing requirement as a trap for the unwary. Critics argue that this rule gives parties a technical defense to oral promises that they have come to regret. A smaller group of defenders argue that the Statute sensibly encourages parties to make some written memorandum of their deal. On this view, the writing requirement provides far more reliable evidence of the contract and prevents unscrupulous parties from using perjured testimony to obtain fraudulent enforcement of an invented oral promise.

For our present purposes, we will focus on the version of the Statute embodied in the contemporary Uniform Commercial Code. Please read UCC § 2-201. Formal Requirements; Statute of Frauds and the related Official Comment 1.

4.1. Principal Case – Monetti, S.P.A. v. Anchor Hocking Corp.

As you read the following case, ask yourself whether Judge Posner could have decided the case on narrower grounds. Consider also whether you agree with his resolution of the many fascinating legal questions that his opinion addresses.

Monetti, S.P.A. v. Anchor Hocking Corporation
United States Court of Appeals, Seventh Circuit
931 F.2d 1178 (1991)

POSNER, CIRCUIT JUDGE.

[1] This is a diversity suit for breach of contract; the parties agree that Illinois law governs the substantive issues. The district judge dismissed the suit, on the defendant's motion for summary judgment, as barred by the statute of frauds, and also refused to allow the plaintiffs to amend their complaint to add a claim of promissory estoppel. The appeal, which challenges both rulings, presents difficult and important

questions concerning both the general Illinois statute of frauds, Ill.Rev.Stat. ch. 59, ¶ 1, and the statute of frauds in the Uniform Commercial Code, UCC § 2-201, adopted by Illinois in Ill.Rev.Stat. ch. 26, ¶ 2-201.

[2] The plaintiffs are Monetti, an Italian firm that makes decorative plastic trays and related products for the food service industry, and a wholly owned subsidiary, Melform U.S.A., which Monetti set up in 1981 to market its products in the U.S. In 1984, Monetti began negotiations with a father-and-son team, the Schneiders, importers of food service products, to grant the Schneiders the exclusive right to distribute Monetti's products in the United States and in connection with this grant to turn over to them Melform's tangible and intangible assets. While these negotiations were proceeding, the Schneiders sold their importing firm to Anchor Hocking, the defendant, and their firm became a division of Anchor Hocking, though—at first—the Schneiders remained in charge. In the fall of 1984, the younger Schneider, who was handling the negotiations with Monetti for his father and himself, sent Monetti a telex requesting preparation of an agreement "formalizing our [i.e., Anchor Hocking's] exclusive for the United States." In response, Monetti terminated all of Melform's distributors and informed all of Melform's customers that Anchor would become the exclusive U.S. distributor of Monetti products on December 31, 1984.

[3] On December 18, the parties met, apparently for the purpose of making a final agreement. Monetti—which incidentally was not represented by counsel at the meeting—submitted a draft the principal provisions of which were that Anchor Hocking would be the exclusive distributor of Monetti products in the U.S., the contract would last for ten years, and during each of these years Anchor Hocking would make specified minimum purchases of Monetti products, adding up to $27 million over the entire period. No one from Anchor Hocking signed this or any other draft of the agreement. However, the record contains a memo, apparently prepared for use at the December 18 meeting, entitled "Topics of Discussion With Monetti." The memo's first heading is "Exclusive Agreement-Attachment # 1"—a reference to an attached draft which is identical to the Monetti draft except for two additional, minor paragraphs added in handwriting. Under the heading appears the

notation "Agree" beside each of the principal paragraphs of the agreement, with one exception: beside the first paragraph, the provision for exclusivity, the notation is "We want Canada" (i.e., exclusive distribution rights in Canada as well as in the U.S.). On the bottom of the left-hand side of the last page appears the legend "SS/mh"—indicating that the younger Schneider (Steve Schneider) had dictated the memo to a secretary.

[4] Shortly after the December 18 meeting, Monetti—which had already, remember, terminated Melform's distributors and informed Melform's customers that Anchor Hocking would be the exclusive distributor of Monetti products in the United States as of the last day of 1984—turned over to Anchor Hocking all of Melform's inventory, records, and other physical assets, together with Melform's trade secrets and know-how.

[5] Several months later, in May 1985, Anchor Hocking abruptly fired the Schneiders. Concerned about the possible implications of this démarche for its relationship with Anchor Hocking, Monetti requested a meeting between the parties, and it was held on May 19. Reviewing the events up to and including that meeting, a memo dated June 12, 1985, from Raymond Davis, marketing director of Anchor Hocking's food services division, to the law department of Anchor Hocking, states that "In the middle to latter part of 1984 Irwin Schneider and his company were negotiating an agreement with [Monetti and Melform] to obtain exclusive distribution rights on Melform's plastic tray product line in the United States"; "later, this distribution agreement was expanded to also include Canada, the Caribbean and Central and South America"; there had been many meetings between the parties, including the meeting of May 19 (at which Davis had been present); "Exhibit A (attached) represents the summary agreement that was reached in the meeting. You will notice that I have added some handwritten changes which I believe represents more clearly our current position regarding the agreement.... Now that we have had our 'New Management' [i.e., the management team that had replaced the Schneiders] meeting with Monetti, both parties would like to have a written and signed agreement to guide this new relationship." Exhibit A to the Davis memo is identical to Attachment # 1 to Steve Schneider's memo, except that it contains the

handwritten changes to which the Davis memo refers. Shortly after this memo was written, the parties' relationship began to deteriorate, and eventually Monetti sued for breach of contract.

[6] Illinois' general statute of frauds forbids a suit upon an agreement that is not to be performed within a year "unless the promise or agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized." The statute of frauds in Article 2 of the Uniform Commercial Code makes a contract for the sale of goods worth at least $500 unenforceable "unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker." The differences between these formulations are subtle but important. The Illinois statute requires that the writing "express the substance of the contract with reasonable certainty." *Frazer v. Howe,* 106 Ill. 564, 574 (1883); see also *Holsz v. Stephen,* 362 Ill. 527, 532, 200 N.E. 601, 603 (1936); *Mariani v. School Directors,* 154 Ill.App.3d 404, 407, 107 Ill.Dec. 90, 92, 506 N.E.2d 981, 983 (1987). The UCC statute of frauds does not require that the writing contain the terms of the contract. Ill.Code Comment 1 to UCC § 2-201. In fact it requires no more than written corroboration of the alleged oral contract. Even if there is no such signed document, the contract may still be valid "with respect to goods ... which have been received and accepted." § 2-201(3)(c). This provision may appear to narrow the statute of frauds still further, but if anything it curtails a traditional exception, and one applicable to Illinois' general statute: the exception for partial performance, on which see, for example, *Payne v. Mill Race Inn,* 152 Ill.App.3d 269, 277-78, 105 Ill.Dec. 324, 330-331, 504 N.E.2d 193, 199-200 (1987); *Grundy County National Bank v. Westfall,* 13 Ill.App.3d 839, 845, 301 N.E.2d 28, 32 (1973). The Uniform Commercial Code does not treat partial delivery by the party seeking to enforce an oral contract as a partial performance of the *entire* contract, allowing him to enforce the contract with respect to the undelivered goods.

[7] Let us postpone the question of partial performance for a moment and focus on whether there was a signed document of the sort

that the statutes of frauds require. The judge, over Monetti's objection, refused to admit oral evidence on this question. He was right to refuse. The use of oral evidence to get round the requirement of a writing would be bootstrapping, would sap the statute of frauds of most of its force, and is therefore forbidden. *Western Metals Co. v. Hartman Co.,* 303 Ill. 479, 485, 135 N.E. 744, 746 (1922); *R.S. Bennett & Co. v. Economy Mechanical Industries, Inc.,* 606 F.2d 182, 186 n. 4 (7th Cir.1979); *Bazak International Corp. v. Mast Industries, Inc.,* 73 N.Y.2d 113, 117-18, 538 N.Y.S.2d 503, 505, 535 N.E.2d 633, 635 (1989). *The Hip Pocket, Inc. v. Levi Strauss & Co.,* 144 Ga.App. 792, 793, 242 S.E.2d 305, 306 (1978), is *contra,* but does not discuss the question and is, we think, wrong; while *Impossible Electronic Techniques, Inc. v. Wackenhut Protective Systems, Inc.,* 669 F.2d 1026, 1034 (5th Cir.1982), on which Monetti also relies, is distinguishable from our case because there the writing was first held to satisfy the statute of frauds and only then was oral evidence admitted to clear up a detail, albeit a vital one—the identity of one of the parties!

[8] Although we have cited cases from different jurisdictions, the question whether oral evidence is admissible to show that an ambiguous document satisfies the requirements of the statute of frauds is ultimately one of state law. So far as we have been able to discover, the question is uniformly assumed to be substantive rather than procedural for purposes of determining, in accordance with the *Erie* doctrine, whether state or federal law applies, though direct authority on the question is sparse. *Lehman v. Dow, Jones & Co.,* 606 F. Supp. 1152, 1156 (S.D.N.Y.1985); *McInnis v. A.M.F., Inc.,* 765 F.2d 240, 245 (1st Cir. 1985) (dictum); 19 Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 4512, at pp. 194-95 (1982). We think the assumption is well founded, although the point is not crucial in this case because neither party questions the applicability of Illinois law. It is true that a statute of frauds is procedural in form and that its main proximate goal is evidentiary; it is largely based on distrust of the ability of juries to determine the truth of testimony that there was or was not a contract. 2 E. Allan Farnsworth, *Farnsworth on Contracts* § 6.1, at p. 85 (1990). But it is usually and we think correctly regarded as a part of contract law, not of general procedural law. Cf. *Harbor Ins. Co. v. Continental Bank Corp.,* 922 F.2d 357, 364 (7th Cir.1990). It is designed to make the contractual

process cheaper and more certain by encouraging the parties to contracts to memorialize their agreement. The end of the statute of frauds thus is substantive (albeit the means is procedural), which makes essential aspects of the administration of the statute, such as the admissibility of oral evidence to disambiguate an ambiguous document that is contended to satisfy the statute of frauds, a matter of primary concern to the states rather than to the federal government. So Illinois law applies to the issue; and *Western Metals* indicates that Illinois courts would not allow oral evidence to be used to enable a vague document to satisfy the statute of frauds.

[9] Because oral evidence was inadmissible on the question whether the documents meet the requirements of the statutes of frauds, it was proper for the judge to resolve it on motion for summary judgment. The parties agree that, if this was proper, our review is plenary. This does not follow, however, from the documentary character of the issue, *Anderson v. City of Bessemer City,* 470 U.S. 564, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985), as the parties may believe. But in view of the parties' agreement concerning the proper scope of our review, we need not resolve the matter, beyond noting that there is authority, illustrated by the *Bazak* case, for regarding the issue as one of law, not fact—and if it is an issue of law, then our review is indeed plenary.

[10] We have two documents (really, two pairs of documents) to consider. The first is Steve Schneider's "Topics for Discussion" memo with its "Attachment ## 1." Since "signed" in statute-of-frauds land is a term of art, meaning executed or adopted by the defendant, *Weston v. Myers,* 33 Ill. 424, 433 (1864); UCC § 1-201(39) and Ill.Code Comment thereto; 2 *Farnsworth on Contracts, supra,* § 6.8, at p. 144, Schneider's typed initials are sufficient. The larger objection is that the memo was written before the contract—any contract—was made. The memo indicates that Schneider (an authorized representative of the defendant) agrees to the principal provisions in the draft agreement prepared by Monetti, but not to all the provisions; further negotiations are envisaged. There was no contract when the memo was prepared and signed, though it is fair to infer from the memo that a contract much like the draft attached to it would be agreed upon—if Monetti agreed to Anchor Hocking's demand for Canada, as Monetti concedes (and the Davis memo states) it did.

[11] Can a memo that precedes the actual formation of the contract ever constitute the writing required by the statute of frauds? Under the Uniform Commercial Code, why not? Its statute of frauds does not require that any contracts "be in writing." All that is required is a document that provides solid evidence of the existence of a contract; the contract itself can be oral. Three cases should be distinguished. In the first, the precontractual writing is merely one party's offer. We have held, interpreting Illinois' version of the Uniform Commercial Code, that an offer won't do. *R.S. Bennett & Co. v. Economy Mechanical Industries, Inc., supra,* 606 F.2d at 186. Otherwise there would be an acute danger that a party whose offer had been rejected would nevertheless try to use it as the basis for a suit. The second case is that of notes made in preparation for a negotiating session, and this is another plausible case for holding the statute unsatisfied, lest a breakdown of contract negotiations become the launching pad for a suit on an alleged oral contract. Third is the case—arguably this case—where the precontractual writing—the Schneider memo and the attachment to it—indicates the promisor's (Anchor Hocking's) acceptance of the promisee's (Monetti's) offer; the case, in other words, where all the essential terms are stated in the writing and the only problem is that the writing was prepared before the contract became final. The only difficulty with holding that such a writing satisfies the statute of frauds is the use of the perfect tense by the draftsmen of the Uniform Commercial Code: the writing must be sufficient to demonstrate that "a contract for sale *has been made*.... The 'futuristic' nature of the writing disqualifies it." *Micromedia v. Automated Broadcast Controls,* 799 F.2d 230, 234 (5th Cir.1986) (emphasis in original); see also *American Web Press, Inc. v. Harris Corp.,* 596 F. Supp. 1089, 1093 (D.Colo.1983). Yet under a general statute of frauds, "it is well settled that a memorandum satisfying the Statute may be made before the contract is concluded." *Farrow v. Cahill,* 663 F.2d 201, 209 (D.C.Cir.1980) (footnote omitted). And while merely because the UCC's draftsmen relaxed one requirement of the statute of frauds-that there be a writing containing all the essential terms of the contract—doesn't exclude the possibility that they wanted to stiffen another, by excluding writings made before the contract itself was made, the choice of tenses is weak evidence. No doubt they had in mind, as the typical case to be governed by section 2-201, a deal made over the phone and evidenced by a

confirmation slip. They may not have foreseen a case like the present, or provided for it. The distinction between what is assumed and what is prescribed is critical in interpretation generally.

[12] In both of the decisions that we cited for the narrow interpretation, the judges' concern was with our first two classes of case; and judicial language, like other language, should be read in context. *Micromedia* involved an offer; in *American Web,* negotiations were continuing. We agree with Professor Farnsworth that in appropriate circumstances a memorandum made before the contract is formed can satisfy the statute of frauds, 2 *Farnsworth on Contracts, supra,* § 6.7, at p. 132 and n. 16, including the UCC statute of frauds. This case illustrates why a rule of strict temporal priority is unnecessary to secure the purposes of the statute of frauds. Farnsworth goes further. He would allow a written *offer* to satisfy the statute, provided of course that there is oral evidence it was accepted. *Id.,* n. 16. We needn't decide in this case how far we would go with him, and therefore needn't reexamine *Bennett.*

[13] Nor need we decide whether the first memo (Schneider's) can be linked with the second (Davis's) —probably not, since they don't refer to each other, *Poulos v. Reda,* 165 Ill.App.3d 793, 800, 117 Ill.Dec. 465, 471, 520 N.E.2d 816, 822 (1987); *Southmark Corp. v. Life Investors, Inc.,* 851 F.2d 763, 767 n. 5 (5th Cir.1988) —to constitute a post-contract writing and eliminate the issue just discussed. For, shortly after the Schneider memo was prepared, Monetti gave dramatic evidence of the existence of a contract by turning over its entire distribution operation in the United States to Anchor Hocking. (In fact it had started to do this even earlier.) Monetti was hardly likely to do that without a contract—without in fact a contract requiring Anchor Hocking to purchase a minimum of $27 million worth of Monetti's products over the next ten years, for that was a provision to which Schneider in the memo had indicated agreement, and it is the only form of compensation to Monetti for abandoning its distribution business that the various drafts make reference to and apparently the only one the parties ever discussed.

[14] This partial performance took the contract out of the general Illinois statute of frauds. Unilateral performance is pretty solid evidence that there really was a contract—for why else would the party have performed unilaterally? Almost the whole purpose of contracts is to

protect the party who performs first from being taken advantage of by the other party, so if a party performs first there is some basis for inferring that he had a contract. The inference of contract from partial performance is especially powerful in a case such as this, since while the nonenforcement of an oral contract leaves the parties free to pursue their noncontractual remedies, such as a suit for quantum meruit (a form of restitution), *Farash v. Sykes Datatronics, Inc.,* 59 N.Y.2d 500, 503, 465 N.Y.S.2d 917, 918, 452 N.E.2d 1245, 1246 (1983); *Robertus v. Candee,* 205 Mont. 403, 407, 670 P.2d 540, 542 (1983); 2 *Farnsworth on Contracts, supra,* § 6.11, at p. 171, once Monetti turned over its trade secrets and other intangible assets to Anchor Hocking it had no way of recovering these things. (Of course, Monetti may just have been foolish.) The partial-performance exception to the statute of frauds is often explained (and its boundaries fixed accordingly) as necessary to protect the reliance of the performing party, so that if he can be made whole by restitution the oral contract will not be enforced. This is the Illinois rationale, *Payne v. Mill Race Inn, supra,* 152 Ill.App.3d at 277-78, 105 Ill.Dec. at 330-331, 504 N.E.2d at 199-200, and it is not limited to Illinois. 2 *Farnsworth on Contracts, supra,* § 6.9. It supports enforcement of the oral contract in this case.

[15] This discussion assumes, however, that the contract is governed by the general Illinois statute of frauds rather than, as the district judge believed, by the UCC's statute of frauds (or in addition to it—for both might apply, as we shall see), with its arguably narrower exception for partial performance. The UCC statute of frauds at issue in this case appears in Article 2, the sale of goods article of the Code, and, naturally therefore, is expressly limited to contracts for the sale of goods. That is a type of transaction in which a partial performance exception to a writing requirement would make no sense if the seller were seeking payment for more than the goods he had actually delivered. Suppose A delivers 1,000 widgets to B, and later sues B for breach of an alleged oral contract for 100,000 widgets and argues that the statute of frauds is not a bar because he performed his part of the contract in part. In such a case partial performance just is not indicative of the existence of an oral contract for any quantity greater than that already delivered, so it is no surprise that the statute of frauds provides that an oral contract cannot

be enforced in a quantity greater than that received and accepted by the buyer. § 2-201(3)(c); cf. § 2-201(1). The present case is different. The partial performance here consisted not of a delivery of goods alleged to be part of a larger order but the turning over of an entire business. *That* kind of partial performance *is* evidence of an oral contract and also shows that this is not the pure sale of goods to which the UCC's statute of frauds was intended to apply.

[16] This is not to say that the *contract* is outside the Uniform Commercial Code. It is a contract for the sale of goods plus a contract for the sale of distribution rights and of the assets associated with those rights. Courts forced to classify a mixed contract of this sort ask, somewhat unhelpfully perhaps, what the predominant purpose of the contract is. *Yorke v. B.F. Goodrich Co.,* 130 Ill.App.3d 220, 223, 85 Ill.Dec. 606, 608, 474 N.E.2d 20, 22 (1985), and cases cited there. And, no doubt, they would classify this contract as one for the sale of goods, therefore governed by the UCC, because the $27 million in sales contemplated by the contract (if there was a contract, as we are assuming) swamped the goodwill and other intangibles associated with Melform's very new, very small operation. Distributorship agreements, such as this one was in part, and even sales of businesses as going concerns, are frequently though not always classified as UCC contracts under the predominant-purpose test. Compare *De Filippo v. Ford Motor Co.,* 516 F.2d 1313, 1323 (3d Cir.1975); *Hudson v. Town & Country True Value Hardware, Inc.,* 666 S.W.2d 51, 53 (Tenn.1984); *Cavalier Mobile Homes, Inc. v. Liberty Homes, Inc.,* 53 Md.App. 379, 394, 454 A.2d 367, 376 (1983); and *WICO Corp. v. Willis Industries,* 567 F. Supp. 352, 355 (N.D.Ill.1983) (applying Illinois law), with *Lorenz Supply Co. v. American Standard, Inc.,* 419 Mich. 610, 615, 358 N.W.2d 845, 847 (1984).

[17] We may assume that the UCC applies to this contract; but must *all* of the UCC apply? We have difficulty seeing why. It is not a matter of holding the contract partly enforceable and partly unenforceable, a measure disapproved in *Distribu-Dor, Inc. v. Karadanis,* 11 Cal.App.3d 463, 468, 90 Cal.Rptr. 231, 234 (1970). Because of the contract's mixed character, the UCC statute of frauds doesn't make a nice fit; it's designed for a pure sale of goods. The general statute works better. The fact that Article 2, which we have been loosely referring to as

the sale of goods article, in fact applies not to the sale of goods as such but rather to "transactions in goods," § 2-102, while its statute of frauds is limited to "contract[s] for the sale of goods," § 2-201(1), could be thought to imply that the statute of frauds does not cover every transaction that is otherwise within the scope of Article 2. 2 *Farnsworth on Contracts, supra,* § 6.6, at p. 126 and n. 5. Perhaps the contract in this case is better described as a transaction in goods than as a contract for the sale of goods, since so much more than a mere sale of goods was contemplated.

[18] Another possibility is to interpret the UCC statute of frauds flexibly (an approach endorsed in *Meyer v. Logue,* 100 Ill.App.3d 1039, 1044-46, 56 Ill.Dec. 707, 710-12, 427 N.E.2d 1253, 1256-58 (1981)) in consideration of the special circumstances of the class of cases represented by this case, so that it does make a smooth fit. There is precedent for doing this. When the partial performance is not the delivery of some of the goods but part payment for all the goods, most courts will enforce oral contracts under the UCC. *Sedmak v. Charlie's Chevrolet, Inc.,* 622 S.W.2d 694, 698-99 (Mo.App.1981); *W.I. Snyder Corp. v. Caracciolo,* 373 Pa. Super. 486, 494-95, 541 A.2d 775, 779 (1988); *The Press, Inc. v. Fins & Feathers Publishing Co.,* 361 N.W.2d 171, 174 (Minn.App.1985). Such cases do not present the danger at which the limitation on using partial performance to take the entire contract outside of the statute of frauds was aimed, that of the seller's unilaterally altering the quantity ordered by the buyer, although they could be thought to present the analogous danger of the seller's unilaterally altering the price the buyer had agreed to pay—by claiming that full payment was actually part payment. *This* case, at all events, presents no dangers of the sort the provision in question was designed to eliminate. The semantic lever for the interpretation we are proposing is that the UCC does not abolish the partial-performance exception. It merely limits the use of partial delivery as a ground for insisting on the full delivery allegedly required by the oral contract. That is not what Monetti is trying to do.

[19] We need not pursue these interesting questions about the applicability and scope of the UCC statute of frauds any further in this case, because our result would be unchanged no matter how they were answered. For we have said nothing yet about the second writing in the

case, the Davis memorandum of June 12. It was a writing on Anchor Hocking's letterhead, so satisfied the writing and signature requirements of the UCC statute of frauds, and it was a writing sufficient to evidence the existence of the contract upon which Anchor Hocking is being sued. It is true that "Exhibit A" does not contain all the terms of the contract; it makes no reference to the handing over of Melform's assets. But, especially taken together with the Davis memo itself (and we are permitted to connect them provided that the connections are "apparent from a comparison of the writings themselves," *Western Metals Co. v. Hartman Co., supra,* 303 Ill. at 483, 135 N.E. at 746, and they are, since the Davis memo refers explicitly to Exhibit A), Exhibit A is powerful evidence that there was a contract and that its terms were as Monetti represents. Remember that the UCC's statute of frauds does not require that the contract be in writing, but only that there be a sufficient memorandum to indicate that there really was a contract. The Davis memorandum fits this requirement to a t. So even if the partial-performance doctrine is not available to Monetti, the UCC's statute of frauds was satisfied. And since the general Illinois statute was satisfied as well, we need not decide whether, since the contract in this case both was (we are assuming) within the UCC *and* could not be performed within one year, it had to satisfy both statutes of frauds. 2 *Farnsworth on Contracts, supra,* § 6.2, at pp. 90-91.

[20] Our conclusion that Monetti's suit for breach of contract is not barred by the statute(s) of frauds makes the district judge's second ruling, refusing to allow Monetti to add a claim for promissory estoppel, academic. The only reason Monetti wanted to add the claim was as a backstop should it lose on the statute of frauds. In light of our decision today, he does not need a backstop.

[21] Can promissory estoppel be used to avoid the limitations that the statute of frauds places on the enforcement of oral promises? It can be argued that a party to a contract for the sale of goods should not be allowed to get around the statute of frauds merely by alleging promissory estoppel and using partial performance to establish the necessary reliance in circumstances in which the requirements for the exception in the statute of frauds for partial performance would for one reason or another not be satisfied. It can further be argued that since

promissory estoppel unlike equitable estoppel is a method of establishing contractual liability, the statute of frauds should be no less applicable than if the contract were supported by consideration or a seal rather than by promissory estoppel. *A/S Apothekernes Laboratorium for Specialpraeparater v. I.M.C. Chemical Group, Inc.,* 725 F.2d 1140, 1142 (7th Cir.1984). On the other side it can be argued that promissory estoppel is deliberately open-ended, and should therefore remain available to overcome, in appropriate cases, possible rigidities in the statute of frauds. *Hoffman v. Red Owl Stores, Inc.,* 26 Wis. 2d 683, 133 N.W.2d 267 (1965). Consistent with this counterargument, we held in *R.S. Bennett & Co. v. Economy Mechanical Industries, Inc., supra,* 606 F.2d at 187-89, that Illinois' version of the UCC statute of frauds was inapplicable to promissory estoppel cases. *Janke Construction Co. v. Vulcan Materials Co.,* 386 F. Supp. 687, 697 (W.D.Wis.1974), aff'd, 527 F.2d 772 (7th Cir.1976), reached a similar conclusion under Wisconsin's general statute of frauds, and in affirming we cut loose promissory estoppel from contract law, thus answering the second argument in favor of applying the statute of frauds in promissory estoppel cases. *Id.* at 777. See also 2 *Farnsworth on Contracts, supra,* § 6.12, at p. 185 n. 26. We have been having second thoughts lately. *Goldstick v. ICM Realty,* 788 F.2d 456, 464-66 (7th Cir.1986); *Evans v. Fluor Distribution Cos.,* 799 F.2d 364, 367-68 (7th Cir.1986). But as in *Goldstick* and *Evans,* so in this case, we need not and do not decide whether *Bennett* was an accurate forecast of Illinois law. Not only is the issue moot in view of our decision that the statute of frauds does not bar Monetti from enforcing the contract, but *Bennett* was not a case in which the plaintiff was using promissory estoppel to avoid the UCC's provision disallowing a defense to the statute of frauds for partial performance consisting of the delivery of some but not all of the quantity allegedly contracted for orally. It is in such a case that the "end run" character of promissory estoppel appears most strongly; yet we need not and do not decide whether the appearance is so strong as to preclude resort to promissory estoppel.

Reversed and Remanded.

4.1.1. Applying the UCC or Common Law Statute of Frauds

Judge Posner discusses at some length the issue of whether U.C.C. § 2-201 or the common law statute of frauds should apply to the transaction in

Monetti. These boundary wars between different legal regimes occur in other transactional settings as well. As we have seen for some other issues like indefiniteness doctrine, U.S. jurisdictions sometimes adopt conflicting solutions to these problems.

Consider, for example, a contract to install a swimming pool. In Kentucky, the UCC applies because a contract to install a swimming pool "is primarily one [for the sale] of goods and the services are necessary to insure that those goods are merchantable…." *Riffe v. Black*, 548 S.W.2d 175, 177 (Ky. App. 1977). In contrast, Connecticut treats the same transaction as a contract for services governed by the common law. *Gulosh v. Stylarama, Inc.*, 33 Conn. Supp. 108, 364 A.2d 1221 (1975). In some other jurisdictions, courts treat the same deal as a mixed contract and apply different rules to different parts of the transaction.

4.1.2. Discussion of Monetti v. Anchor Hocking

How could Judge Posner have decided *Monetti* on far narrower grounds?

Consider whether you agree with Posner's resolution of the many other issues he addresses including:

(1) Whether the trial judge should have refused to admit oral evidence about the memos.

(2) Whether the UCC statute of frauds can be satisfied by a writing that precedes the parties' agreement.

(3) Whether the UCC's limits on enforcement for partial performance apply to mixed contracts of this sort, including the clever textual argument about the difference between "transactions in goods" and "contracts for the sale of goods," and the distinction between partial delivery and partial payment.

4.1.3. Hypo on the UCC Statute of Frauds

On September 1, Bob Byar phones Sally Starbuck, the owner of a local microbrewery, to order a special holiday edition of her Starbuck Ale. At the conclusion of their conversation, Bob and Sally agree that Starbuck will produce and deliver 100 cases at a unit price of $20 per case. On September 7, Starbuck sends Byar the following note:

Starbuck Brewery, LLC

Just a quick note to confirm your September 1st order for 50 cases of our holiday edition of Starbuck Ale at a unit cost of $20 per case to be delivered no later than November 1st.

On September 14, Byar discovers that he can obtain a similar holiday product from another local brewery for only $15 per case. The next day, he responds to Starbuck with the following note:

Sally,

I thought that we had agreed on 75 cases, but never mind because I've decided that I no longer want any at all this year. Hope though that we can do business in the future.

Best,

/s/ Bob Byar

Now imagine that Starbuck has consulted you about her legal options. She wants to know whether she can bring a suit against Byar for breach of contract. Do the writings in this case satisfy the applicable statute of frauds?

Consider also the following variations on the quantities described above:

Case	**Oral**	**Confirm**	**Rescind**
Original	100	50	75
Different Quantity	50	50	75
Denies Agreement	100	50	0

4.1.4. Proposed Amendments to U.C.C. § 2-201

Many commentators have raised questions about whether the UCC statute of frauds is compatible with modern business methods. The following excerpt describes the commercial norms and practices in the global currency market:

> There is an uneasy tension between the technology and business practices of the foreign exchange market on the one hand, and the demands of contract enforceability rules in sales law on the other hand. The technology is telephonic. It expands the ways in which market participants negotiate and execute

currency trades. Communications between [currency traders] are not face-to-face meetings in which written draft contracts are exchanged and marked up by lawyers representing the parties during endless rounds of coffee and take-out sandwiches. The trading floors of [currency traders] are entirely different from the conventional lawyers' conference room; traders often communicate by telephone. In sum, the deals made in the currency bazaar are oral and are concluded rapidly and informally.

The statute of frauds must adapt to this telephonic technology…. Foreign exchange market participants might not reduce their agreements to writing for good reason. Because bid-ask spreads are thin for trading in liquid currencies, profits are made through a high volume of trading. To maximize profits, market participants seek to conclude as many transactions as cheaply and quickly as possible. Outdated legal formalities like the statute of frauds requirements lead to higher transaction costs and delay the completion of transactions. Not surprisingly, many market participants prefer tape recordings of conversations among traders instead of written agreements.

The law also must account for the culture of the currency bazaar. Trust among participants in the foreign exchange market is high. Perhaps this aspect of business culture also distinguishes the trading floor from the conference room. The participants repeatedly deal with one another. To engage in fraudulent or deceptive practices is to invite ostracism: a trader's unctuous behavior quickly becomes widely known and other traders decide it is risky and imprudent to deal with the rogue trader.

Raj Bhala, *A Pragmatic Strategy for the Scope of Sales Law, the Statute of Frauds, and the Global Currency Bazaar*, 72 Denv. U. L. Rev. 1, 27–28 (1994).

Proposed amendments to Article 2 of the UCC include the following revisions to the statute of frauds:

§ 2-201. Formal Requirements; Statute of Frauds

(1) A contract for the sale of goods for the price of $5,000 or more is not enforceable by way of action or defense unless there is some record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against which enforcement is sought or by

the party's authorized agent or broker. A record is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this subsection beyond the quantity of goods shown in the record.

(2) Between merchants if within a reasonable time a record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against the recipient unless notice of objection to its contents is given in a record within 10 days after it is received.

(3) A contract that does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable:

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, or in the party's testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606).

(4) A contract that is enforceable under this section is not unenforceable merely because it is not capable of being performed within one year or any other period after its making.

Uniform Commercial Code § 2-103(1)(m) defines a “record” in the following terms:

(m) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.