Contracts outline, Spring 2004. Professor Colson.

I. Third party beneficiaries

A. Who: the modern rule looks primarily at intent--"intended beneficiaries" may sue on the underlying contract, whereas "incidental beneficiaries" may not. Modern courts will look at something like the totality of the circumstances to determine who a contract's intended beneficiaries are.

1. The Restatement 2d test: a beneficiary is "intended" if (1) recognition of a right to performance for him is appropriate to "effectuate the intention of the [both] parties" and (2) the promisee intends to give him the benefit of the promised performance. "Incidental" beneficiaries are all other beneficiaries.

2. Special cases

a) Public contracts: generally, the public is not considered the intended beneficiary of municipal contracts.

(1) Cases

(a) *H.R. Moch* (N.Y. 1928): citing no intention in the promisor to benefit the public and the small charge the promisor contracted for, the court said that the city residents were not third-party beneficiaries of a contract for water supply to fire hydrants.

(b) *Chevron* (N.Y. 1979): with a contract for reaching disabled cars on the N.Y. Thruway, although toll-paying users were intended beneficiaries, Pf.'s personal injury from heartattack was no forseeable and thus not compensable for breach of contract, under *Hadley*.

(c) *Koch v. Con. Ed.* (N.Y. 1984): NYC and some institutions there were held 3PBs of ConEd's electric power supply contract because they were "precisely the consumers for whose benefit the agreements were made." The court distinguished itc. from *Moch* and *Chevron* because the legislation in which the contract was embodied mentioned that ConEd was undertaking to provide energy for NYC and the other Pfs.

b) Attorney-client contracts

3. Cases

a) ***Lawrence v. Fox*** (N.Y 1859): the court says that while the underlying contract was a loan, and so there is no *res* on which to found a constructive trust, the constructive trust idea represents a broader policy: "that a promise made to one for the benefit of another, he for whose benefit it is made may bring an action for its breach." So, this case opens the door to third-party beneficiary doctrine.

b) ***Seaver*** (N.Y. 1918): here, unlike in *Fox* which involved a debtor-creditor relationship, the relationship between 3PB and promisee here is one of donor-donee. The court expands the third-party beneficiary doctrine to encompass these situations as well, pointing to *Fox* as an announcement of a broad policy.

c) ***Grigerik*** (Conn. 1998): a person is a third-party beneficiary of a contract only if both parties to that contract intended that person to benefit. That is, it is not a forseeability test--it is an intent test; and it isn't the intent of the promisee--it's the intent of both parties.

d) ***Septembertide*** (2d Cir. 1989): the court determines whether Pf. is an intended beneficiary by looking at things like "timing, language, and financial obligations,"

which it says "shed much light" on the intent; importantly however, the court seems to be looking not at the intent of both parties to the underlying contract, but only to the intent of Pf.'s promisor (who's in financial trouble and probably can't pay Pf.). Overall, the court appears to employ a "forseeability" test for determining intended beneficiaries--this breaks from traditional contract law, which employs an "intent" test (e.g., *Grigerik*, where the court explicitly rejects a forseeability test).

B. When: the traditional rule said that a 3PB's rights vest at the time the underlying contract is made--thus the parties to the underlying contract couldn't change it if it had 3PBs. The newer rule, from the Restatement 2d, says the 3PB's rights only vest in certain situations--after the 3PB has given some pain for his rights. (Note that if a 3PB gets too excited about making sure his rights are vested, a court may say there's been a novation, leaving the 3PB with only the promisor--not either party--to sue.)

1. **The Restatement 2d rule:** a 3PB's rights vest only if one of three things happens:
   - **a)** The 3PB materially changes his position in justifiable reliance on the promise.
   - **b)** The 3PB brings suit on the promise.
   - **c)** The 3PB, at the request of either the promisor or promisee, manifests his assent to the promise.
2. **Cases**
   - **a)** ***Olson v. Etheridge*** (Ill. 1997): the court considers the old vesting rule and overrules it with the newer, Restatement 2d rule.

C. Related doctrines

1. **Agency:** an agent is someone who agreed to act on another's behalf. A party who's not deemed to be a third-party beneficiary to a contract might argue express agency as an alternative (e.g., A loans to B, who gives money to C; if A isn't a third-party beneficiary of B & C's agreement, A might argue that B gave money to C so that C could be B's agent in repaying A--but A would have to show an express agency agreement between B and C for this to work).
2. **Trust:** a party who's not deemed to be a third-party beneficiary to a contract might argue that there's an express or constructive trust; for there to be a trust, though, there has to be some underlying property--the *res*. (E.g., A loans to B, who gives money to C; if A isn't a third-party beneficiary of B & C's agreement, A might argue to B gave A's money to C for C to hold in trust for A--but if B & C's transaction was a loan, the C's taking the money for himself, not in trust, and so there's no *res* on which to found the trust.)

II. "The law of the contract"

Comment: That is, the (specific) law of a (specific) contract; the rights and duties created by the parties themselves.

A. Intrinsic sources of "the law"

1. Interpretation

Comment: Note the special problem we have: unlike with wills, statutes, and deeds, where we only have to identify the intent of a single entity (the testator, legislator, or grantor), with a contract we have to identify and reconcile the intent of two parties; and each party might attach very different meanings to language.

- **a) Theories**
  - **(1) Subjectivist (Humpty Dumpty's approach):** "all words have a fixed,

precisely ascertained meaning . . . a lawyer, having a document referred to him may sit in his chair, inspect the text, and answer all questions without raising his eyes" (¶1p572, Thayer).

(2) Objectivist (Holmes's approach): "a word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used" (¶ 1p572, Holmes).

b) Rules

(1) Joint maximization criteria for "best efforts" contracts: some "best efforts" contracts are used instead of vertical integration within a single firm, and so "can most sensibly be construed as requiring the level of effort necessary to maximize the joint net product flowing from the contractual relationship" (n2pp625-626, Goetz and Scott).

(a) At least one court has followed this criteria explicitly: a buyer under a best efforts exclusive dealership agreement must "consider the best interests or the seller and itself as if they were one firm" (*Tigg Corp.*, n2p626).

c) Cases

(1) *Frigaliment* (the chicken case): Pf. says "chicken" in this contract means a "young chicken"; Df. says "chicken" here means any chicken meeting the weight and quality specifications spelled out in the adopted writing.

(a) Separating the evidence: probative from nonprobative, objective from subjective.

i) Negotiations: not probative because when Df. asked Pf. what kind of chickens, Pf. said "any kind of chickens."

ii) Course of performance: not probative because Pf. had been complaining about the problem throughout--there is no undisputed course of performance to look to.

iii) "Chicken" standing alone: not probative because, as the court analogizes, a contract for apples in two sizes could be filled with different types of apples even though only one type grew in both sizes. This is highly subjective.

iv) Dictionary definitions: not probative because the court finds both of the parties' proposed definitions there.

v) Market prices: somewhat probative since it is objective.

vi) Government regulations: definitely objective, and probative too because the contract included the phrase "Grade A, Government Inspected."

vii) Trade usage: somewhat probative. Note that Pf.'s expert admits he himself doesn't follow what he testifies is the trade custom.

(b) N.b. that the PER does not operate to bar any extrinsic evidence itc. because of the substantial uncertainty as to the object or extent of the agreement.

(2) *Raffles*: the two ships Peerless; making the same point as *Frigaliment*, says Colson.

(3) *Oswald*: the Swiss coin collection; making the same point as *Frigaliment*, too, says Colson.

(4) *Falstaff Brewing Corp.*: Pf. was to get a certain percentage of Df.'s profits, and the contract contained a "best efforts" clause. Df. had financial difficulties and had to scale back. The court interpreted a meaning for the best efforts clause and held that Df., through a series of misfeasances and nonfeasances, had breached their duty under that clause.

(5) ***Prentice-Hall*:** Pf. writer claims Df. publisher didn't do enough. The court has to balance two ¶¶ in the contract: one saying that the ms. "will be published" and another giving the publisher the right to, essentially, publish however it sees fit. The court interprets the contract, using both ¶¶ together, to have set "privishing" as a baseline for Df.'s obligations; so, since Df. privished the book, it fulfilled its obligations under the contract.

(a) Implied duty of good faith: had the contract only said that the ms. "will be published" and didn't have the other ¶, then the court might have had to construe the contract some--i.e., fill some gaps. In that case, the court would probably look at "will be published," imply a duty of good faith attached to it, and then look to trade usage to find what good faith required; it would find that privishing was the baseline, and Pf. would still lose.

(b) Joint maximization: note that the "as if a single firm," joint-maximization criteria used to analyze some "best efforts" contracts doesn't work here; Df. publisher only cares about its own profits--it is not using the "best efforts" contract for an effective vertical integration.

B. Extrinsic sources of "the law"

1. The Plain Meaning Rule (PMR)

Comment: Note on distinguishing the PMR and the PER: the PER deals with prior, negotiated terms only; the PMR deals with all extrinsic evidence--i.e., anything not within the four corners of the adopted writing(s). Therefore, the PMR is "larger" than the PER--the set of all extrinsic evidence (PMR) contains as a proper subset the set of all prior and negotiated terms (PER).

a) Coverage: the PMR applies to all extrinsic evidence--anything that's not within the four corners of the writings that the parties adopt.

b) Effect: if the PMR applies, extrinsic evidence will not be considered in determining the law of a contract.

c) The rule

(1) Extrinsic evidence is not admissible when the adopted writings are clear and complete: "when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing" (*WWW Associates*, ¶2p589).

(a) Underlying theory: the rule "imparts stability to commercial transactions by safeguarding against fraudulent claims, perjury, death of witnesses, infirmity of memory, and the fear that the jury will improperly evaluate the extrinsic evidence" (*WWW Associates*,¶2p589).

(2) Extrinsic evidence is not admissible to create an ambiguity where there

was none before: "extrinsic and parol evidence is not admissible to create an ambiguity in a written agreement which is complete and clear and unambiguous on its face" (*WWW Associates*,¶5p589).

(3) Traynor's PMR: extrinsic evidence is admissible as long as it's relevant for proving a meaning that language in the adopted writing is "susceptible" to. That is, extrinsic evidence is barred only if it's feasible to determine the intended meaning of the parties solely from the words in the adopted writings (and it may never be feasible to do that).

(a) Underlying theory: when a court interprets a contract using the conventional PMR, "it determines the meaning of the instrument in accordance with the extrinsic evidence of the judge's own linguistic education and experience. The exclusion of testimony that might contradict the linguistic background of the judge reflects a judicial belief in the possibility of perfect verbal expression" (*PG&E*, ¶5p592).

d) Cases

(1) *WWW Associates*: the parties use a form contract with their own cancellation clause addendum. Pf. wants to submit an affidavit asserting that the clause was added "for Pf.'s sole benefit."

(2) *PG&E*

(3) *Hurst*: "50%" can mean as little as 49.53%.

(a) "The language of dictionaries is not the only language spoken in America" (*Hurst*, ¶4p601).

(4) Problem, p598: right of first refusal where the purchase price was set as the "equivalent market value of the premises according to the assessment rolls as maintained by the County of Warren."

(a) The problem here is that "market value" and "assessment" are not synonyms. So, the issue is whether the price clause clear and complete as it is, or does it rely on standard usage for its meaning. Under the PMR, we can (and in class we did) go both ways on the admissibility of extrinsic, usage evidence.

2. The Parol Evidence Rule(s) (PER)

Comment: Not only are there multiple "rules," there are multiple ideas involved here. The PER is essentially shorthand for the various questions that come up when a party wants to include in or exclude from a contract some term that's not obviously part of the written documentation the parties adopted.

a) Coverage: the PER applies to oral and written negotiations, assurances, promises, and other understandings that took place before the contract in question was "reduced to writing.

b) Effect: if the PER applies, it is not the evidence only that is barred--it is the matter of fact itself that is completely barred from being included in the contract.

c) The rules

(1) "Integration"

Comment: See Restatement 2d ss 209, 210, 215.

(a) Step 1: has a writing been adopted by the parties as a "final expression of one or more terms of the agreement"?

i) Yes: the agreement is integrated--the PER bars evidence of prior

agreements or negotiations that will contradict a term of the writing.

(b) Step 2: if the agreement is integrated, has the writing been adopted by the parties as a "complete and exclusive statement of the terms of the agreement?

i) Yes: the agreement is completely integrated--the PER bars all evidence of additional terms in prior discussions, whether consistent or not.

ii) No: the agreement is partially integrated--the PER bars only evidence of contradictory terms in prior discussions (so, evidence is allowed of terms from prior discussions that are consistent with the adopted writing--this evidence can be used to add to or elucidate the adopted writing).

(2) The *Gianni* rule (the "face of the document" rule): determine whether the contract is integrated by looking only at the adopted writing itself.

(a) Is the adopted writing "couched in such terms as import a complete legal obligation without any uncertainty as to the object or extent of the engagement"? If Yes, then the adopted writing will be "conclusively presumed that the whole engagement of the parties, and the extent and manner of their undertaking, were reduced to writing" (*Gianni*, ¶1p558).

(3) The *Masterson* rule: determine whether the contract is integrated by looking at all the evidence; it is the parties' intent that is important.

(a) "The conception of a writing as wholly and intrinsically self-determinative of the parties' intent to make it a sole memorial of one or seven or twenty-seven subjects of negotiation is an impossible one" (*Masterson*, ¶4p561, citing Wigmore on Evidence).

(b) Underlying theory: "Evidence of oral collateral agreements should be excluded only when the fact finder is likely to be misled. The rule must therefore be based on the credibility of the evidence.

(4) The Restatement (1st) rule: related collateral agreements are admissible if they "might naturally be made as a separate agreement by parties situated as were the parties to the written contract" (Restatement (1st) § 240(1)(b)).

(5) The UCC rule: bar additional terms only if "they would certainly have been included in the document" (UCC § 2-202).

d) Application to separate collateral agreements: there is no bar whatever to evidence of collateral agreements when there is no relation between those agreements and the agreement in dispute.

(1) Ask whether the collateral agreement would naturally have been included in the written document; i.e., is the agreement "in the field" of the adopted writing?

(a) N.b., that in *Gianni*, Pf. argued that the exclusivity clause he wanted enforced would not naturally have been included in his lease--that it would naturally have been included only in the leases to tenants besides him. The court rejected Pf.'s argument, saying that such a clause would naturally have been in both his and the other leases.

e) Cases

(1) ***Gianni*** (Penn. 1924):

(2) ***Masterson***

(3) ***Bollinger*****:** Pf. seeks to introduce evidence about an understanding that Df. would restore topsoil during a project. Pf. signed a contract with Df., thinking that condition would be in it. It wasn't. However, early in the project Df. had been replacing topsoil, but later it stopped.

(a) Underlying theory: "A court of equity has the power to reform the written evidence of a contract and make it correspond to the understanding of the parties. . . . Once a person enters into a written agreement he builds around himself a stone wall, from which he cannot escape by merely asserting he had not understood what he was signing. However, equity would completely fail in its objectives if it refused to break a hole through the wall when it finds, after proper evidence, that there was a mistake between the parties, that it was real and not feigned, actual and not hypothetical" (*Bollinger*, ¶5p568).

C. Constructive sources of "the law"

1. The implied duty of good faith and fair dealing

a) Coverage: all contracts. (N.b., the Florida rule, below, applies only to express terms of the contract.)

b) Effect: whenever there is an implied duty of good faith, it is a breachable contract duty just like any other (express) contract duty.

c) The rule

(1) What you can and can't do

(a) You can't destroy the other parties fruits: "neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract." Where the contract contemplates discretion, it includes a promise to not act arbitrarily or irrationally in exercising that discretion" (*Dalton*, ¶1p607).

(b) You can't sharply deal: "you can't take advantage of an oversight by your contract partner concerning his rights under the contract. Such taking advantage is no the exploitation of superior knowledge or the avoidance of unbargained-for expense; it is sharp dealing" (*Market Street Associates*, ¶1p615).

(c) You can take advantage of the other party: "You are not obliged to become an altruist toward the other party are relax the terms if he gets into trouble in performing his side of the bargain." If you can't exploit your superior knowledge of the market, you will not be able to recoup the investment you made in obtaining that knowledge. (*Market Street Associates*, ¶1p615).

i) So, note that since you can take advantage of your contract partner, but can't sharply deal, the good faith issue may become a subjective inquiry--into the mind of one of the parties.

(2) The gap-filling boundary: the implied duty can't be inconsistent with other terms. "No obligation can be implied that would be inconsistent with other terms of the contractual relationship" (*Dalton*, ¶1p607).

(3) The Florida rule (express terms only): "where a party to a contract has in good faith performed the express terms of the contract, an action for breach of the implied covenant of good faith will not lie" (*Burger King*, ¶0p610).

(4) Good faith between merchants (UCC): "between merchants, good faith means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade" (UCC § 2-306).

(a) Relevant commercial practices

Comment: "Express terms shall control course of performance and course of performance shall control both course of dealings and usage of trade." UCC 2-208 (2).

i) Course of performance (UCC § 2-208(1))

Comment: "The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the beset indication of what that meaning was." Official comment to UCC 2-208.

ii) Course of dealing (UCC § 1-205(1))

iii) Usages of trade (UCC § 1-205(2))

d) Cases

(1) *Dalton*: Pf. submitted material to prove that he didn't cheat on the SAT, which Df. only cursorily considered. The court held that there was nothing in the contract to require Df. to prove Pf. hadn't cheated, rather the contract place the burden on the Pf. to overcome a finding of cheating. So, the court would not read into the contract an implied duty of good faith requiring Df. to prove Pf. cheated since such a duty would be inconsistent with the contractual language.

(a) The court orders Df. to consider the relevant materials that Pf. provided, but says it will not interfere with Df.'s decision unless it performs "arbitrarily or irrationally." This means that the court will only look at the Df.'s process--whether it received Pf.'s documentation, distributed it to readers, and whether those readers actually read it. Even then, the court won't interfere unless Df. acted arbitrarily or irrationally in that process. Note that this is like *Miranda*--we believe that if we have a fair process, we'll get a just result.

(2) *Burger King*: Df. granted Pf. a franchise, then later authorized another Burger King nearby. The court held that there is an implied duty of good faith with respect to express terms only--the duty does not fill gaps.

(3) *Eastern Air Lines*: Pf. complains that Df. is freighting fuel, which violates an implied duty of good faith. So, naturally course of performance evidence is very probative, and the court finds no violation of any duty considering that Pf. is complaining for the first time about something which has been going on and that both parties knew could and would go on.

(4) *Market Street Associates*: Pf. seeks specific performance of a leaseback clause that entitled Pf. to buy certain property back if negotiations over financing broke down. Pf. wrote to Df. requesting $4 million in financing, but didn't mention the leaseback clause; when Df. refused the financing, Pf. sought to buy the property back. The court remands "for a tour through Pf.'s mind," says Colson, to determine whether Pf. was sharply dealing (if he wanted to exploit Df.'s oversight) or taking allowable advantage (if he

believed Df. "knew or would surely find out about" the leaseback clause).

(5) ***Dickey*:** Pf. lessor entered with Df. into a percentage lease with a minimum rent, and claims that Df. is not fulfilling its obligation, rooted in good faith, to grow its business in order to keep its percentage rent up. The court held there was no implied duty because it would necessarily be "vague, uncertain, and generally impracticable."

(a) The effect of the minimum rent: the minimum here was substantial, obviating the need for an implied duty of good faith in growing the business. Had the minimum been less substantial, then perhaps such a duty of good faith would be implied, since it wouldn't seem as inconsistent with the existing terms.

(b) This isn't a gap-filling case: the implied duty of good faith the Pf. wants included would be tied to the express, minimum rent term, and so the court doesn't have to fill any gaps in the contract. Of course, if there was no minimum rent term, then the implied duty of good faith would be very important in the analysis.

(6) ***Bak-A-Lum*:** Pf. had an exclusive distributorship agreement with Df., which it claimed Df. breached when Df. appointed four more distributors in Pf.'s region. The contract was an oral agreement; no term setting a duration for the distributorship was set. The court construes, citing the implied duty of good faith, a duty for Df. to give reasonable notice. However, the court makes sure it's clear that Df.'s duty is only to give reasonable notice--it is not a duty to maintain the distributorship.

(a) Better drafting: note that Df. could have protected itself by setting a specific notice term and abiding by it, as long as the length of the notice is not unconscionable (as in *Shell*, p414). So, too, could Df. protect itself with a "termination at will" term, as long as it gave Pf. reasonable notice before termination.

(7) *Teddy's Frosted Foods*: Pf. employee had an employment at will contract with Df. Pf. told Df. that its packages didn't fulfill food labeling requirements, then Df. fired him. The court held that Pf.'s retaliatory termination claim will not fly because it doesn't advance the public policy behind that the food labeling law--viz., to protect public health; Pf. might have been subject to criminal sanctions for not reporting the violations, and should have notified the appropriate regulatory agency, not just tell his employer about the problem (if he had done these things, he may have been protected from termination itc.).

(a) Wood's Rule: the courts will prefer termination at will in employment contracts--they will assume it as long as it can be in any way consistent with the contract's express terms.

i) Wood's Rule is losing force lately, though. More and more, courts are holding that termination must be at least without bad cause in order to satisfy the implied duty of good faith.

(8) ***Balla*:** in-house counsel objected to his employer's selling illegal dialysis machines. The court held that there is no tort action for retaliatory discharge available to in-house counsel: no public good would come from allowing

such a tort because RD is meant to encourage whistleblowing and lawyers must whistleblow under the codes of professional conduct (thus, we don't need to encourage lawyers to do that).

(a) Tort of Retaliatory Discharge: an employer can not discharge an at-will employee out of spite. This provides a remedy where none would be available in contract.

(b) Tort vs. contract re: remedies

i) Tort generally compensates only for actual damages, although punitives are available.

ii) Contract gives you your expectations--but how substantial can your expectations be if you're an at-will employee??!

D. Realist approaches to determining "the law"

1. Cases

a) ***Nanakuli*:** the court employs both interpretation and construction, and finds that both lead to the same "law" of this contract.

(1) Admissibility of evidence under the UCC: course or performance, course of dealing, and trade usage evidence is always admissible to give meaning to a contract, but if that evidence can't be reconciled with the express terms, then the added meaning is not binding on the parties (¶2p657).

b) *Columbia Nitrogen*: Df. buyer ordered only 10% of what it was scheduled to, and argued that trade usage showed that express price and quantity terms in this industry are only projections. The court held that that might be right--COD and usage evidence supplement the writing always, unless "carefully negated" by the parties. Colson thinks that to exclude it, the parties would probably have to refer to each specific custom they wanted to exclude--a blanket exclusion of "trade custom" generally would not likely be enforced.

III. Performance, breach, and excuse

A. Conditioned performance

1. Taxonomy of conditions

a) Express conditions

Comment: Express conditions must be met (unless waived). Period. (Unlike constructive conditions.)

(1) Promissory condition: a promise the performance of which satisfies a condition.

(2) Mitigating the harshness of express conditions that don't occur

(a) Prevention

(b) Waiver, estoppel, and election

i) Taxonomy

a. Waiver: the intentional relinquishment of a known right. Reliance by the other party is not required.

b. Election: a choice which is binding on the party who makes it. Reliance by the other party is not required.

c. Estoppel: the essential element is reliance.

ii) Cases

a. *McKenna*: Owner's duty to pay builder, for each installment, conditioned on architect's written approval. But owner had always paid without the written approval. The court held that owner had waived the approval condition, especially considering builder's reliance evidenced through his continuing the work.

iii) *Hicks v. Bush* (p690):

(3) Cases

(a) *Luttinger*: homebuyer's duty to pay conditioned on finding financing; seller's duty to refund earnest money conditioned on homebuyer not finding financing. Both conditions protect the buyer. Buyer promised to use "due diligence" in securing financing. The court held that "the law does not require the performance of a futile act" and so buyer satisfied his duty of "due diligence" by applying to the only bank that might have lent to him.

(b) ***Internatio-Rotterdam* (the rice case):** seller's duty to ship rice to port conditioned on "two weeks call from buyer"--that is, timely notice. The court held this was a promissory condition: buyer had a duty to give notice, and seller's duty to ship was conditioned on buyer giving notice. Further, because of a term specifying that shipment for "December," time was of the essence, and buyer's duty and condition was to give notice within two weeks of the end of December.

(c) *Peacock Construction*: general's duty to pay subs expressly conditioned on three occurrences: (1) completion of work by subs, (2) architect's written acceptance of subs' work, and (3) full payment for the subs work by the owner to the general. The court held that the "full payment by the owner" condition was not actually a condition--it did this by interpreting the term in favor of subs by looking to the intent of these parties and general/sub parties generally. A fairness decision. Subs must have payment quickly to stay in business, it said, and so general/sub parties in most cases do not intend payment to the sub to be conditioned on payment to the general. Parties may still shift the payment risk--but it is the general's burden to make that clear and unambiguous in the writings.

(d) *Gibson v. Cranage*: satisfaction contract, where painting buyer's duty to pay conditioned on his satisfaction with the painter's work. The court held that it's the buyer that has to be satisfied--a subjective inquiry--rather than third parties or other artists (objective). But, n.b., if the buyer didn't even have to look at the painting, his promise would be illusory and no contract would have been formed.

(e) *Doubleday & Co.*: satisfaction contract, where publisher's duty to pay conditioned on author providing a satisfactory manuscript. Author argues that he was prevented from producing a satisfactory ms. because publisher did not provide him with a good editor. Court finds no duty to provide a good editor either in the contract or in course or performance.

b) Implied conditions

c) Constructive conditions

(1) Mitigating the harshness of constructive conditions that don't occur

(a) Substantial performance

i) Factors for evaluation

a. Purpose to be served (and desire to be gratified).

b. Excuse for deviation from the letter of the contract.

c. Cruelty of enforcing adherence.

ii) Cases

a. ***Jacobs & Young*:** owner specified Reading pipe, got Cohoes pipe, refuses to pay builder. The purpose to be served by the specification of Reading pipe was only to indicated a standard, the court held. But the cruelty of enforcing adherence would be very high, since the builder would stand to lose a substantial amount if it had to rebuild the home. Thus, builder substantially performed, condition is satisfied, and owner must pay.

(b) Divisibility

i) Factors for evaluation

a. Severability: if a party's performance consists of several, distinct items, the contract is divisible only if either:

1) The price paid by the other party is apportioned to each item, or

2) The price paid by the other party is left to be implied by law.

b. Entirety: if the consideration to be paid by a party is single and entire, the contract is not divisible, even if the other party's performance consists of several, distinct items.

ii) Cases

a. ***Gill* (Johnstown flood case):** The duty of Df., a buyer of logs, to pay the Pf. seller was constructively conditioned on their delivery--but, the contract was divisible into separate lots of logs, and so Df. had to pay for those lots that had been delivered (and so did not get out of the entire contract).

(c) Restitution

i) Cases

a. *Britton*:

(2) Cases

(a) ***Kingston v. Preston*:** "the dependence or independence of covenants was to be collected from the evident sense and meaning of the parties." After itc., performance that is dependent on other performance will be constructively conditioned (wherever it is not expressly conditioned).

(b) *Stewart v. Newbury*: builder claimed that after his offer and before receiving owner's acceptance, the two discussed payment "in the usual manner"; owner denied the conversation. Builder said "the usual manner" meant installment payments--and thus that his duty to continue to build was constructively conditioned on owner making installment payments. The court held that where "no agreement is made as to payment, the work must be substantially performed before payment can be demanded."

B. Looming nonperformance

1. Material breach

a) Factors for evaluation

(1) Purpose to be served (and desire to be gratified).

(a) Extent to which the injured party will obtain substantial benefit it could have reasonably anticipated.

(b) Extent to which the injured party can be adequately compensated for its damages.

(c) Level of uncertainty that the failing party will perform the remainder of the contract.

(2) Excuse for deviation from the letter of the contract.

(a) Whether the failing party's conduct was wiful, negligent, or innocent.

(3) Cruelty of enforcing adherence.

(a) Extent to which the injured party has partly performed or prepared to perform.

(b) Level of hardship on the failing party.

b) Consequences

c) Cases

(1) ***Walker & Co.*** **(the tomato case):** signmaker sued a buyer who was getting good service but also hadn't paid lately. The buyer argued that it was excused from its payment duties because the signmaker had materially breached by not servicing the sign as promised. The court looked at the circumstances and thought that the impact of the signmakers derogations were not sufficient to show material breach.

(a) Purpose to be served: signmaker wins slightly--buyer, after all, had his sign and could have knocked the cobwebs out, and "the rain probably washed some of the tomato off," etc.

(b) Excuse for deviation: buyer wins slightly--the signmaker didn't have to make much effort to service the sign.

(c) Cruelty of enforcing adherence: signmaker wins a lot--if the condition is strictly enforced, the signmaker gets $0 for its product.

2. Anticipatory repudiation

a) Consequences

(1) The repudiated party can sue for damages, or

(2) The repudiated party can suspend its own performance, or

(3) Otherwise, the repudiated party will be treated as affirming the contract.

b) Exceptions

(1) Unilateral contracts: AR doctrine is not available in unilateral contracts.

(2) Effectively unilateral contracts: AR doctrine is not available in effectively unilateral contracts--where one of the parties has completed its performance. E.g., a sale with up-front payment.

c) Cases

(1)

3. Assurance

C. Excuses from performance

1. Taxonomy of excuses

a) Mutual mistake

(1) Elements

(a) A mutual

(b) mistake

(c) of material fact

(d) constituting an essential part of the contract,

(e) and constituting a condition of the contract.

(2) Cases

b) Impossibility

(1) Cases

c) Impracticability

(1) Elements of impracticability

(a) An unexpected occurrence actually occurs.

(b) The unexpected occurrence must have been an unallocated risk.

(c) The unexpected occurrence must have rendered performance impracticable.

(2) Stranded sellers

(a) Cases

i) ***Selland*:**

ii) ***Dunbar*:**

(3) Cases

(a) ***Transatlantic*:**

d) Frustration of purpose

(1) Stranded buyers

e) Force majeure clauses: these are attempts at displacing the common law to create more possible excuses from performance than would ordinarily be available. These clauses will end up as grist for the interpretation and construction mill; the courts typically will limit their effect by giving them a narrow and strict reading.

Comment: Force majeure clauses are attempts by parties at displacing the common law and creating more possible excuses from performance. These clauses will almost always end up in interpretation and construction--and often the courts will limit them.

2. Mitigating the harshness of complete excuse

a) Divisibility

b) Restitution

c) Compensation for reliance interests

IV. Remedies

A. Underlying policies

1. Redress of injuries

2. Compensation for unmet expectations

3. **Substitution with money**
4. **Mitigation of injury**
5. **Encouragement of enterprise**

B. Specific relief

1. **Cases**
   a) ***Klein v. PepsiCo*** (
   b) ***Laclede Gas*** (
   c) ***Walgreen v. Sara Creek*** (7th Cir.): a law and economics analysis of the appropriateness of specific relief. Generally, specific relief is not favored, but court should weigh the costs and benefits of granting specific relief and grant it when the benefits outweigh the costs.

C. Substitutional relief

1. **The template formula**
   a) **damages = (LIV + OL) - ((CA + AC) + (LA + AL))**
      (1) **LIV** (loss in value)
      (2) **OL** (other losses): recovery for other losses (aka. special damages) is sharply limited since *Hadley*.
      (3) **CA** (costs avoided):
      (4) **AC** (avoidable costs):
      (5) **LA** (loss avoided):
      (6) **AL** (avoidable loss):
2. **Situation-specific formulas**
   a) **Contract types**
      (1) **Goods**
         (a) **Buyers**
            i) LIV = cost of cover; CA = the contracted price
      (2) **Services**
      (3) **Construction**
      (4) **Real estate**
3. **Limitations on damages**
   a) **Avoidability:** an injured party is not allowed to recover loss that it could reasonably have avoided.
      (1) **Economic waste:** generally speaking, the law will not promote economic waste. The basic rule precludes damages for cost of completion where completion would either (a) involve tearing something down or (b) spending $X to increase wealth by an amount less than $X; if either, then the difference in value is the damage measure, rather than cost of completion.
         (a) **Cases**
            i) ***Jacobs & Young*** (N.Y. 1921): in measuring the damages due to a contractor who had substantially performed, the court would not reduce them by the owner's cost of completion because completion would have involved tearing most of the house up to change brands of pipe--that is, "the cost of completion is grossly and unfairly out of

proportion to the good to be attained." The appropriate damage measure in this case, then, was the difference in value.

ii) ***Groves*** (Minn. 1939): the court recognizes the economic waste doctrine only wrt. tearing stuff down--not wrt. economic inefficiency. So, even though the cost of completion was much greater than the benefit of performance, cost of completion was assessed as damages. (This case may be distinguishable from *Jacobs & Young* because the contract breach here was willful--"there was nothing of good faith about it.")

iii) ***Peevyhouse*** (Okla. 1962): the court recognizes the economic waste doctrine but finds it not to apply where, as here, the breach term was "merely incidental" to the contract's main purpose. (The dissent argues that because the Pfs. insisted on the breached term, it couldn't have been incidental.)

(2) Cases

(a) ***Rockingham County*** (4th Cir. 1929): Pf. could not recover for damages it "piled on" after Df. repudiated the contract--Pf. had a duty to mitigate its damages by stopping work.

(b) ***Tongish*** (Kan. 1992):

(c) ***Parker*** **(the Shirley MacLaine case)** (:

b) Forseeability: "other losses" (aka. "consequential", "incidental", "special" damages) have very limited availability--OL only includes the damages resulting from breach that could be contemplated, or at least, forseen by both parties.

(1) Emotional injury: generally, recovery for emotional injury is unavailable; however, if emotional injury is a forseeable consequence of breach, emotional injuries may be compensable.

(a) The Idaho rule: Idaho courts have analogized damages for emotional loss to punitive damages, and so they are almost never recoverable--they are only recoverable if there is an independent tort to which contract damages may attach.

(b) Cases

i) *Brown v. Fritz* (Idaho 1985): defrauded homebuyer could not recover in contract for emotional damages because the court felt they were too much like punitive damages, which cannot be recovered unless there is either an independent tort involved or the breacher acted in a way that extremely deviates from reasonable standards of conduct and in disregard of the likely consequences.

(2) Cases

(a) ***Hadley v. Baxendale*** (Eng. 1854): the landmark cases curbing the availability of OL. "If special circumstances under which the contract was actually made were communicated by the Pfs. to the Dfs., and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated."

(b) *Delchi Carrier* (2d Cir. 1995): a "forseeability" test variation on *Hadley*. "Damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of the contract."

(c) ***Kenford*** (N.Y. 1989): "contemplation plus intent-to-assume" test variation on *Hadley*--not only must the damages must be contemplated, the breaching party must have actually intended to assume the risk of those damages.

i) Also note O.W. Holmes's "tacit agreement" test: the damages "should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind." This test has not found favor in the courts, and is explicitly rejected by the UCC.

c) Certainty: a party seeking contract damages must be able to show (1) that they suffered some certain harm and (2) that the extent of that harm is certain. Modern courts require only "reasonable certainty" rather than certain "certainty" (e.g., UCC § 1-106, comment 1: damages don't have to "be calculable with mathematical accuracy"--they just have to be "at best approximate"). Generally, if a party can show certain harm, courts will be lenient wrt. the certainty of extent requirement.

(1) Cases

(a) ***Fera*** **(the book and bottle case)** (Mich. 1976): typically, new businesses can't recover for lost profits, because those damages are too speculative (i.e., not certain (enough))--there's no basis on which to estimate profits. But this new business did--mainly, it seems, because both parties presented extensive, conflicting evidence, including expert testimony, and the jury found for the new business in an amount within the range of the evidence. The court did not want to invade the jury's decision.

4. Liquidated damages: for a long time, courts didn't like liquidated damages clauses--they saw a danger of oppression, and saw the clauses as exacting penalties from breachers (whereas, contract law usually strives to be amoral and nonretributive). The modern trend is toward merely inspecting liquidated damages clauses for signs of penalization.

a) Reasonability test: courts will enforce liquidated damages clauses that are reasonable either (a) as forecasts of provable damages resulting from breach, or, sometimes, (b) because actual damages from breach would be difficult to measure.

(1) Assessment epoch: the modern trend is towards assessing reasonableness either (a) at the time of contract formation or (b) at the time of breach. Note that if a court uses (b), assessment at the time of breach, the parties will have to prove approximate actual damages at trial.

(2) Burdens of proof: the modern trend is to presume liquidated damages clauses are reasonable--so the party challenging them must prove their unreasonableness.

b) Cases

(1) ***Wasserman's*** (N.J. 1994): the portion of a liquidated damages clause that

provided for 25% of gross profits remanded for trial on its reasonableness.

(a) Benefits of liquidated damages clauses: parties can control their exposure to risk, avoid the headaches of the judicial process, fashion an economically efficient remedy, correct inadequate judicial remedies. Plus, they're consistent with the broad policies of judicial economy and freedom of contract.

(b) Risks of liquidated damages clauses: public law, not private law, should govern parties' remedies--courts must ensure that private remedies don't stray from just legal principles; also, courts need to protect parties from unfairness and oppression in bargaining.

V. Transfer

A. Assignment

1. Taxonomy of assignments

a) Sales: an outright transfer of a contract's rights. If the assignee collects more from the promisor than he paid the assignor for the contract, he keeps the surplus; if he collects less, he suffers the loss.

b) Securities: a transfer of only a limited interest in a contract's rights. This is used where the assignee is the assignor's creditor and wants to assure the creditor that he will pay up--if he doesn't, the assignee can assert the assigned rights against the promisor (or the "nonassigning party"). If the assignee collects more from the promisor than the assignor owed, he must give the surplus to the assignor; if the assignee collects less than the assignor's debt, he can still get the balance from the assignor.

2. Effecting an assignment:

for an effective assignment, a promisee must manifest an intention to transfer the right to someone else now (i.e., without doing anything else or manifesting any more intent). Assignments take place between the assignor and the assignee--the promisor doesn't have to assent to the assignment.

a) Promises to pay: typically, promises to pay, even if they are promises to pay out of a particular fund, are not assignments.

b) Approval clauses: the law favors free assignability, and so courts will read approval clauses narrowly--typically, unless there are indications otherwise, such clauses will only limit a party's right, but not its power, to assign. To eliminate a party's power to assign, an approval clause should say that unapproved assignments are "void."

3. Cases

a) ***Herzog*** (Me. 1991): lawsuit winner assigns to his doctor his right to payment from a law firm's trust account; "request that payment be made directly from settlement" was sufficient to effect an assignment. The law firm messed up by paying the lawsuit winner rather than the doctor--a promisor who pays an assignor "does so at his peril because the assignee may enforce his rights against" the promisor directly. The firm's argument that they had an ethical obligation to the client was rejected--the court said the firm's ethical obligation was to the client's money.

b) *Bel-Ray* (3d Cir. 1999): the court reads an assignment approval clause read narrowly--limiting only the assignor's right to assign, not its power to. Thus, the

assignment is valid, but the promisor has an action against the assignor.

B. Delegation

1. Validity of delegations: wrt. some kinds of contracts (e.g. a contract for payment of a definite sum) the promisee must be prepared to accept performance from anybody--the promisor or a delegatee. Wrt. other kinds of contracts (e.g., a singer's contract to perform in public), performance is not delegable.

a) Effecting a delegation: sometimes, the words of an assignment will make for a delegation, as well. The new rule, adopted in the UCC, is to presume delegation goes with assignment. The older rule says that assignments are assignments only, unless there are indications otherwise.

2. Cases

a) ***A.C. Associates*** (S.D.N.Y. 1989): defaulting contractor assigns a subcontract to the owner, and the subcontractor argues for the court to adopt the newer rule--that, absent indications otherwise, an assignment of rights is also a delegation and assumption of duties. The court sticks to the old rule, though--that general words of assignment do <u>not</u> result in delegation and assumption of duties. So, the sub.'s only remedy it to sue its general (because "it is well established that a party cannot relieve himself of his contract obligations by assigning the contract").

(1) However, if the owner had asked the sub. to do additional work <u>after</u> the assignment was made, a court would almost certainly infer that the owner had assumed at duty to pay the sub.

(2) <u>Mechanics' liens</u>: typically, a sub. in a situation like this has a mechanic's lien on the owner's property it's working on; here, there's likely no lien because the property involved is public property.

b) ***Sally Beauty*** (7th Cir. 1986): prima facie, the obligations of personal services contracts are <u>not</u> delegable, on the grounds that a party should not be forced to accept a bargain it didn't contract for. The non-delegation presumption can be rebutted with evidence that the promisee consented to the delegation. (It might be possible, if needed, to narrow this holding to coverage only of exclusive agency contracts, involving "best efforts"; also, itc. can be distinguished from many cases because the delegatee here is a direct competitor of the promisee.)

(1) Posner's dissent: there is no reason to think that the market won't work here--the delegatee will gain nothing from underperforming, even though its promisee is a direct competitor.