

Contracts I Outline

Fall Semester 2017
Lewis & Clark Law School
Professor Douglas Newell

Can't touch this!

Contracts and Obligation: The Theories that Govern Contractual Agreements

Corrective justice as umbrella

Facts first, then reasons and rules

Underlying policies and reasons for rulings¹

Classic Consideration

The Bargain Theory

A bargain for a bargain.

Restatement (First) of Contracts § 75 | Consideration²

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

Restatement (Second) of Contracts § 81 | Consideration³

The fact that what is bargained for does not of itself induce the making of a promise does not prevent it from being consideration for the promise.

The fact that a promise does not of itself induce a performance or a return promise does not prevent the performance or return promise from being consideration for the promise.

¹ Newell Office Hours 2 October 2017

² Restatement (First) of Contracts § 75, Williston

³ Restatement (Second) of Contracts § 81

Hardesty v. Smith, Supreme Court of Indiana, 1851⁴

The doing of an act by one at the request of another, which may be a detriment to the party performing, or a *benefit* to the party requesting, is consideration.

The parting of a *right*, which one can legally fix a price upon, is consideration for a promise to pay that price.

Daugherty v. Salt, New York Court of Appeals, 1919⁵

Gratuitous promises lack consideration when there is no exchange or reliance on the promise or forbearance.

Maughs v. Porter, Virginia Court of Appeals, 1931⁶

A *gift* lacks consideration unless the giver has intent AND delivers, thus creating an executed contract.

A mere *condition* of a gratuitous promise lacks consideration.

Hamer v. Sidway, Court of Appeals of New York, 1891⁷

It is enough that something is promised, done, forborne, or suffered by the party to whom the promise is made as consideration for the promise made to them.

*Promissory Estoppel qualifies, but decided before PE was enshrined in common law.*⁸
*Again.*⁹

Baehr v. Penn-O-Tex Oil Corp., Supreme Court of Minnesota, 1960¹⁰

Consideration insures that the promise enforced as a contract is not accidental, casual, or *gratuitous*, but has been uttered *intentionally* as the result of some deliberation, manifested by reciprocal *bargaining* or negotiation.

Springstead v. Nees, Supreme Court of New York, Appellate Division, 1908¹¹

⁴ The IP case with the lamp that is worthless

⁵ Aunt signing note to nephew for being a “good boy”

⁶ The ad posted for people to come to auto show

⁷ Uncle told nephew if he refrained from drinking and smoking that he would give him \$5,000

⁸ Newell Office Hours 2 October 2017

⁹ Newell Office Hours 30 November 2017

¹⁰ Unpaid rents on leased gasoline stations.

¹¹ The Atlantic Ave and Sackett St property will w/ 5 kids and 2 getting more

Forbearance to assert either a legal or an equitable claim is sufficient consideration.

It is not essential that the claim should be valid but it is enough if it could be regarded as doubtful or colorable, but if the claim be not even doubtful, or colorable, or plausible, in that there is no reason for an honest belief that it has some foundation in law or in equity, then forbearance applied to it is not good consideration.

Wood v. Lucy, Lady Duff-Gordon, Court of Appeals of New York, 1917¹²

A promise may be lacking, and yet the whole writing may be instinct with an *obligation*, imperfectly *implied*.¹³

Without an *implied promise*, the transaction cannot have business efficacy, as both parties must have intended that at all events it should have.¹⁴

In determining the intention of the parties, the promise has a value.

Weiner v. McGraw-Hill, Inc., Court of Appeals of New York, 1982¹⁵

While coextensive promises may constitute consideration for each other, *mutuality*, in the sense of requiring such reciprocity, is not necessary when a promisor receives other valid consideration.

Unilateral contract qualities.¹⁶

Mattei v. Hopper, Supreme Court of California, 1958¹⁷

When the parties attempt to make a contract where promises are exchanged as the consideration, the promises must be *mutual in obligation*. Without mutuality of obligation, the agreement lacks consideration and no enforceable contract has been created.¹⁸ For the contract to bind either party, both must have assumed some legal obligations.

If one of the promisees leaves a party free to perform or to withdraw from the agreement at their own unrestricted pleasure, the promise is deemed **illusory** and it provides no consideration.¹⁹

¹² Exclusive rights to place designs on sale w/ inaction resulting.

¹³ *McCall Co. v. Wright*, 133 App Div 62, 117

¹⁴ Bowen, L.J., in the Moorcock, 14 P.D. 64, 68.

¹⁵ Dude left his job for McGraw-Hill and was then fired

¹⁶ Newell Office Hours 2 October 2017

¹⁷ Contract to sell a piece of land rescinded

¹⁸ *Shortell v. Evans-Fergusun Corp.*, 98 Cal App 650, 660-662

¹⁹ *J.C. Millett Co. v. Park & Tilford Distillers Corp.*, 123 F Supp 484, 493

While contracts making the duty of performance of one of the parties' conditional upon their satisfaction would seem to give them wide latitude in avoiding any obligation and thus present serious consideration problems, such "**satisfaction clauses**" have been given effect. The *two primary categories* are in (1) those contracts where the condition calls for satisfaction as to commercial value or quality, operative fitness, or mechanical utility, dissatisfaction cannot be claimed arbitrarily, unreasonably, or capriciously²⁰ and (2) the standard of a reasonable person is used in determining whether satisfaction has been received where the question is one of judgement, the promisor's determination that he is not satisfied, when made in good faith has been held to be a defense to an action on the contract.²¹

*A focus on the term "dissatisfaction" as being the main point above.*²²

Secondary Sources

A promise conditional upon the promisor's **satisfaction** is not illusory since it means more than that validity of the performance is to depend on the arbitrary choice of the promisor. Their expression of dissatisfaction is not conclusive. That may show only that they have become dissatisfied with the contract, they must be dissatisfied with the performance, as a performance of the contract, and their dissatisfaction must be genuine.²³

One important exception [to consideration] consists of those performances that are required of the performer, exactly as rendered by him, by a **pre-existing legal duty**. The same is true of a promise to render such a performance.²⁴

If a contract or term thereof is **unconscionable** at the time the contract is made, a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.²⁵

²⁰ *Collins v. Vickter Manor, Inc.*, 47 Cal 2d 875, 882-883

²¹ *Tiffany v. Pacific Sewer Pipe Co.*, 180 Cal 700, 702-705

²² Office Hours w/ Newell, 2 October 2017

²³ Corbin, *Contracts* (1951), §§ 644, 645, pp. 560-572

²⁴ 1A Corbin on *Contracts* § 171 at 105 (1963)

²⁵ 2 Corbin on *Contracts*, § 208 (rev. ed. 1993)

Promissory Estoppel

Restatement (First) of Contracts § 90 | Promissory Estoppel²⁶

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

Restatement (Second) of Contracts § 90 | Promissory Estoppel²⁷

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

Cochran v. Robinhood Lane Baptist Church, Court of Appeals of Tennessee, 2005²⁸

The aggrieved party must show that they had a vested right to the benefit *at the time of execution* of the contract in order to constitute consideration.

The detriment suffered in reliance must be substantial in an economic sense, the substantial loss to the promisee in acting in reliance must have been foreseeable by the promisor, and the promisee must have acted reasonable in justifiable reliance on the promise as made.

Wheeler v. White, Supreme Court of Texas, 1965²⁹

Where one party has, by words or conduct, made to the other a promise or assurance which was intended to affect the legal relations between them and to be acted on accordingly, then, once the other party has taken them at their word and acted on it, the party who gave the promise cannot afterward be allowed to revert to the previous relationship as if no such promise had been made. This does not create a contract where none existed before, but only prevents a party from insisting upon their strict legal rights when it would be unjust to allow them to enforce it.

The vital principle is that a party who by their language or conduct leads another to do what they would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which they acted.

²⁶ Restatement (First) of Contracts, Williston

²⁷ Restatement (Second) of Contracts § 90

²⁸ The widowed wife not receiving contracted stipends from the church

²⁹ δ breached K to secure or provide a loan to π to build on land

Where the promisee has failed to bind the promisor to a legally sufficient contract, but where the promisee has acted in reliance upon a promise to their detriment, the promisee is to be allowed to recover **no more than reliance damages** measured by the detriment sustained.

Hoffman v. Red Owl Stores, Supreme Court of Wisconsin, 1965³⁰

If a party makes promissory representations and the aggrieved party relies thereon in the exercise of ordinary care and fulfills the conditions required of them by the terms of negotiations with the promisor, the promise and resulting actions constitute consideration.

The conditions imposed for promissory estoppel by the Restatement are;

- 1. Was the promise one which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee?**
- 2. Did the promise induce such action or forbearance?**
- 3. Can injustice be avoided only by enforcement of the promise?**

Alfred v. Walt Disney Co., Delaware(?), 2015³¹

The promise to hear a proposal out cannot be reasonably relied upon as a promise to consummate a contract. There is simply no basis for the imposition of relief under a rubric of promissory estoppel.

Secondary Sources

Promissory estoppel is applicable ONLY in the absence of an otherwise enforceable contract.³²

³⁰ The dude that was trying to buy a franchise store that got screwed

³¹ Disney wouldn't hear this guy's proposal and he sued

³² Contract and Related Obligation, Summers, Hillman and Hoffman, 106

Unjust Enrichment

Restitution, Quasi-Contract & Contract Implied-in-LAW

Restatement (Third) of Restitution § 1³³

A person who is unjustly enriched at the expense of another is subject to liability in restitution.

Bloomgarden v. Coyer, United States Court of Appeals, District of Columbia Circuit, 1973³⁴

An implied-in-fact contract is a true contract, containing all necessary elements of a binding agreement; it differs from other contracts only in that it has not been committed to writing or stated orally in express terms, but rather is inferred from the conduct of the parties.

In order to establish an implied-in-fact contract to pay for services, the party seeking payment must show that the services were carried out under such circumstances as to give the recipient reason to understand that they were performed for them and not for some other person and, that they were not rendered gratuitously, but with the exception of compensation from the recipient; and that the services were beneficial to the recipient. The elements essential to implication must concur is the time at which the services are rendered.

A quasi-contract is not a contract at all but a duty thrust under certain conditions upon one party to requite another in order to avoid the former's unjust enrichment.

A party must show that that the other party was unjustly enriched at their expense, and that the circumstances were such that in good conscience the enriched party should make restitution.

A quasi-contract will be recognized in appropriate circumstances, even though no intention of the parties to bind themselves contractually can be discerned for the purpose of preventing unjust enrichment.

There is no general responsibility in quasi-contract law to pay for services *irrespective* of the circumstances in which they are carried out.

Sparks v. Gustafson, Supreme Court of Alaska, 1988³⁵

Unjust enrichment exists where the defendant has received a benefit from the plaintiff and it would be inequitable for defendant to retain the benefit without compensating plaintiff for its value. A person confers a benefit upon another if they give the other

³³ Restatement (Third) of Restitution § 1

³⁴ The guy that introduced developers then expected money after the fact

³⁵ The guy that managed the Nome Center, expecting to purchase the building

some interest in money, land or possessions; performs services beneficial to or at the request of the other; satisfies a debt of the other; or in any way adds to the other's advantage.

Even where a person has conferred a benefit upon another, however, he is entitled to compensation ONLY if it would be just and equitable to require compensation under the circumstances.

Gay v. Mooney, Supreme Court of New Jersey, 1901³⁶

A reasonable and proper expectation that there would be compensation must be shown.

When, in pursuance of a bargain for the reason of it being related to land and thus unenforceable by the statute of frauds, services have been rendered, the legal remedy is by an action on the quantum meruit for the value of the services.

Kelley v. Hance, Supreme Court of Errors of Connecticut, 1928³⁷

Where one retains goods received in part performance of a contract, a promise to pay for them is ordinarily implied since they have the option to either pay for or return them.

When it comes to land, except where there has been an actual acceptance of the work prior to its abandonment by the plaintiff, **mere inaction on the part of the defendant will not be treated as an acceptance of the work from which a promise to pay for it may be implied.**

Recovery can be had for partial performance which has been beneficial *only when* the benefit has been appropriated by the defendant under circumstances sufficient to raise an *implied promise* to pay for the reasonable value of what has been received.

***De Leon v. Aldrete*, Texas Civ App, 1965³⁸**

The old majority rule was that a defaulting purchaser cannot recover any money paid by them under the contract to the vendor even though, as a result of the purchaser's breach, the vendor has abandoned all idea of further performance and retains the money, not for application on the purchase price, but as forfeited. Dogmatic application of the majority rule leads to indefensibly absurd results. Under the rule of forfeiture, the amount of the forfeiture will always and necessarily depend simply on the stage to which the purchaser's performance has progressed, with complete disregard of the amount of damages suffered by the vendor.

³⁶ The decedent's promise to provide a place of living for π 's kids

³⁷ The idiot that left the sidewalk job halfway done then abandoned ship

³⁸ Dude defaulted on his loan payment for land, of which he had a majority of it paid

This principle of liability of one who breaches contemplates that the liability to respond in compensatory, as distinguished from punitive, damages will afford sufficient protection to the innocent party, and this is the only interest, absent extraordinary circumstances, which the social welfare demands should be the subject of judicial solicitude.

Watts v. Watts, Supreme Court of Wisconsin, 1987³⁹

A change in one party's circumstances in performance of the agreement may imply an agreement between the parties.

Courts have recognized that money, property, or services (including housekeeping and childrearing) may constitute adequate consideration independent of the parties' sexual relationship to support an agreement to share or transfer property. Courts have held that such a relationship and joint acts of a financial nature can give rise to an inference that the parties intended to share equally.

In Wisconsin, an action for unjust enrichment, or quasi-contract, is based upon the proof of three elements; (1) a benefit conferred on the defendant by the plaintiff, (2) appreciation or knowledge by the defendant of the benefit, and (3) acceptance or retention of the benefit by the defendant under circumstances making it inequitable for the defendant to retain the benefit.

Secondary Sources

The promisor whose substantial breach derailed the exchange must restore whatever was given or done in response to and in conformity with its terms and it will not matter in the slightest degree whether this had brought profit or advantage to them.⁴⁰

Courts have refused to enforce such agreements between spouses as: payment by one spouse to another for domestic, child care, or other services in the home; planned termination of the marriage after a given period of time; alteration of statutory duties of support; and provision in advance for the eventuality of divorce. However, spouses are entitled to share in the accumulation of property of the marital estate.⁴¹

³⁹ The unmarried couple

⁴⁰ Restitution without Enrichment, Dawson, 61 Boston UL Rev 563, 582-83 (1981)

⁴¹ Contract and Related Obligation, Summers, Hillman and Hoffman, 161

Promissory Restitution

Moral Obligation

Restatement (Second) of Contracts § 82(1)

A promise to pay all or part of an antecedent contractual or quasi-contractual indebtedness owed by the promisor is binding if the indebtedness is still enforceable or would be except for the effect of a statute of limitations.⁴²

Restatement (Second) of Contracts § 86

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

(2) A promise is not binding under Subsection (1)

(a) if the promisee conferred the benefit as a gift or for other reasons the promisor has not been unjustly enriched; or

(b) to the extent that its value is disproportionate to the benefit.⁴³

Mills v. Wyman, Supreme Judicial Court of Massachusetts, 1825⁴⁴

There must have been some preexisting obligation, which has become inoperative by positive law, to form a basis for an effective promise. Express promises founded on such preexisting equitable obligations may be enforced; there is good consideration for them; they merely remove an impediment created by law to recover debts honestly due, but which public policy protects the debtors from being compelled to pay.

The general position, that moral obligation is a sufficient consideration for an express promise, is to be limited in its application, to cases where at some time or other a good or valuable consideration has existed.

Webb v. McGown, Court of Appeals of Alabama, 1935⁴⁵

Where the promisee cares for, improves, and preserves the property of the promisor, though done without his request, it is sufficient consideration for the promisor's subsequent agreement to pay for the service, because of the material benefit received.

A moral obligation is a sufficient consideration to support a subsequent promise to pay where the promisor has received a material benefit, although there was no original duty or liability resting on the promisor. For a moral obligation to support a subsequent promise to pay, there must have existed a prior legal or equitable obligation,

⁴² Restatement (Second) of Contracts § 82(1)

⁴³ Restatement (Second) of Contracts § 86

⁴⁴ The case of the dead child that may not actually have died, dad promised to pay after the fact

⁴⁵ The guy that wouldn't drop the block on the other employee

which for some reason had become unenforceable, but for which the promisor was still morally bound. This rule, however, is subject to qualification in those cases where the promisor, having received a material benefit from the promisee, is morally bound to compensate them for the services rendered and in consideration of this obligation promises to pay.

Benefit to the promisor or injury to the promisee is sufficient legal consideration for the promisor's agreement to pay.

Edson v. Poppe, South Dakota Supreme Court, 1910⁴⁶

The general rule is that past services are not a sufficient consideration for a promise to pay therefor, made at a subsequent time, and after such services have been fully rendered and completed; but moral obligation was adopted and it is held that a moral obligation, founded on previous benefits received by the promisor at the hands of the promisee, will support a promise by them. Such a promise is supported by a sufficient consideration if the services were beneficial, and were not intended to be gratuitous.

A subsequent promise, founded on a former enforceable obligation, or on value previously had from the promisee, is binding.

⁴⁶ The well that was dug

Damages and Other Remedies to Contractual Breach

Restatement (Second) of Contracts § 344 | Judicial Remedies Available

Judicial remedies under the rules stated in this Restatement serve to protect one or more of the following interests of a promisee:

- (a) “**expectation interest**,” which is their interest in having the benefit of their bargain by being put in as good a position as they would have been in had the contract been performed,
- (b) “**reliance interest**,” which is their interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as they would have been in had the contract not been made, or
- (c) “**restitution interest**,” which is their interest in having restored to them any benefit that they have conferred on the other party.

Expectation Interest

*Mainly Classic Consideration*⁴⁷

To put the injured party in as good a position as full performance would have.

Problem 3-8⁴⁸

On Jan 7, 2015, Seller Co. and Buyer Co. agree that S will manufacture standard valves for B for delivery on July 1 at a price of \$40,000. On Jan 30, B repudiates. S tells you that (1) its cost of manufacture would have been \$27,000, and it can (2) cease manufacturing the valves, (3) reallocate the \$15,000 of labor allocated to B’s contract to less skilled tasks worth \$10,000, and (4) resell for \$8,000 components purchased for this contract for \$10,000. Overhead of \$2,000 allocated to the contract cannot be saved. What can seller recover under **UCC § 2-708(2)**?

Seller wants to know if it can complete manufacture. Assume that S tells you that the market for such valves is “firm,” and that in July it is “very likely” another buyer could be found for such valves “at \$40,000 or above.” You advise S to complete on the basis of UCC § 2-708(2), which provides:

Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgement for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease

⁴⁷ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 53-57 (1936)

⁴⁸ **Answer:** \$22,000 [$15 - 10 = (5) - (2) = (7) + 2 = (5) + 27 = 22$]

manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

On July 1, S is able to sell the valves for only \$15,000, the market having unexpectedly fallen because of a new technological breakthrough. What, if anything, can S recover from B? Would the recovery conflict with the principle of *Clark v. Marsiglia* (see page 19)?

Problem 3-9⁴⁹

On May 1, 2015, Illinois Furnace Co. entered into a long-term (6 year) contract with Ohio Valley Coke, Inc. for the purchase of coke at \$40/ton. Assume that on May 20, 2015, Ohio Valley Coke repudiated. At this time, other suppliers were offering long-term contracts at between \$50 to \$53/ton. This appreciable increase in price was attributable to flooding in the Ohio Valley that had interfered with the mining of coke during three successive years. Illinois Furnace assumed it could always buy on the spot market and declined to enter into a long-term contract when Ohio Valley repudiated. Six months later, unable to buy sufficient quantities of coke on the spot market, Illinois Furnace was forced to close one of its plants for three weeks at a loss in profits of \$450,000. Can Illinois Furnace recover this sum from Ohio Valley Coke?

Problem 3-10

Alan Turlway calls your law office and tells you that Arlo Electronics has wrongfully fired him from his job as a television salesperson. Alan had a contract for one more year of employment, but Arlo's business was slow. Alan was earning \$275 per week. He tells you that he has been offered employment at Teale Electronics as a computer salesperson for \$300 per week. Teale Electronics is 20 miles from Alan's home, however, whereas Arlo Electronics is only five miles away, and Alan is reluctant to accept. He asks you whether he should take the job, and what the consequences will be if he does not. Advise Alan. What further information would you seek?

Restatement (Second) of Contracts § 347⁵⁰

Subject to the limitations stated in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by;

- (a) the loss in value to him of the other party's performance caused by its failure or deficiency, plus**
- (b) any other loss, including incidental or consequential loss, caused by the breach, less**
- (c) any cost or other loss that he has avoided by not having to perform.**

Comment B: The first element that must be estimated in attempting to fix a sum that will fairly represent the expectation interest is the loss in value to the injured party of the other party's performance that is caused by the failure of, or deficiency in, that performance. In

⁴⁹ **Answer:** Illinois Furnace cannot recover anything because they failed to mitigate their damages by covering.

⁵⁰ Restatement (Second) of Contracts § 347, comment b

principle, this requires a determination of the value of that performance to the injured party themselves and not the value to some hypothetical reasonable person or on some market. The value of performance therefore depends on their own particular circumstances or those of their enterprises.

Restatement (Second) of Contracts § 351 | General v. Consequential Damages⁵¹

- (1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.
- (2) Loss may be foreseeable as a probable result of a breach because it follows from the breach;
 - (a) in the ordinary course of events, or
 - (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.
- (3) A court may limit damages for foreseeable loss by excluding recovery for **loss of profits**, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid *disproportionate compensation*.⁵²

Restatement (Second) of Contracts § 352 | Uncertainty as a Limitation on Damages⁵³

Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty.

Restatement (Second) of Contracts § 353 | Loss Due to Emotional Disturbance⁵⁴

Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result.

Restatement (First) of Contracts § 331 | Lost Profit Damages⁵⁵

- (1) **Damages are recoverable for losses caused or for profits and other gains prevented by the breach only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty.**
- (2) **Where the evidence does not afford a sufficient basis for a direct estimation of profits, but the breach is one that prevents the use and operation of property from which profits would have been made, damages may be measured by the rental value of the property or by interest on the value of the property.**

⁵¹ Restatement (Second) of Contracts § 351, The American Law Institute

⁵² Enshrined into common law by Supreme Court in reviewing verdict in *Sunnyland Farms v. Central New Mexico Elec. Coop. Inc.*, 301 P3d 387 (2013), overruled the tacit agreement test.

⁵³ Class 24 October 2017

⁵⁴ Class 24 October 2017

⁵⁵ *Evergreen Amusement Corp. v. Milstead*, CB327

Groves v. John Wunder Co., Supreme Court of Minnesota, 1939⁵⁶

Where a contractor willfully and fraudulently varies from the terms of a construction contract, he cannot sue thereon and have the benefit of the equitable doctrine of substantial performance.

Value of land, as distinguished from the value of the intended product of the contract which ordinarily will be equivalent to its reasonable cost, is no proper part of any measure of damages for willful breach of a building contract.

Under a construction contract, when the thing lost by a breach is a physical structure or accomplishment, or a promised and paid for alteration in land is the injury, the law gives compensation and the only appropriate measure is the **cost of performance**.

Sometimes defects in a completed structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste. If no such waste is involved, the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance.⁵⁷ The *economic waste* declaimed against by the decisions applying that rule has nothing to do with the value in money of the real estate, or even with the product of the contract. The waste avoided is only that which would come from wrecking a physical structure, completed or nearly so, under the contract. The cases applying that rule go no further.

Peevyhouse v. Garland Coal & Mining Co., Oklahoma, 1962⁵⁸

Groves is the only case which has come to our attention in which the cost of performance rule has been followed under circumstances where the cost of performance greatly exceeded the diminution in value resulting from the breach.

Where the economic benefit which would result to lessor by full performance of the work is grossly disproportionate to the cost of performance, the damages which may be recovered are limited to the diminution in value resulting to the premises because of the non-performance. The rule does not interfere with the property owner's right to do what they will with their own or their right, if they choose, to contract for improvements which will actually have the effect of reducing their property's value. Where such result is in fact contemplated by the parties, and is a main or principal purpose of those contracting, it would seem that the measure of damages for breach would ordinarily be the cost of performance.

⁵⁶ The lease where ∂ agreed to remove all the sand and gravel upon vacating

⁵⁷ Restatement (First) of Contracts § 346, Comment B

⁵⁸ Strip mining case for coal

Rock Island Improvement Company v. Helmerich & Payne, Inc., Tenth Circuit, 1983⁵⁹

The proper measure of damages was the reasonable cost of reclamation, unless the reclamation requirement was incidental to the lease's main purpose and the cost of reclamation would be grossly disproportionate to the diminution in the land's fair market value. **The cost of performance is the proper measure of damages.**

Radford v. De Froberville, Chancery Division (England), 1977⁶⁰

If one contracts for the supply of that which they think serves their interests, be it commercial, aesthetic or merely eccentric, then if that which is contracted for is not supplied by the other contracting party, in principle, they should be compensated by being provided with the cost of performance, subject to the proviso, that they are seeking compensation for a genuine loss and not merely using a technical breach to secure an uncovenanted profit.

Thorne v. White, District of Columbia Court of Appeals, 1954⁶¹

A party damaged by a breach may only recover for losses which are the natural consequence and proximate result of that breach. Damages are awarded for the purpose of compensation and the injured party should not be placed in a better position than they would have been in had no breach occurred.

Freund v. Washington Square Press, New York, 1974

An owner agrees to pay money or other consideration to a builder and expects, under the contract, to receive a completed building in return. The value of the promised performance to the owner is the properly constructed building. Damages are not measured, however, by what the defaulting party saved by the breach, but by the natural and probably consequences of the breach to the plaintiff.

Warner v. McLay, Supreme Court of Errors of Connecticut, 1918⁶²

In this case, the plaintiff had the right to recover such sum in damages as they would have realized in profits had the contract been fully performed. To measure this, it was necessary to find the cost of expense of the work and materials necessary to complete the contract. This sum, deducted from the contract price, would have given a balance which would be the profit which would have accrued to the plaintiff out of the contract had it been fully performed.

⁵⁹ Another strip mining with reclamation clause

⁶⁰ The case of the wall stipulated in the sale of a portion of land sold

⁶¹ The roof case

⁶² Breach of written building contract

Handicapped Children's Education Board of Sheboygan County v. Lukaszewski, Supreme Court of Wisconsin, 1983⁶³

A health danger will not excuse nonperformance of a contractual obligation when the nonperforming party causes the danger, nor will a health condition or danger which was foreseeable when the contract was entered into justify its breach.

Damages for breach of contract are measured by the expectations of the parties.

An injured party must take all reasonable steps to **mitigate** damages.

Neri v. Retail Marine Corp., Court of Appeals of New York, 1972⁶⁴

UCC § 2-708(2): Sellers Damages for Non-Acceptance or Repudiation [Lost Volume]⁶⁵

- (1) Subject to subsection (2) and to the provisions of this article with respect to proof of market price (§ 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (§ 2-710), but less expenses saved in consequence of the buyer's breach.
- (2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (§ 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

Elements of Lost Volume According to *Neri*:

1. There is ample supply
2. Regular customers
3. Would have sold to third party despite breach of K

The measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done and hence under subsection (2), the seller is entitled to its profit, including reasonable overhead, together with any incidental damages, due allowance for costs reasonably incurred and due credit for payments or proceeds of resale. *Attorney's fees not included within the scope of protective expenses contemplated by this statute.*

Hadley v. Baxendale, England, 1854

⁶³ The teacher that tried to leave for a higher paying job

⁶⁴ The boat that the buyer breached on purchasing

⁶⁵ Newell Office Hours 13 October 2017

UCC § 2-715: Buyer's Incidental and Consequential Damages

- (1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.
- (2) Consequential damages resulting from the seller's breach include:
 - a. Any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
 - b. Injury to person or property proximately resulting from any breach of warranty.

Damages which the other party ought to receive in respect to such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probably result of the breach of it.

If the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, 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 the injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. If these special circumstances were wholly unknown to the party breaking the contract, they, at the most, could only be supposed to have had in their contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from a breach. Had the special circumstances been known, the parties might have specially provided for the breach by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them.

Armstrong v. Bangor Mill Supply Co., Maine Supreme Judicial Court, 1929

In a defendant's contract to repair something, the law implies an undertaking on their part to perform the work in a reasonably skillful and workmanlike manner.

Clark v. Marsiglia, Sup Ct New York, 1845

The party employed cannot persist in working, though they are entitled to the damages consequent upon their disappointments.

The just claims of the party employed are satisfied when they are fully recompensed for their part performance AND indemnified for their loss in respect to the

unexecuted portion of the contract. To persist in accumulating a larger demand is not consistent with good faith towards the employer.

Schiavi Mobile Homes, Inc. v. Gironde, Maine, 1983

When a contract is breached, the non-breaching party has an affirmative duty to take reasonable steps to mitigate their damages. If a party has in their power to take measures, by which their loss may be less aggravated, this will be expected of them.

The touchstone of the duty to mitigate is reasonableness. The non-breaching party need only take reasonable steps to minimize their losses; they are not required to unreasonably expose themselves to risk, humiliation, or expense.

Parker v. Twentieth Century-Fox Film Corp., Supreme California, 1970

The measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service, less the amount which the employer affirmatively proves the employee has earned or with reasonable effort might have earned from other employment. However, before projected earnings from other employment opportunities not sought or accepted by the discharged employee can be applied in mitigation, the employer must show that the other employment was comparable, or substantially similar, to that of which the employee has been deprived; the employee's rejection of or failure to seek other available employment of a different or inferior kind may not be resorted to in order to mitigate damages.

Reasonableness is not an element of a wrongfully discharged employee's option to reject, or fail to seek, different or inferior employment lest the possible earnings therefrom be charged against him in mitigation of damages.

In Re WorldCom, Inc., SDNY, 2007

Lost Volume: (1) capacity to simultaneously perform two contracts, (2) the second contract would be profitable, and (3) the second contract would have formed in the absence of the first contract's breach.

Evergreen Amusement Corp. v. Milstead, Maryland, 1955

Loss of profit is a definite element of damages in an action for breach of contract or in an action for harming an established business which has been operating for a sufficient length of time to afford a basis of estimation with some degree of certainty as to the probably loss of profits, but that, on the other hand, loss of profits from a business which has not gone into operation may not be recovered because they are merely speculative and incapable of being ascertained with the requisite degree of certainty.

The **new business rule** is in *decline*.

Lakota Girl Scout Council, Inc. v. Havey Fundraising Management, Inc., 8th Circuit, 1975

Lost profits are recoverable provided: (1) there is proof that some loss occurred, (2) that such loss flowed directly from the agreement breached and was foreseeable, and (3) there is proof of a rational basis from which the amount can be inferred or approximated.

The jury need not make the computation of damages [for lost profit] with mathematical exactness. It is enough if there is proof of a rational basis for computation.

The admission of an expert's opinion on a particular subject and that expert's qualifications are matters given to the sound discretion of the trial court. An appellate court will not overrule a ruling of one of these points absent an abuse of discretion.

A unique promotional venture: one reasonable source for computing damages rests with the opinion testimony of **expert witnesses**. Where there is no other "reasonably safe basis" for measuring the substantial damages which the plaintiff has suffered by reason of the defendant's breach of contract, expert testimony may be utilized for the purpose.

A defendant whose wrongful conduct has rendered difficult the ascertainment of the precise damages suffered by the plaintiff, is not entitled to complain that they cannot be measured with the same exactness and precision as would otherwise be possible. The wrongdoer should bear the risk of uncertainty that their own conduct has created.

Corbin: If the mind of the court is certain that profits would have been made if there had been no breach by the defendant, there will be a greater degree of liberality in allowing the jury to bring in a verdict for the plaintiff, even though the amount of profits prevented is scarcely subject to proof at all. The trial court has a large amount of discretion in determining whether to submit the question of profits to the jury; and when it is so submitted, the jury will also have a large amount of discretion in determining the amount of its verdict.

Chrum v. Charles Heating and Cooling, Inc., Michigan, 1982

Where an action is for a breach of a commercial contract, damages for mental distress are not recoverable. The general (*Stewart*) exception is where the contract breached is a personal agreement involving matters of mental concern and solicitude, damages for emotional suffering are recoverable.

The rule of *Stewart* applies where deep, personal human relations are involved. Where property loss is involved, the courts have generally not allowed recovery for mental distress in breach of contract actions. One's property can be lost on a public carrier, in a fire, or as the result of a bailment and, under *Kewin*, damages for mental distress will not be recoverable. Other than the *Stewart* exception, the only grounds upon which damages for

mental distress are recoverable in a breach of contract case is where the plaintiff alleges tortious conduct, independent of any breach of the commercial contract.

The unskilled performance of a contract may give rise to an independent tort action and may be a basis for damages for mental distress.

Secondary Sources

In a case where the contracted performance diminishes the value of the property, the parties have not factored the cost of completion into the price paid by the plaintiff, saving that cost would not result in a windfall to the defendant, and if the plaintiff has no intent to complete, a decree of specific performance would enable the plaintiff to extract a windfall settlement. Suppose, however, that the value the plaintiff assigns to the difference between the existing and promised states of the subject matter, although less than the cost of completion, is higher than the market value differential. In principal, the plaintiff's recovery should be measured by this intermediate figure.⁶⁶

The rule that the plaintiff must after the defendant's breach take steps to mitigate damages tends to corroborate the suspicion that there lies hidden behind the protection of the expectancy a concern to compensate the plaintiff for the loss of the opportunity to enter other contracts. In seeking justification for the rule granting the value of the expectancy there is no need to restrict ourselves by the assumption that the rule can only be intended to cure or prevent the loss caused by reliance.⁶⁷

In nonmarket transactions, except to the extent that the values of component parts of the performance in question are affected by market movements, inaction by the party promised a performance does not give rise to a reliance loss on their part. Accordingly, until that party actually incurs expenses in reliance on the other party's promise of future performance, only a 'gentlemen's agreement' exists if damages for failure to perform are limited to the reliance interest. Therefore, except to the extent that sociological, commercial, or ethical considerations give binding force to such agreements, where prompt reliance by the promisee will not occur there seems little point in contracting unless the parties can agree upon a penalty clause or upon a measure of damages other than reliance. Furthermore, should the parties in circumstances where prompt reliance is not normal enter into a contract for whose breach damages are to be assessed on the basis of reliance, the promisee might well, in order to put pressure on the promisor to perform, rely in a manner that, judged in terms of economic efficiency, was premature or excessive. The expectation measure seems, therefore, appropriate in principle if the legal order wishes to give effect to wholly executory transactions.⁶⁸

⁶⁶ The Responsive Model of Contract Law, Eisenberg, 36 Stan L Rev 1107, 1163-64 (1984)

⁶⁷ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 57, 58, 60-63 (1936)

⁶⁸ Contracts in General, Von Mehren, 7 Int'l Ency Comp L 89 (ch 1) (1982)

Efficient Breach: The opportunity cost of completion to the breaching party is the profit that they would make from a breach, and if it is greater than his profit from completion, then completion will involve a loss to them. If that loss is greater than the gain to the other party from completion, breach would be value-maximizing and should be encouraged. And because the victim of the breach is made whole for their loss, they are indifferent.⁶⁹

Damages for breach of contract by one party consists of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. **Such 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 they then knew or ought to have known, as a possible consequence of the breach of contract.**⁷⁰

The proper test for consequential damages is the *Hadley* standard as interpreted by the Restatement (Second) of Contracts § 351. In a contract action, a defendant is liable only for those consequential damages that were objectively foreseeable as a probable result of their breach when the contract was made. They overturned the Tacit Agreement Test.⁷¹

A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to **mitigate** the loss, including loss of profit, resulting from the breach. If they fail to take such measures, the party in breach may claim a **reduction in the damages** in the amount by which the loss should have been mitigated.⁷²

Lost profit is typically calculated on the basis of business information related to the promisee's operations, such as materials and labor costs, inventory size, availability of alternative suppliers, the identity of their downstream contracting partners (customers), and, in the case of **newer businesses**, their business plan. However, this may conflict with their secrecy interest.⁷³

Expectancy damages typically exclude medical contexts and loss of reputation or goodwill.

⁶⁹ Economic Analysis of Law, Posner, 89-90 (2d ed 1977)

⁷⁰ Convention on Contracts for the International Sale of Goods, Article 74

⁷¹ *Sunnyland Farms v. Central New Mexico Elec. Coop., Inc.*, NM Supreme Court 2013.

⁷² Convention on Contracts for the International Sale of Goods, Article 77

⁷³ Ben-Shahar and Bernstein, The Secrecy Interest in Contract Law, 109 Yale L.J. 1885, 1886-1889 (2000).

Reliance Interest

Mainly Promissory Estoppel⁷⁴

To put the injured party in as good a position as they would have been had the contract not been made.

Essential Reliance Interest and Incidental Reliance Interest.

Reliance interest must be interpreted as at least potentially covering (1) gains prevented as well as (2) losses caused. Whether gains prevented through reliance on a promise are properly compensable in damages is a question here determined.⁷⁵

Restatement (Second) of Contracts § 349 | Damages Based on Reliance Interest

As an alternative to the measure of damages stated in § 347, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.

Comment a: damages under this section cannot exceed the full contract price.

Problem 3-14

At the end of Alice White's 40-year career as an airplane mechanic, her employer, Federal Aviation, promised White a pension of \$200 per week. A few days after retirement, Alice refused an offer of employment for 3 years at \$175 per week from American Aviation, a competitor of Federal. After three months of retirement, it became clear that Federal was not going to honor its promise of a pension. Alice comes to your law office and asks you what her rights are against Federal. Please explain. Consider all theories and appropriate remedies.

Chicago Coliseum Club v. Dempsey, Appellate Court of Illinois, 1932

Compensation for damages for a breach of contract must be established by evidence from which a court or jury are able to ascertain the extent of such damages by the usual rules of evidence and to a reasonable degree of certainty.

Defendant should not be required to answer in damages for salaries of paid regular officials of the corporation who were presumed to be receiving such salaries by reason of their position, but special expenses are recoverable.

⁷⁴ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 53-57 (1936)

⁷⁵ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 53-57 (1936)

Anglia Television LTD. v. Reed, England, 1971

A plaintiff can claim, also, the expenditures incurred before the contract, provided that it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken.

Merry Gentlemen, LLC v. George & Leona Prods., Inc., United States Court of Appeals, Seventh Circuit, 2015

Reliance interest involves reimbursement for loss caused by reliance on a contract.

As an alternative to expectation damages, the injured party has a right to damages based on their reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed. (Rest. 2d 349)

Reliance damages are designed to put the injured party in as good a position as they would have been had the contract not been made.

A party seeking reliance damages under § 349 has a relatively low bar to clear to establish causation and that once it makes this showing, the burden shifts to the breaching party to prove any reduction in those damages. This causation threshold is low because the injured party is forced to prove a counterfactual: what would have happened if the contract had not been signed in the first place.

In the typical case where reliance damages are sought, the defendant has simply repudiated the contract and walked away from the deal. In those cases, it is appropriate for the injured party to claim as damages all expenditures made in preparation for the performance because the other side failed to perform at all.

An injured party cannot reasonably claim that all of its expenditures were caused by the other party's breach without some reason to think the breach destroyed the entire value of the breaching party's performance.

Reliance damages are not insurance. Courts will not knowingly put the plaintiff [receiving a reliance recovery] in a better position than they would have occupied had the contract been fully performed.

Goodman v. Dicker, DC Circuit, 1948

Justice and fair dealing require that one who acts to his detriment on the faith of conduct of the kind revealed here should be protected by estopping the party who has brought about the situation from alleging anything in opposition to the natural consequences of their own course of conduct.

The vital principle is that they who by their language or conduct leads another to do what they would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which they acted. Such a change of position is sternly forbidden. This remedy is always so applied as to promote the ends of justice.

The true measure of damage is the loss sustained by expenditures made in reliance upon the assurance(s) made.

Walters v. Marathon Oil Co., Seventh Circuit, 1981

An equity court possesses some discretionary power to award damages in order to do complete justice. Furthermore, since it is the historic purpose of equity to secure complete justice, the courts are able to adjust the remedies so as to grant the necessary relief, and a district court sitting in equity may even devise a remedy which extends or exceeds the terms of a prior agreement between the parties, if it is necessary to make the injured party whole.

Since promissory estoppel is an equitable matter, the trial court has broad power in its choice of a remedy.

Validity of Clauses Providing Specific Monetary Remedies

Liquidated Damages and Penalties

Restatement (First) of Contracts § 339 | Liquidated Damages and Penalties⁷⁶

- (1) An agreement, made in advance of breach, fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless
- (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and
 - (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.
- (2) An undertaking in a penal bond to pay a sum of money as a penalty for non-performance of the condition of the bond is enforceable only to the extent of the harm proved to have been suffered by reason of such non-performance, and in no case for more than the amount named as a penalty, with interest.

Is it reasonable in forecasting or actual.

UCC § 2-718: Liquidation or Limitation of Damages; Deposits

- (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.
- (2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of their payments exceeds:
- a. The amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or
 - b. In the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller.
- (3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes:
- a. A right to recover damages under the provisions of this Article other than subsection (1), and
 - b. The amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

⁷⁶ § 1 enshrined into common law by *H.J. McGrath Co. v. Wisner*, 189 Md 260

- (4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling the goods received in part performance, the resale is subject to the conditions laid down in this Article on resale by an aggrieved seller (§ 2-706).

Problem 3-13

Fran Burns and Blanken Construction Co. are negotiating for the construction of a house. You are a senior partner at Truman & Budweiser and Blanken is an important client. Blanken's president, Alice Drake, asks the firm to draft a clause that will protect the company from unlimited liability in case it is late in completing the house. Brown gives you the following proposed provision:

The Owner will suffer financial loss if the Project is not completed by the above date. The Contractor shall be liable for and shall pay the Owner, on an actual expense basis as established by receipts, not more than \$1,000 for packing and storage of furnishings and \$30 per day for temporary accommodation.

Evaluate the provision. What additional language would you include, if any? What changes would you make, if any? Is the provision one for liquidated damages or is it a limitation of consequential damages? Does it matter? (For the rule governing the latter type of clause in the sale of goods setting.

UCC § 2-719: Contractual Modification or Limitation of Remedy

- (1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,
 - a. The agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
 - b. Resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.
- (2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.
- (3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

H.J. McGrath Co. v. Wisner, Maryland, 1947

Codified Rest. 2d § 339 into common law.

In comment b of the Restatement, it is said that where a contract “promises the same reparation for the breach of a trivial or comparatively unimportant stipulation as for the breach of the most important one or of the whole contract, it is obvious that the parties have not adhered to the rule of just compensation.”

Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc., Appeals NY, 1977

Liquidated damages constitute the compensation which, the parties have agreed, should be paid in order to satisfy any loss or injury flowing from a breach of their contract.

Parties to a contract have the right to agree to such clauses, provided that the clause is neither unconscionable nor contract to public policy. The contracting parties may agree between themselves as to the amount of damages to be paid upon breach rather than leaving that amount to the calculation of a court or jury.

Liquidated damages provisions will not be enforced if it is against public policy to do so and public policy is firmly set against the imposition of penalties or forfeitures for which there is no statutory authority.

A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. If, however, the amount fixed is plainly or grossly disproportionate to the probably loss, the provision calls for a penalty and will not be enforced.

Southwest Engineering Co. v. United States, Eight Circuit, 1965

Where parties have by their contract agreed upon a liquidated damage provision as a reasonable forecast of just compensation for breach of contract and damages are difficult to estimate accurately, such provision should be enforced. If in the course of subsequent developments, damages prove to be greater than those stipulated, the party entitled to damages is bound by the liquidated damage agreement.⁷⁷

Vanderbilt University v. DiNardo, Sixth Circuit, 1999

Any doubt as to the character of the contract provision will be resolved in favor of finding it a penalty.

Parties to a contract may include consequential damages and even damages not usually awarded by law in a liquidated damages provision provided that they were contemplated by the parties.

We measure the reasonableness of the liquidated damages provision at the time the parties entered the contract, not when the breach occurred.

⁷⁷ Casebook 372

Secondary Sources:

Freedom of contract enjoys a predominant role as a justificatory principle of contract law. Contract law allows parties to agree on contract terms as they choose and, in the absence of demonstrable market failures such as unequal bargaining power or concrete infirmities such as diminished capacity, evaluates the validity of their choices largely based on their objective manifestation of assent. On the other hand, courts readily impinge on freedom of contract when assessing the validity of agreed (liquidated) damages clauses.⁷⁸

If the promisee paid a premium for an agreed damages provision that is greater than actual damages and the promisor understood the significance of agreeing to the term, just compensation, arguably, would entail enforcing the provision. In fact, in the context of fair bargaining between business people, courts sometimes find palatable (and enforceable) provisions that amount to penalties, such as “take or pay” contracts in which purchasers of natural gas agree to pay regardless of whether they take the gas.⁷⁹

⁷⁸ Hillman, *The Limits of Behavioral Decision Theory in Legal Analysis: The Case of Liquidated Damages*, 85 *Cornell L. Rev.* 717, 718-719, 726-728, 738 (2000).

⁷⁹ *Id.*

Restitution Interest

Mainly Unjust Enrichment⁸⁰

Restitution interest unites two elements: (1) reliance by the promisee, and (2) a resultant gain to the promisor.⁸¹

Problem 3-15

Ajax Construction Company agreed to construct a restaurant for Hal Evans on his land for \$350,000. After Ajax had spent \$105,000 in preparation and part performance, only \$5,000 of which was salvageable, Hal repudiated the contract because of a lack of funds. The cost of completing construction would have been \$255,000. The partial performance increased the value of Hal's land by \$100,000. Hal can hire another contractor to complete the work for \$270,000. Ajax received no progress payments. Ajax's president, Turlway, has asked you how much the company can recover from Hal Evans. Turlway tells you that he has received a settlement offer of \$60,000. Should he accept the offer?⁸²

Restatement (Second) of Contracts § 371 | Measure of Restitution Interest

If a sum of money is awarded to protect a party's restitution interest, it may as justice requires be measured by either;

- (a) the reasonable value to the other party of what he received in terms of what it would have cost him to obtain it from a person in the claimant's position, or
- (b) the extent to which the other party's property has been increased in value or his other interest advanced.

Restatement (Second) of Contracts § 373 | Restitution When Other Party Is in Breach

(1) Subject to the rule stated in Subsection (2), on a breach by non-performance that gives rise to a claim for damages for total breach or on a repudiation, the injured party is entitled to restitution for any benefit that he has conferred on the other party by way of part performance or reliance.

(2) The injured party has no right to restitution if he has performed all of his duties under the contract and no performance by the other party remains due other than payment of a definite sum of money for that performance.

Realmark Developments, Inc. v. Ranson, W. Virginia, 2003

There may be cases (1) where the enhancement to the defendant's property will be far less than the quantum meruit value of the plaintiff's efforts or (2) where the value of the

⁸⁰ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 53-57 (1936)

⁸¹ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 53-57 (1936)

⁸² **Answer:** \$90,000 for expectancy. **\$100,000 for restitution.** \$270,000 if contract price had been paid.

enhancement greatly exceeds the cost of the improvements. Thus, the rule has evolved that the proper measure of damages in unjust enrichment should be the greater of the two measures.

The rule has evolved that the proper measure of damages in unjust enrichment should be the greater of the two measures⁸³; the enhancement is less than *quantum meruit* value of the plaintiff's efforts or the enhancement greatly exceeds the cost of the improvements.

United States for Use of Susi Contracting Co. v. Zara Contracting Co., Second Circuit, 1944

The promisee upon breach has the option to forego any suit on the contract and claim only the reasonable value of their performance.

The contract price or the unit price per cubic yard of a construction or excavation contract does not limit recovery. A plaintiff may well have completed the hardest part of a job for which an average cost had been set. With the breach fall all the other parts of the contract. Hence it is clear that plaintiffs are not limited to the contract prices in the situation disclosed here.

The measure of recovery by way of restitution, though often confused with recovery on the contract, should not be measured or limited thereby; but he does point out that the contract may be important evidence of the value of the performance to the defendant, as may also the cost of the labor and materials.⁸⁴

It is to be valued, not by the extent to which the defendant's total wealth has been increased thereby, but by the amount for which such services and materials as constituted the part performance could have been purchased from one in the plaintiff's position at the time they were rendered.⁸⁵

Oliver v. Campbell, California, 1954

One who is wrongfully discharged and prevented from further performance of their contract may elect as a general rule to treat the contract as rescinded, may sue upon a quantum meruit as if the special contract of employment had never been made and may recover the reasonable value of the services performed even though such reasonable value exceeds the contract price.

The remedy of restitution in money is not available to one who has fully performed their part of a contract, if the only part of the agreed exchange for such performance that has not been rendered by the defendant is a sum of money constituting a liquidated debt.

⁸³ Restatement (Second) of Contracts § 371, comment b.

⁸⁴ 5 Williston on Contracts, Rev. Ed. §§ 1482, 1483, 1485.

⁸⁵ Restatement (First) of Contracts § 347, comment c.

Losing Contracts

City of Philadelphia v. Triple, Pennsylvania, 1911

A plaintiff may recover from a defaulting defendant the cost of labor and materials less payments made, although such cost exceeds the price fixed in the contract.

Where the owners breached the contract by refusing to make required payments to builder, builder was entitled to recover the reasonable value of their services, but the contract price constituted a ceiling on their recovery of restitution. **Courts are divided over the question of whether restitution should be limited by the contract.**

Non-Breaching Plaintiff Conferred Benefit but Can't Prove Expectancy

Bausch & Lomb, Inc. v. Bressler, Second Circuit, 1992

A plaintiff must prove with a reasonable degree of certainty that any claimed loss of profits was caused by the defendant's breach.

Under reliance damages doctrine, a plaintiff may recover their expenses of preparation and of part performance, as well as other foreseeable expenses incurred in reliance upon the contract. However, alternative reliance measure of damages rests on the premise that the injured party's reliance interest is no greater than the party's expectation interest. Courts will not knowingly put the plaintiff [receiving a reliance recovery] in a better position than they would have occupied had the contract been fully performed.

Thus, a reliance recovery will be offset by the amount of any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been fully performed.⁸⁶

If the breaching party establishes that the plaintiff's losses upon full performance would have equaled or exceeded its reliance expenditures, the plaintiff will recover nothing under a reliance theory.

The doctrine of restitution is premised upon the equitable principle that a person who has been unjustly enriched at the expense of another is required to make restitution to the other.⁸⁷

⁸⁶ Quoting Restatement (Second) of Contracts § 349

⁸⁷ Quoting Restatement of Restitution § 1

The plaintiff may recover the reasonable value of services rendered, goods delivered, or property conveyed less the reasonable value of any counter-performance received.

Restitution is available even if the plaintiff would have lost money on the contract if it had been fully performed.

The reasonable value of the benefit unjustly received, not the contract price, determines the amount of an award in restitution. HOWEVER, the contract may provide probative evidence of the value of the benefit. Courts are split on this though.

In the absence of a readily available market price, the value that the parties ascribed to a benefit in their contract may be the best valuation measure available to the court.

Plaintiff Conferred Benefit but Contract is Unenforceable

Restitutionary relief may be granted to a party whose agreement is unenforceable.

Plaintiff Breaches after Conferring Benefit

A plaintiff who has committed an uncured material breach of contract cannot recover on a contract theory. Nevertheless, the plaintiff may have conferred a benefit on the defendant and it may be unjust for the defendant to retain the benefit, in whole or in part. In a proper case, our law permits such a plaintiff to have restitutionary relief premised on the prevention of unjust enrichment.

Problem 3-16

Assume that A contracts to make repairs to B's building in exchange for a promise by B to pay \$10,000 for this work. A expends \$8,000 making repairs but inadvertently fails to follow the specifications so that A does not substantially perform and therefore cannot recover their expectancy in contract. Assume that to correct the defects, a large portion of the repairs would have to be redone. Nevertheless, A's work has increased the value of the building by \$4,000. B can hire another contractor for \$9,000 to complete the work promised by A. B has not paid A anything. How much should A recover? \$8,000? \$4,000? \$1,000? Nothing? Does the unjust enrichment theory for imposing liability on B suggest an answer? Comment b to § 374 of the Restatement (Second) of Contracts, on restitution in favor of a party in breach, states:

Since the party seeking restitution is responsible for posing the problem of measurement of benefit, doubts will be resolved against them, and their recovery will not exceed the less generous of the two measures stated in § 371, that of the other party's increase in wealth. *** If no value can be put on this, they cannot recover. *** Although the contract price is evidence of the benefit, it is not conclusive. However, in no case will the party in breach

be allowed to recover more than a ratable portion of the total contract price where such portion can be determined.

Do you agree with the approach of the Restatement?

Secondary Sources:

Even in those cases where the promisor's gain results from the promisee's reliance it may happen that damages will be assessed somewhat differently, depending on whether we take the promisor's gain or the promisee's loss as the standard measurement.⁸⁸

The bulk of the work of **quantum meruit** is in the field of quasi-contractual liabilities [unjust enrichment]. One cannot speak of the law of restitution without confronting the many mysteries of the idea of quantum meruit. It is a restitution which, almost without exception, restores the status quo by awarding a claimant the reasonable market value of their performance, not by forcing the defending party to disgorge benefit unjustly retained. The essence of the quantum meruit count is an allegation of indebtedness for the labor and services of the plaintiff, "done and bestowed at the request of" the defendant, who, being so indebted, in consideration thereof promised the plaintiff to pay him on request.

A claim in quantum meruit authorizes a court to alter the parties' basic risk allocation.

An injured party who has performed in part will usually prefer to seek damages based on their expectation interest instead of a sum of money based on their restitution interest because such damages include their net profit and will give them a larger recovery. Even if they cannot prove what their net profit would have been, they will ordinarily seek damages based on their reliance interest, since this will compensate them for all of their expenditures, regardless of whether they resulted in a benefit to the party in breach. In the case of a contract on which they would have sustained a loss instead of having made a profit, however, their restitution interest may give them a larger recovery than would damages on either basis. The right of the injured party under a losing contract to a greater amount in restitution than they could have recovered in damages has engendered much controversy. The rules entitle them to such recovery even if the contract price is stated in terms of a rate per unit of work and the recovery exceeds that rate.⁸⁹

⁸⁸ The Reliance Interest in Contract Damages, Fuller & Perdue, 46 Yale LJ 52, 53-57 (1936)

⁸⁹ Restatement (Second) of Contracts § 373, comment d.

Specific Performance

Restatement (Second) of Contracts § 363 | Effect of Insecurity as to the Agreed Exchange

Specific performance or an injunction may be refused if a substantial part of the agreed exchange for the performance to be compelled is unperformed and its performance is not secured to the satisfaction of the court.

Kitchen v. Herring, Supremes of North Carolina, 1851

Land cannot be taken to pay debts until the personal property is exhausted. Contracts concerning land must be in writing.

Land is assumed to have a peculiar value, so as to give an equity for specific performance, without reference to its quality or quantity. In regard to other property, less favored, a specific performance will not be decreed, unless there be peculiar circumstances; for, if with the money, an article of the same description can be bought in market – corn, cotton, etc., the remedy at law is adequate.

According to the general view today, a vendee of land is entitled to specific performance (absent a defense). The theory is that land is inherently unique and thus damages cannot be an adequate remedy. In addition to specific performance, the vendee can also recover money damages for any delay.⁹⁰

Curtice Brothers Co. v. Catts, New Jersey, 1907

Taking into account the discretionary nature of the jurisdiction an agreement for the sale of land is prima facie presumed to come within their operation, so as to be subject to specific performance, but a contrary presumption exists in regard to agreements concerning chattels.

Notwithstanding the distinction between personal contracts for goods and contracts for lands is to be found laid down in the books, as a general rule; yet there are many cases to be found where specific performance of contracts, relating to personality, have been enforced in chancery; and courts will only view with greater nicety contracts of this description than such as relate to land.

Curran v. Barefoot, North Carolina, 2007

The remedy for a breach of contract for the sale of personal property is an action at law, where damages are awarded. However, there are recognized exceptions. Jurisdiction to enforce specific performance rests, not on the distinction between real and personal property, but on the ground that damages at law will not afford a complete remedy.

⁹⁰ CB414; *Daves v. Potter*, Washington, 1998

UCC § 2-716: Buyer's Right to Specific Performance or Replevin

1. Specific performance may be decreed where the goods are unique or in other proper circumstances.
2. The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

In Re Dorsey Trailer Co., Inc., Alabama, 2009, UNPUBLISHED

One of the ways a buyer may recover goods is specific performance which may be decreed where the goods are unique or in other proper circumstances. A more liberal test in determining entitlement to specific performance has been established than the test one must meet for classic equitable relief.

Uniqueness is not the sole basis of the remedy under UCC 2-716 for the relief may also be granted in other proper circumstances and inability to cover is strong evidence of other proper circumstances. The scarcity of a chattel has been recognized as an important factor in determining whether specific performance of a contract for its sale will be granted.

Basically, courts now determine whether goods are replaceable as a practical matter – for example, whether it would be difficult to obtain similar goods on the open market.

In Re IBP, Inc. Shareholders Litigation, Delaware, 2001

An acquirer argues that it cannot be made whole unless it can specifically enforce the acquisition agreement, because the target company is unique and will yield value of an unquantifiable nature, once combined with the acquiring company.

This court has not found any compelling reason why sellers in mergers and acquisitions transactions should have less of a right to demand specific performance than buyers.

Secondary Sources:

Decrees for specific performance are enforced differently from decrees or judgements for damages. This process is in accordance with an elaborate scheme of rules, *mostly statutory*.⁹¹

The plaintiff may initiate a show-cause proceeding in which the defendant must show cause why they should not be cited for contempt of the court's decree and subjected to imprisonment or a fine when the defendant refuses to obey a specific performance decree.

⁹¹ CB419

The risk of non-persuasion in such a proceeding typically rests on the defendant, who sometimes must meet a standard of proof that is somewhat higher than a preponderance of the evidence yet is below beyond a reasonable doubt. The usual theory of such imprisonment is not punitive. Rather, it is to coerce the defendant to comply. One of several limitations on a court's power to imprison for contempt is the constitutional or statutory prohibition (in most states) against imprisonment for nonpayment of debt.

A second sanction for contempt is a fine. Not punitive but to coerce.

Defenses to Specific Performance

When a defense or limitation is applicable to bar specific performance, the plaintiff may still usually recover any damages for contractual breach.

The grounds of unfairness (many of which overlap) include (1) sharp practices, (2) unfair advantage taking, (3) non-disclosure, (4) post contractual unconscionability, (5) inadequacy of consideration, (6) mistake, (7) misrepresentation, (8) duress, (9) undue influence, (10) lack of mutuality of performance⁹², (11) indefiniteness of the agreement, (12) impracticability of performance, and the like.

(11) In order for a contract to be so certain and unambiguous in its terms and in all its parts that a court can require the specific thing contracted for to be done. A contract may not be invalid on this ground, yet be too indefinite to serve as the basis for a decree of specific performance.

(12) It must be conceded that the items of renovation and construction work are numerous and noticeably diversified. Moreover, by their nature, they are such as to render their actual performance and accomplishment provocative of frequent disputes. The difficulty in supervision that would be necessary is obvious.

Courts will not grant specific performance of a contract to provide personal services.

⁹² See Restatement (Second) of Contracts § 363, page 35 above.

Punitive Damages

Restatement (Second) of Contracts § 355 | Punitive Damages⁹³

Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.⁹⁴

Exceptions being,⁹⁵

- 1) Tort
- 2) Marriage
- 3) Public company with monopoly or quasi-monopoly failing to discharge its obligations to the public
- 4) Breach of fiduciary duty
- 5) Fraud
- 6) Bad faith refusal of insurance company to settle an insurance claim for which it is liable

⁹³ Restatement (Second) of Contracts § 355

⁹⁴ Relevant to IIED in contracts, class 10-26

⁹⁵ CB341

Defenses of a Contractual Breach

When parties satisfy the requirements of a theory of obligation, prima facie duties arise. But a party with such a duty may have one or more defenses, thus ultimately owe no duty at all (or a lesser duty). Such defenses may be grouped into two broad categories: (1) those arising pursuant to “policing doctrines” – defenses involving either grossly unfair terms or overreaching by one party at the bargaining or promising state (or both), and (2) other full or partial defenses such as those based on changed circumstances after making an agreement or promise.

Policing Doctrines

Policing doctrines fall into two basic categories: (i) those addressed to the existence and quality of assent, and (ii) those concerned with the content of the agreement or promise.

(i) Assent oriented defenses such as duress, misrepresentation, and nondisclosure, show the lack of a valid agreement or promise. Others focus on the substantive content of an agreement or promise rather than on the quality of assent. Doctrines such as inequality of the exchange, public policy, mutuality of obligation, and substantive unconscionability all focus on the substantive terms of the exchange.

Policing doctrines sometimes generate affirmative claims for damages, as well as serve as defenses. For example, a misrepresentation may not only provide a defense to a breach of contract claim but may also generate a cause of action for damages in tort.

Duty to Read Rule: *Most courts today generally adhere to the common law doctrine that a party who signs a contract, understandable to a reasonable person, is bound by its terms regardless of whether they read or understood those terms. By signing the agreement, a party manifests assent to the agreement.*

The same rule applies even without a signature if the acceptance of a document which purports to be a contract implies assent to its terms.

Exception: *If a party was the victim of fraud, or was unfairly induced to sign an agreement, or if certain terms of the agreement were not truly understandable, courts usually have no problem finding an exception to the duty to read rule.*

Courts apply policing doctrines in light of the nature of the transaction involved. For example, the problem of policing fully-negotiated agreements is very different from policing standardized form contracts. And policing a transaction between a merchant and a consumer is very different from policing between two business entities.

UCC § 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. *Say unconscionable one more time, please.*
- (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.

UCC § 2-316: Exclusion or Modification of Warranties

- (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol[e] or extrinsic evidence (§ 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.
- (2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that “there are no warranties which extend beyond the description on the face hereof.”
 - (3) Notwithstanding subsection (2):
 - a. Unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like “as is”, “with all faults”, or other language which in common understanding calls the buyer’s attention to the exclusion of warranties and makes plain that there is no implied warranty; and
 - b. When the buyer before entering into the contract has examined the goods or the sample or model as fully as they desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to them; and
 - c. An implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.
- (4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (§§ 2-718 & 2-719).

(i) Duress

Restatement (First) of Contracts § 492: Duress and Undue Influence

Duress in the Restatement of this subject means:

- (a) any wrongful act of one person that compels a manifestation of apparent assent by another to a transaction without their volition; OR
- (b) any wrongful threat of one person by words or other conduct that induces another to enter into a transaction under the influence of such fear as precludes them from exercising free will and judgment, if the threat was intended or should reasonably have been expected to operate as an inducement.

Comment F: Not only must fear be produced in order to constitute duress of the second type but the fear must be a cause inducing entrance into a transaction, and though not necessarily the sole cause, it must be one without which the transaction would not have occurred.

Restatement (First) of Contracts § 493: Methods of Exercising Duress

Duress may be exercised by:

- (a) personal violence or a threat thereof; OR
- (b) Imprisonment, or threat of imprisonment, except where the imprisonment brought about or threatened is for the enforcement of a civil claim, and is made in good faith in accordance with law; OR
- (c) Threats of physical injury, or of wrongful imprisonment or prosecution of a husband, wife, child, or other near relative; OR
- (d) Threats of wrongfully destroying, injuring, seizing, or withholding land or other things; OR
- (e) Any other wrongful acts that compel a person to manifest apparent assent to a transaction without their volition or cause such fear as to preclude them from exercising free will and judgement in entering into a transaction.

Machinery Hauling, Inc. v. Steel of West Virginia, W. Virginia, 1989

Future expectancy is not a legal right on which the plaintiff can anchor a claim of economic **duress**. There appears to be general acknowledgement that duress is not shown because one party to the contract has driven a hard bargain or that market or other conditions now make the contract more difficult to perform by one of the parties or that financial circumstances may have caused one party to make concessions.

S.P. Dunham & Company v. Kudra, New Jersey, 1957

Courts have rejected the objective test that **duress** is irremediable unless it is of such severity as to overcome the will of a person of ordinary firmness. **THE TEST NOW is:**

has the person complaining been constrained to do what they otherwise would not have done?

A person cannot claim to have made a payment under duress if, before they made the payment, there was available to them an immediate and adequate remedy in the courts to test or resist it. **This harsh rule has been rejected by the Restatement (First) of Contracts § 493.** See page 42.

One person cannot claim to have been placed under duress if they pay money to the defendants for the relief of another person.

Problem 5-1⁹⁶

In which of the following factual situations, if any, would you advise the party subject to the pressure that they could make out a case of duress?

- A. The vendors at Yankee Stadium, realizing that they have a captive audience, mark up the cost of refreshments by 200%.
- B. Vendors sell water in the middle of the desert for \$50 per glass more than otherwise realizable to persons literally dying of thirst.
- C. Gasoline stations during an oil supply shortage mark up the price of gasoline by 200%.
- D. A supplier of construction materials, with knowledge that X has entered into a contract with Y to build a warehouse and that X cannot get supplies in time from anyone but the supplier, marks up the price by 200%.

Most states have enacted price gouging statutes. Generally, these apply only if the state has declared a state of emergency and a vendor charges an unconscionable or excessive and unjustified price.

(i) Undue Influence

*Undue influence has been defined as undue susceptibility of one party and excessive pressure placed on that party by another. The pressure must be exerted by a person enjoying a **special relationship** with the victim that makes the victim especially susceptible to the pressure.*

*The pattern usually involves several of the following **elements**: (1) discussion of the transaction at an unusual or inappropriate time, (2) consummation of the transaction in an unusual place, (3) insistent demand that the business be finished at once, (4) extreme emphasis on untoward consequences of delay, (5) the use of multiple persuaders by the dominant side against a single servient party, (6) absence of third-party advisers to the servient party, and (7) statements that there is no time to consult financial advisers or attorneys.*

⁹⁶ **Answer:** None of the above.

(i) Misrepresentation, Concealment, and the Duty to Disclose

*A contracting party has a duty **not to mislead** the other.*

Bates v. Cashman, Massachusetts, 1918

A person seasonably may rescind a contract to which they have been induced to become a party in reliance upon false though innocent misrepresentations respecting a cognizable material fact made of their own knowledge by the other party to the contract.

Holcomb v. Hoffschneider, Iowa, 1980

A buyer cannot generally be held to be able to judge the contents of a parcel of land by the eye. Even though a buyer examines land before purchasing, they may normally rely upon the representations of the seller as to measurement.

The Benefit-of-the-Bargain Rule: A defrauded purchaser is entitled to the difference between the value the property would have had as represented and the value of the property they actually received.

A recovery of exemplary or **punitive damages** in an action based on fraudulent sale will be allowed **ONLY WHERE** the fraud is an aggravated one, as where it is malicious, deliberate, gross, or wanton.

Weintraub v. Krobatsch, New Jersey, 1974

Silence may be fraudulent and relief may be granted to one contractual party where the other suppresses facts which they, under the circumstances, are bound in conscience and duty to disclose to the other party, and in respect to which they cannot, innocently, be silent.

If either party to a contract of sale conceals or suppresses a material fact which they are in good faith bound to disclose, then the silence is fraudulent.

Minor conditions which ordinary sellers and purchasers would reasonably disregard as of little or no materiality in the transaction would clearly not call for judicial intervention.

(ii) Public Policy

Exculpatory Clauses and Non-Compete Clauses

Even arm's length transactions without any duty of explanation may be unenforceable on public policy grounds. A decision overturning contract terms because of their content alone tests the limits of freedom of contract and, if carried too far, threatens the sanctity of contract. A decision

based not only on objectionable content but also on insufficiency of assent is therefore generally more acceptable.⁹⁷

Exculpatory Clauses

McCutcheon v. United Homes Corp., Washington, 1971

One who leases a portion of their premises but retains control over the approaches, common passageways, stairways, and other areas to be used in common by the owner and tenants, has a duty to use reasonable care to keep them in safe condition for use of the tenant in their enjoyment of the demised premises.

A bargain for exemption from liability for the consequences of negligent not falling greatly below the standard established by law for the protection of others against unreasonable risk of harm, is legal.⁹⁸

In the landlord-tenant relationship, it is extremely meaningful to require that a landlord's attempt to exculpate itself from liability for the result of their own negligence, not fall greatly below the standard of care set by law. However, a clause which exculpates the lessor from liability to its lessee, for personal injuries caused by lessor's own acts of negligence, not only lowers the standard imposed by the common law, it effectively destroys the landlord's affirmative obligation or duty to keep or maintain the common areas in a reasonably safe condition for the tenant's use.

Henderson v. Quest Expeditions, Tennessee, 2005

Exculpatory agreements in the recreational sports context do not implicate the public interest.

It is well settled [in this state] that **parties may contract that one shall not be liable for their negligence to another but that such other shall assume the risk incident to such negligence**. Further, it is not necessary that the word 'negligence' appear in the exculpatory clause and the public policy of Tennessee favors freedom to contract against liability for negligence. The latter is a split among states and is jurisdictionally determined.

An **exception** to this rule was recognized by the Supreme Court in *Olson v. Molzen*, wherein the Court held that certain **relationships** required greater responsibility which would render such a release "obnoxious." Where the public interest would be affected by an exculpatory provision, such provision could be held invalid.

The six criteria set forth in *Tunkl*:

(1) It concerns a business of a type generally thought suitable for public regulation.

⁹⁷ CB652

⁹⁸ Quoting Restatement (First) of Contracts § 574

- (2) The party seeking exculpation is engaged in performing a service of great importance to the public, which is often a matter of practical necessity for some members of the public.
- (3) The party holds themselves out as willing to perform this service for any member of the public who seeks it, or at least for any member coming within certain established standards.
- (4) As a result of the essential nature of the service, in the economic setting of the transaction, the party invoking exculpation possesses a decisive advantage of bargaining strength against any member of the public who seeks their services.
- (5) In exercising a superior bargaining power the party confronts the public with a standardized adhesion contract of exculpation, and makes no provision whereby a purchaser may pay additional reasonable fees and obtain protection against negligence.
- (6) As a result of the transaction, the person or property of the purchaser is placed under the control of the seller, subject to the risk of carelessness by the seller or their agents.

Not all of the factors have to be present in order to invalidate an exculpatory agreement, but generally, the factors are limited to circumstances involving a contract with a profession, as opposed to tradespeople in the marketplace.

Doctor-patient and home buyers-inspectors enjoy this kind of relationship.

An exculpatory provision which specifically and expressly releases a defendant from its own negligence will be upheld, without regard to whether the injury sustained is one typically thought to be **inherent in the sport**. However, **there is a split of authority** among the states regarding whether the word ‘negligence’ is even required to be present in the exculpation clause for the provision to be construed as releasing the defendant from its own negligence.

Non-Compete Clauses

Karpinski v. Ingrasci, New York, 1971

Since there are powerful considerations of public policy which militate against sanctioning the loss of a person’s livelihood, the courts will subject a covenant by an employee not to compete with their former employer to **an overriding limitation of reasonableness**.

Such covenants by physicians are, if reasonable in scope, generally given effect. It is firmly established doctrine that a member of one of the learned professions, upon becoming assistant to another member thereof, may, **upon a sufficient consideration, bind themselves not to engage in the practice of their profession upon the termination of their contract of employment, within a reasonable territorial extent**, as such an agreement is not in restraint of trade or against public policy.

Each case must depend on its own facts. It may well be that a restriction not to conduct a profession or a business in two counties or even one, may exceed permissible limits.

It is settled that such a covenant will not be stricken merely because it contains no time limit or is expressly made unlimited as to time.

It is not reasonable for a person to be excluded from a profession for which they have been trained when they do not compete with their former employer by practicing it.

Courts and commentators explicitly recognize a court's power of severance and divisibility in order to sustain the covenant insofar as it is reasonable. If in balancing the equities the court decides that the employee's activity would fit within the scope of a reasonable prohibition, **it is apt to make use of the tool of severance, paring an unreasonable restraint down to appropriate size and enforcing it.**

The mere inclusion of a covenant of **a liquidated damages provision does not automatically bar the grant of an injunction.**

Dwyer v. Jung, New Jersey, 1975

Lawyer restrictive covenants are to be distinguished from noncompetitive covenants incident to the sale of a business where the covenants are designed to protect the good will of the business for the benefit of the buyer. A lawyer's clients are neither chattels nor merchandise, and their practice and good will may not be offered for sale.

Nor may lawyer restrictive covenants, whether contained in a partnership agreement or an agreement of employment, be classified within the general category of agreements restricting post-employment competition. The usual employee restrictive covenant is a legitimate device to protect the business and good will of an employer against various forms of unfair competition.

Although not freely as enforceable as a seller's noncompetitive agreement, such restrictive covenants will nevertheless be given effect if it is reasonable under all of the circumstances. **It will generally be found to be reasonable where it simply (1) protects the legitimate interests of the employer, (2) imposes no undue hardships on the employee, and (3) is not injurious to the public.**

Commercial standards may not be used to evaluate the reasonableness of lawyer restrictive covenants. Strong public policy considerations preclude their applicability.

DR 2-108(A) of the Disciplinary Rules of the Code of Professional Responsibility of the American Bar Association:

A lawyer shall not be a party to or participate in a partnership or employment agreement with another lawyer that restricts the right of a lawyer to practice law after the termination of a relationship created by the agreement except as may be provided in a bona fide retirement plan and then only to the extent reasonably necessary to protect the plan.

The insertion of a restrictive covenant in a law partnership agreement is an attempt to control and divide the “**client market**” by means other than individual performance.

Quant’s Wholesale Distributors, Inc. v. Giardino, New York SD, 1982

Non-compete covenants will be enforced only if reasonably limited temporally and geographically and then only to the extent necessary to protect the employer from employee’s use or disclosure of **trade secrets or confidential customer lists**.

Problem 5-4

Faces Boutique, a facial spa on Hilton Head Island, offered skin care and face lifts to its customers. Faces hired Deborah Ann Gibbs as an esthetician to give facials to customers. Under South Carolina law, an esthetician is “any person who is licensed to practice skin care, make up, or similar work. Skin care shall be limited to moisturizing, cleansing, or facial or neck massages for the sole purpose of beautifying the skin.” The parties’ contract included a covenant not to compete:

For a period of three years after the termination of this agreement, the Employee will not, **WITHIN THE TOWN OF HILTON HEAD ISLAND**, directly or indirectly, own, manage, operate, control, be employed by, participate in, or be connected in any manner with the ownership, management, operation, advertisement, or control of any business in direct competition with the type of business conducted by Faces. It is understood and agreed that this prohibition applies to **FACIALS, SELLING OF COSMETICS, AND ALL COSMETIC APPLICATION OR FACIAL SPA RELATED SERVICES**.

After a maternity leave, Gibbs returned to work as a manicurist at Tara’s, a Hilton Head beauty salon. S. Carolina law defines a manicurist as “any person who is licensed to practice manicuring or pedicuring the nails or similar work.” Faces sought to enforce the covenant not to compete on the theory that Tara’s also offered facials. At trial, the owner of Faces argued that Gibbs violated the covenant by taking employment at a competitor even though Gibbs was not giving facials. The owner also testified that “she would not attempt to enforce the clause in a manner which would exceed the ‘spirit’ of the agreement”. Please decide the case.⁹⁹

Secondary Sources:

Most courts follow the admonition to leave the parties where it finds them, meaning that courts will not enforce illegal contracts even if defendants have already gained from them.

⁹⁹ **Answer:** What a joke. Invalid.

Unconscionability

*The paradigm case for finding unconscionability involves both bargaining naughtiness, characterized as procedural unconscionability, and grossly unfair terms, characterized as substantive unconscionability.*¹⁰⁰

Ryan v. Weiner, Delaware, 1992

Contracts or transfers induced by fraudulent misrepresentation can be avoided. Similarly, a lack of legal capacity or the existence of duress can lead a court to declare a promise unenforceable or a transfer voidable.

The adequacy or fairness of the consideration that adduces a promise or a transfer is not alone grounds for a court to refuse to enforce a promise or to give effect of a transfer.¹⁰¹

Mere inadequacy of price will not invalidate a contract or a transfer. But as standard as that generalization is, it has not precluded courts, on occasion, from striking down a contract or transfer that amounts to inequitable or oppressive conduct. **The rule that courts will not weigh consideration or assess the wisdom of bargains, has not fully excluded the opposite proposition, that at some point, courts will do so even in the absence of actual fraud, duress, or incapacity.** Courts have invoked this doctrine with extreme reluctance and then only when all of the facts suggest a level of unfairness that is unconscionable.

UCC § 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.

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.

When one with substantially greater knowledge, experience, and resources seeks out the powerless to deal with them directly on matters of vital importance, they assume

¹⁰⁰ Professor Arthur Leff; CB692

¹⁰¹ Corbin on Contracts § 127

some responsibility to assure, to the extent circumstances permit, that they do understand the nature of the transaction proposed. If they do not do this and if the transaction they initiate is oppressive and shockingly one-sided, they cannot retain the bargain.

Industralease Automated & Scientific Equipment Corp. v. R.M.E. Enterprises, Inc., NY, 1977

The original concept was broad: An unconscionable contract was one such as no person in their senses and not under delusion would make on the one hand, and as no honest and fair person would accept on the other. The test has been more sharply defined 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, and characterized by a gross inequality of bargaining power.

UCC § 2-316: Exclusion or Modification of Warranties

See page 41.

UCC § 1-102: Scope of Article

This Article applies to transaction to the extent that it is governed by another Article of the Uniform Commercial Code.

UCC § 2-313: Express Warranties by Affirmation, Promise, Description, Sample

- (1) Express warranties by the seller are created as follows:
- a. Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
 - b. Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
 - c. Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.
- (2) It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that they have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller’s opinion or commendation of the goods does not create a warranty.

UCC § 2-314: Implied Warranty, Merchantability, Usage of Trade

- (1) Unless excluded or modified (§ 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section, the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as:

- a. Pass without objection in the trade under the contract description; and
- b. In the case of fungible goods, are of fair average quality within the description;
and
- c. Are fit for the ordinary purposes for which such goods are used; and
- d. Run, within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and
- e. Are adequately contained, packaged, and labeled as the agreement may require;
and
- f. Conform to the promise or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (§ 2-316) other implied warranties may arise from course of dealing or usage of trade.

Dillman & Associates, Inc. v. Capitol Leasing Co., Illinois, 1982

Courts should not assume paternalistic attitude toward the parties to a contract by relieving one or another of them of the consequences of what is at worst a bad bargain, and in declaring the lease in issue here unconscionable, we would be doing exactly that.

The Uniform Commercial Code

Nonconforming Acceptance – UCC 2-714:

The cost of the contract is thrown out (for now) therefore we are looking at the value of the original contracted good of \$5,200 and the value of the nonconforming good that was accepted of \$4,600. The difference in value of what would have been delivered and what was delivered is \$600. You with me? Now, the cost of the K comes back in when the buyer has not paid anything yet. They can essentially deduct the damages of \$600 from the original K price of \$5,000, thus paying \$4,400. This meets the standards of expectancy as much as it can because the buyer is still gaining a \$200 value over the price they are paying for the good.

Aggrieved Buyer	Aggrieved Seller
Sub: Actual cover 2-712	Sub: Resale – 2-706 <i>Mentioned for Exam</i>
“” Hypo market 2-713	“” Hypo Market – 2-708(1)
No sub: Spec. perf. 2-716	No sub: Price – 2-709
“” Nonconforming accepted 2-714	“” Lost volume 2-708(2)

Jurisprudence of Contracts & The Contract Giants

Williston

Rules.

Fuller¹⁰²

Evidentiary Function: The most obvious function of a legal formality is that of providing evidence of the existence and purport of the contract, in case of controversy. The need for evidentiary security may be satisfied in a variety of ways – by (1) requiring a writing, or (2) attestation, or (3) the certification of a notary.

Cautionary Function: A formality may also perform a cautionary or deterrent function by acting as a check against inconsiderate action. Examples include a seal, a wax wafer, and to a lesser extent, writing, attestation, and notarization. The purpose is to provide a symbol in the popular mind of legalism and weightiness.

Channeling Function: The most useful analogy is that of language – one who wishes to communicate their thoughts to others must force the raw materials of meaning into defined and recognizable channels. Moving from thoughts to articulated words.

The rule that the plaintiff must after the defendant's breach take steps to mitigate damages tends to corroborate the suspicion that there lies hidden behind the protection of the expectancy a concern to compensate the plaintiff for the loss of the opportunity to enter other contracts. In seeking justification for the rule granting the value of the expectancy there is no need to restrict ourselves by the assumption that the rule can only be intended to cure or prevent the loss caused by reliance.

*Williston stickler for rules but understood facts and reason, Fuller parted in that he would leave the realm of rules before Williston would – Prof. Newell citing Fuller's autobiography, which is apparently quite dull.*¹⁰³

¹⁰² Contract and Related Obligation: Theory, Doctrine, and Practice Seventh Ed. Summers, Hillman, and Hoffman.

¹⁰³ Office Hours w/ Newell, 2 October 2017

Posner

Efficient Breach: The opportunity cost of completion to the breaching party is the profit that they would make from a breach, and if it is greater than his profit from completion, then completion will involve a loss to them. If that loss is greater than the gain to the other party from completion, breach would be value-maximizing and should be encouraged. And because the victim of the breach is made whole for their loss, they are indifferent.

Corbin

A promise conditional upon the promisor's **satisfaction** is not illusory since it means more than that validity of the performance is to depend on the arbitrary choice of the promisor. Their expression of dissatisfaction is not conclusive. That may show only that they have become dissatisfied with the contract, they must be dissatisfied with the performance, as a performance of the contract, and their dissatisfaction must be genuine.

One important exception [to consideration] consists of those performances that are required of the performer, exactly as rendered by him, by a **pre-existing legal duty**. The same is true of a promise to render such a performance.

If a contract or term thereof is **unconscionable** at the time the contract is made, a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.

If the mind of the court is certain that profits would have been made if there had been no breach by the defendant, there will be a greater degree of liberality in allowing the jury to bring in a verdict for the plaintiff, even though the amount of profits prevented is scarcely subject to proof at all. The trial court has a large amount of discretion in determining whether to submit the question of profits to the jury; and when it is so submitted, the jury will also have a large amount of discretion in determining the amount of its verdict.