CONTRACTS II: OUTLINE

§1: AVOIDING ENFORCEMENT

I. General Overview:

A. There are four main doctrines which allow for a party to avoid enforcement of a contract which has offer, acceptance, and consideration.

1. Incapacity.
2. Bargaining misconduct:
    a. Fraud,
    b. Duress,
    c. Undue Influence,
    d. Misrepresentation and non-disclosure.
3. Unconscionability.
4. Public Policy.

B. **G/R:** The plaintiff or defendant can assert any of the doctrines to avoid enforcement of the contract.

§1.1: Minority and Mental Incapacity.

I. Minority Doctrine

A. Cases: (1) *Dodson v. Shrader:* the P, a minor, sought to rescind a K for the sale of an automobile nine months after he purchased it because of mechanical failure and it was involved in an accident and the court allowed the P to rescind the K because he was a minor.

B. **G/R:** Minor Rule: contracts entered into by persons under the age of eighteen (18) are voidable at the election of the minor.

1. This is a bright line rule and is not determined on a case-by-case basis because a party to a contract is either 18 or he is not.
2. **Policy:** protect minors from losing money to adults who take unfair advantage of the minor's age.
3. **Exception:** Contracts entered into for necessaries are not voidable at the election of the minor.
    a. Necessaries include food, shelter, and clothing.
    b. **Policy:** if a minor was able to void a contract for necessaries, then merchants would be reluctant to sell merchandise to minors.

C. **G/R:** Affirmation Rule: once the minor reaches the age of majority (18 and over in most states) and continues to enjoy the benefit of a contract he entered into when he was a minor, the contract is affirmed upon reaching the age of majority and he loses the right to void the contract.

D. **G/R:** Classical Infant Rule: (majority view): Contracts of infants are not void, but only voidable and subject to be disaffirmed by the minor either before or after attaining the age of majority.

1. A minor can void a contract and all he has to do is return the good and then he receives his consideration back.
2. **Policy:** it is not hard for a merchant to check someone's age before entering into a contract with him or her.

E. **G/R:** Benefit Rule: (minority view #1): Contracts of infants are voidable, however, upon rescission, recovery of the full purchase price is subject to a deduction of the minor's use of the merchandise.

1. A minor can void a contract but must pay for the benefit he received from using the merchandise while in his possession.

F. **G/R:** Depreciation Rule: (minority view #2): Contracts of infants are voidable, however, the minor's recovery of the full purchase price is subject to a deduction for the minor's "use" of the consideration he received under the contract, or for the depreciation or deteriorations of the consideration while in his possession.

G. **G/R:** Modified Depreciation Rule: (Dodson Rule): where the minor: (1) has not been overreached in any way, (2) there has been no undue influence, (3) the contract is a fair and reasonable one, and (4) the minor actually paid money on the purchase price, the minor will not be permitted to recover the amount actually paid without allowing the vendor of the goods reasonable compensation for the use of, depreciation, and willful or negligent damage to the article purchased while in the minor's possession.

1. A minor's recovery form an adult will be reduced by the value of the benefit that the minor has received under the contract or the depreciation in the value of the property purchased by the minor.
    a. Upon rescission of the contract, recovery of the full purchase price is subject to a deduction for the minor's use of the merchandise.
2. **Exception:** if there has been any fraud or imposition on the part of the seller of if the contract is unfair, or any unfair advantage has been taken of the minor inducing him to make the purchase, then the rule does not apply.
    a. The contract must be made in good faith.
3. **Policy:** teaches the minor to take of property that he purchases and is fairer to merchants who acted in good faith.
    a. The modified depreciation rule will fully and fairly protect the minor against injustice or imposition, and at the same time will be fair to a business person who has dealt with such a minor in good faith.
    b. The rule is best adapted to modern conditions under which minors are permitted and do in fact transact a great deal of business for themselves.
    c. The rule also encourages honesty and integrity and helps prepare the minor for business dealings in the future.
    **[Dodson].

H. **Rst. (2) §14:** Infants: unless a statute provides otherwise, a natural person has the capacity to incur only voidable contractual duties until the beginning of the day before the person's 18th birthday.

1. **Comment *f:*** the minor is liable for the reasonable value of necessaries based on quasi-contractual relief rather than enforcement of the actual contract.
2. Even if the minor enters into a contract that does not involve necessaries the contract is not void but only voidable at the election of the minor.
3. Once the minor reaches the age of majority, he has the power to affirm the contract, in which event the minor is bound. Moreover, on reaching the age of majority, the minor must act within a reasonable period of time to disaffirm the contract or he will be deemed to have affirmed the transaction.

I. **G/R:** Minors are also able to disaffirm exculpatory agreements, such as binding prospective releases and post-injury settlement agreements.

J. **G/R:** Minor Misrepresentation Rule: If a minor misrepresents his age, it may not affect the contract and its voidability, however, the minor can be sued in tort for misrepresentation.

K. Courts are split on which of the above rules to use in considering contracts entered into by minors and the classical rule, benefit and depreciation rules, and modified depreciation rule are all used.

II. Mental Incapacity Doctrine

A. Cases: (1) *Hauer v. Union State Bank of Wautoma*: The P, who was at one time adjudicated mentally incompetent entered into a loan K with the D; after defaulting on the loan due to a third party spending her money, the P sought to rescind the K for lack of mental competency and the court allowed her to rescind the K because the knew or should have known she was mentally incompetent.

B. **G/R:** Incompetency Rule: an incompetent person's transactions are voidable—the incompetent has the power to void the contract entirely [Hauer].

1. A cause of action exists to rescind a contract or conveyance based upon the lack of mental competency *at the time of the transaction*.
2. The law presumes every adult person is competent until satisfactory proof to the contrary is presented.
3. The burden of proving incompetency is on the person seeking to rescind or void the contract.
4. **Policy:** (a) protects individuals with mental deficiencies so that they are not taken advantage of; and (b) doctrine of mutual assent: an incompetent person cannot assent and therefore there is no mutual assent for the contract.

C. **Tests for Determining Competency:**

1. Cognitive Test: (majority view): a person lacks capacity to enter into a contract if the person is unable to understand in a reasonable manner the nature of the transaction or its consequences [Rst. (2) §15(1)(a); Hauer].
    a. Almost any conduct may be relevant, as may lay opinions, expert opinions, and prior subsequent adjudications of incompetency.
    b. Competency must be determined on the date the instrument was executed.
2. Volitional Test: (minority view): a person lacks capacity to enter into a contract if the person is unable to act in a reasonable manner in the transaction and the other party has reason to know of the condition [Rst. (2) §15(1)(b)].
3. With mental incompetency, unlike the minority doctrine, the court will have to decide competency on a case-by-case approach.

D. **G/R:** A person does not have the capacity to enter into contracts if the person's property is under guardianship [Rst. (2) §13].

E. **G/Rs:** Remedies: (a) If the contract is made on fair terms and the other party has no reason to know of the incompetency, the contract ceases to be voidable where performance in whole or in part changes the situation such that the parties cannot be restored to their previous positions [Rst. (2) §15 cmt. f]. (b) A contracting party exposes itself to a voidable contract when it is put on notice or given a reason to suspect the other party's incompetence such that it would indicate to a reasonably prudent party that inquiry should be made into the other party's mental condition. That is, the contract can be voided if the contracting party knew of should have known the adhering party was incompetent [Rst. (2) §15(b)(1)]. (c) A contract is voidable due to mental incompetency and if the contract was made in good faith the parties must be returned to their pre-contract condition; however, if the competent party knew or should have known of the other party's mental incompetency then the parties *do not* need to be returned to their pre-contract condition.
    1. Courts are more apt to protect mentally incompetents (if the competent party acted in bad faith) and if the competent party acted in good faith the contract is not voidable.

§1.2: Duress and Undue Influence

I. Doctrine of Duress and Economic Duress

A. Cases: *Totem Marine v. Alyeska Pipeline:* The P entered into a K with D to haul pipeline from Texas to Alaska. The P experience many troubles in hauling the pipeline which caused delays then when P stopped to refuel in California the D unloaded the P's tug and cancelled the K. P settled with D for services rendered but claimed D forced them into settling by the use of economic duress and the court agreed.

B. Historically: Duress was a physical threat or use of force to compel an individual to sign a contract. The doctrine of duress gradually expanded to duress of goods and eventually to include economic duress.

1. Classical Rule: duress consists in unlawful confinement of another's person, or relatives, or property, which causes him to consent to a transaction through fear [Ordorizzi].

C. **G/R:** Duress: duress is 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 him from exercising free will and judgment, if the threat was intended or should be reasonably expected to operated as such an inducement [Rst. (1) §492(b)].

D. **Rst. (2) §175(1):** Elements of Duress: a contract is voidable when (a) one parties manifestation of assent is induced by an **improper threat**; (b) that leaves the party with **no reasonable alternative**.

1. Improper Threats: a threat is improper if:
   a. what is threatened is a crime or tort, or the threat itself would be a tort or crime if property was obtained;
   b. what is threatened is criminal prosecution;
   c. what is threatened is use of the civil process or made in bad faith; or
   d. the threat is a breach of the duty of good faith and fair dealing under a contract with the recipient.
   [Rst. (2) §176].

1(a). Improper Threats: it is not always improper to withhold payment or execution of the contract.

a. The element is satisfied where the alleged wrongdoers conduct is criminal or tortious but the act can be improper if it was wrong in a moral sense. Thus, a threat not to pay or fulfill a contract can be improper.

b. A threat to withhold payment of an admitted debt or a threat to breach a contract is an improper threat because implicit in such a threat is that it will be done in bad faith [Totem-Marine].

2. No Reasonable Alternative: a party has no reasonable alternative when adjudication under the circumstances is not a reasonable alternative and/or the party is in financial distress.

E. **G/R:** Elements of Economic Duress: (1) The party alleging economic duress must show he has been the victim of a wrongful or unlawful threat or act; and (2) such an act must be one which deprives the victim of his free will [Williston].

F. **Test for Economic Duress:** Economic duress exists where:

1. One party involuntarily accepted the terms of another;
2. Circumstances permitted no other alternative; and
3. Such circumstances were the result of coercive acts of another party.
   a. In order to demonstrate the other party used coercive acts the plaintiff must go beyond the mere showing of reluctance to accept and of financial

embarrassment. There must be a showing on the part of the defendant which produced those two factors.

b. The assertion of duress must be proven by evidence that the duress resulted from the defendant's wrongful or oppressive conduct and not by the plaintiff's necessities.

G. **G/R:** Financial Distress Rule: Financial distress alone is not enough to support a claim of economic duress; the other party MUST CAUSE the plaintiff's economic hardship [Selmer Co. v. Blakesless-Midwest Co.].

1. Courts often consider unequal bargaining power in determining if one party caused another's financial hardships, however, the elements of the restatement still must be met in order to prevail under economic duress.

H. **Policy:** (1) Against the economic duress rule: courts are reluctant to set aside agreements because of the notion of freedom of contract and because of the desirability of having private dispute resolution. (2) For the economic duress rule: there is an increasing recognition of the law's role in correcting inequitable or unequal exchanges between parties of disproportionate bargaining power and a greater willingness to not enforce agreements which were entered into under coercive circumstances.

II. Doctrine of Undue Influence

A. Cases: *Odorizzi v. Bloomfield School District:* The P was arrested on criminal charges for homosexuality and the school district superintendent and principle came to P's home and pressured him to sign a resignation contract. P signed the resignation but later, after the criminal charges were dropped, sought to rescind the contract because of undue influence.

B. **G/R:** Undue Influence: undue influence is used to describe persuasion which tends to be coercive in nature, persuasion which overcomes the will without convincing the judgment.

1. The hallmark of such persuasion is high pressure, a pressure which works on mental, moral, or emotional weakness to such an extent that it approaches the boundaries of coercion.

2. Misrepresentations of law or fact are not essential to the charge, for a person's will may be overborne without misrepresentation.

3. Undue influence includes taking unfair advantage of another's weakness of mind; or taking grossly oppressive and unfair advantage of another's necessities or distress.

4. A confidential, authoritative, or fiduciary relationship between the parties need not be present when the undue influence involves taking unfair advantage of another's weakness or distress.

a. Undue influence developed when one party breached a fiduciary relationship of trust. An employee/employer relationship is not fiduciary because there is no trust. In some jurisdictions still need to show that a fiduciary relationship exists.

**[Odorizzi]

C. **Elements of Undue Influence:** undue influence involves:
1. Unfair or excessive persuasion by a dominant party;
2. Over a vulnerable party who is susceptible to such persuasion.
**[Rst. (2) §177]

D. **G/R:** Factors that Indicate Unfair Persuasion:
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 (insistence on haste);
4. Extreme emphasis on the consequences of delay;
5. The use of multiple persuaders by the dominant side against one party;
6. Absence of third party advisers to the vulnerable party;
7. Statements that there is no time to consult financial advisers or attorneys.
*Only a number, but not all, of the factors need to be present for the court to infer undue influence.

a. Excessive Pressure: is an application of excessive strength by a dominant subject against a vulnerable party. Whether from weakness on one side, strength on the other, or any combination of the two, undue influence exists whenever there results that kind of influence of supremacy of one mind over another by which that other is prevented from acting according to his wish or judgment and whereby the will of the person is overborne and he is induced to do or forbear to do an act which he would not do, or would do, if he could act freely.

E. **G/R:** Vulnerable Parties: a vulnerable party exists by virtue of temporary circumstances or due to confidential relationship.
1. Vulnerability may consist of a total weakness of the mind which leaves a person entirely without understanding; or a lesser weakness which destroys the capacity of a person to make contract even though he is not totally incapacitated.
2. Vulnerability may be temporary and can exist due to age, physical condition, emotional anguish, or a combination of such factors.

§1.3: Misrepresentation and Non-Disclosure

I. Doctrine of Misrepresentation

A. Cases: *Syester v. Banta*: The P sued the defendant because D had misrepresented and used fraud to get her, an old widow, to buy more than three lifetimes worth of dancing lessons by telling her she would become a professional and that she had exemplary talent, which were basically not true.

B. **G/R:** Misrepresentation: a contract is voidable if a party's manifestation of assent is induced by either a *fraudulent* or a *material misrepresentation* by the other party upon which the recipient is justified in relying [Rst. (2) §164(1)].

C. **G/R:** Fraudulent or Material Misrepresentation:

1. **Fraudulent:** a misrepresentation is fraudulent if the maker intends his assertion to induce a party to manifest assent and the maker:

a. knows the assertion is not in accord with the facts;

b. does not believe in the truth of the assertion; and

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

*[Rst. (2) §162(1)]: looks at intent of person making misrepresentations.

2. **Material:** a misrepresentation is material if it would induce a reasonable person manifest assent, or the person making the misrepresentations knows the recipient will be likely to manifest assent.

*[Rst. (2) §162(2)]: does not look at intent.

D. **G/R:** The elements of the tort cause of action for misrepresentation are similar, but not exactly, the same as a contract misrepresentation claim. The elements for the tort cause of action for misrepresentation are:

1. The defendant made one or more representations to the plaintiff;
2. one or more of the statements were false;
3. the false statements or representations were as to material matters with reference to entering into the contract;
4. the defendant knew the representations were false;
5. the representations were made with the intent to deceive and defraud the plaintiff;
6. the plaintiff believed and relied upon the false representations and would not have entered into the contract, except for believing and relying upon the misrepresentations;
7. the plaintiff was damaged in some amount by relying on the representations.

E. **G/R:** Representations as Opinion or Fact: A statement of opinion amounts to a misrepresentation of fact if the person giving the opinion misrepresented his state of mind (i.e. stated that he held a certain opinion when in fact, he did not) [Rst. (2) §159 cmt. d].

1. An opinion is a belief about a fact; and a fact is something that can be proven to the jury.
2. Classical Rule: caveat emptor, the seller of an opinion could not be held liable for giving his opinion, he could only be held liable for a misrepresentation.
3. Modern Rule: A person cannot be held liable for an opinion, but some opinions can be held as facts [Rst. (2) §168].
4. Modern Rules: A statement of opinion amounts to an implied representation that the person giving the opinion does not know of any facts that would make the opinion false and that the person giving the opinion knows sufficient facts to be able to render the opinion [Rst. (2) §168(2)].
5. Modern Rule: A statement of opinion may be actionable if the one giving the opinion:

a. stands in a relationship of trust or confidence to the recipient (a fiduciary relationship);

b. is an expert on matters covered by the opinion; or

c. renders the opinion to one who, because of age or other factors, is peculiarly susceptible to misrepresentation [Rst. (2) §169].

II. Doctrine of Non-Disclosure

A. Cases: *Hill v. Jones:* The P sued the D to rescind a K for the sale of a home because the D misrepresented the value of the home by not disclosing the fact that there had been extensive termite damage to the property; although the D never came out and explicitly said that there was no termites in the home he still misrepresented the fact by not saying anything and because termite damage is ordinarily not visible the court found the D misrepresented the value of the home by non-disclosure and allowed the P to rescind the K.

B. **G/R:** Non-Disclosure Rule: A vendor has an affirmative duty to disclose material facts where:

1. disclosure is necessary to prevent a previous assertion from being a misrepresentation or from being fraudulent, or from being material [§161(a)];
2. disclosure would correct a mistake of the other party as to a basic assumption on which that is making the contract AND if non-disclosure amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing (the catch-all provision) [§161(b)];
3. disclosure would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part [§161(c); and
4. the other person is entitled to know the fact because of a relationship of trust and confidence [§161(d)].

*[Rst. (2) §161].

C. **G/R:** There are several factors a court should consider in deciding when fairness [under Rst. (2) §161(b)] requires disclosure of material information:

1. Bargaining power of the parties;
2. the relation that the parties bear to each other;
3. the manner in which the information was acquired (chance, effort, or criminal conduct);
4. the nature of the fact not disclosed (extrinsic versus intrinsic defects);
5. whether the person disclosing the information is the buyer or seller;
6. the nature of the contract itself (in releases and insurance contracts almost all information is material);
7. the importance of the fact not disclosed;
8. any conduct of the person not disclosing something to prevent discovery by the other party.

*[Keeton].

D. **G/R:** Material Facts Rule: a matter is material if it is one to which a reasonable person would attach importance in determining his choice of action in the transaction in question [Hill].

E. **G/R:** Home Seller Rule: A seller of a home has a duty to disclose material facts where:
1. Vendor has knowledge of the defect [subjective test as to seller's knowledge];
2. there is a material defect [a material defect is one that substantially affects the value of the home];
3. the defect is not readily apparent; and
4. the purchaser is unaware of the defect.
*[Hill].

E(1). **G/R:** Where the seller of the home knows of facts materially affecting the value of the property which are not readily observable and are not known to the buyer, the seller is under a duty to disclose them to the buyer [Florida and Arizona Rule].

E(2). **G/R:** Where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer [California Rule].

F. **G/R:** There is no general duty to disclose *all* information in a legal bargaining transaction.
1. A party may reasonably expect the other party to take normal steps to inform himself and draw his own conclusions [Rst. (2) §161 cmt. d].
2. Classical Rule: when two parties are of equal bargaining power there is not a duty to disclose all material information.
a. A party to a business transaction could not avoid the transaction because of non-disclosure of material information by the other party.
b. The vendee, or buyer, has not duty to disclose market conditions to the vendor, or seller, when both parties are merchants because marketplace conditions are available to anyone and therefore not really a material fact [Laidlaw v. Organ].
i. It seems to make a difference when the buyer, rather than the seller, is withholding information.

G. **G/R:** Under certain circumstances, non-disclosure of a fact known to one party may be equivalent to the assertion that the fact does not exist. When one conveys a false impression by the disclosure of some facts and the concealment of others, such concealment is, in effect, a false representation that what is disclosed is the whole truth [Hill].

H. **G/R:** Fiduciary Duty Rule: In the context of a confidential relationship, suppression of a material fact which a party is bound in good faith to disclose in equivalent to a false representation.
1. Once an attorney is in a client-attorney relationship fiduciary relationship, the attorney has a *higher* duty of disclosure than a normal individual because of the existence of a relationship of trust [Miller v. Sears].

I. **G/R:** Waivers of Non-disclosure Duty: any provision in a contract making it possible for a party thereto to free himself of his own fraud in procuring the execution of a contract is invalid and does not constitute a defense.

1. Parol evidence is always admissible to show fraud, and this is true, even though it has the effect of varying the terms of a writing between parties.

J. **Policy:** For Non-Disclosure Rule: Although the law of contracts supports the finality of transactions, over the years courts have recognized that under certain limited circumstances it is unjust to strictly enforce the policy favoring finality.

1. This policy is expressed in the law of fraudulent and negligent misrepresentations. Where a misrepresentation is fraudulent or where a negligent misrepresentation is one of material fact, the policy of finality gives way to the policy of promoting honest dealings between the parties [Rst. (2) §164(1)].

§1.4: Unconscionability

I. Doctrine of Unconscionability

A. Cases: *Williams v. Walker-Thomas Furniture Co.*: The P sued the D to rescind a K after all the products she had bought from D where repossessed when she fell behind on her payments for the fourth item she had purchased from the D claiming that the "add-on" clause in the contract for the purchase of a stereo was unconscionable and the court found the clause was unconscionable because of the business practices of the region.

B. **G/R:** Unconscionability: it has long been held as a matter of common law that unconscionable contracts are unenforceable.

1. UCC §2-302(1): If the court, as a matter of law, finds the contract or any clause of the contract to be unconscionable at the time it was made the court may:
    a. refuse to enforce the contract;
    b. sever the unconscionable clause and enforce the rest of the contract; or
    c. may limit the effect of the unconscionable clause to avoid an unconscionable result.
    **Applies only to contracts involving the sale of goods.
2. Rst. (2) §208: if a contract or term of the contract is unconscionable at the time the contract is made the court may:
    a. refuse to enforce the contract;
    b. sever the unconscionable clause and enforce the rest of the contract; or
    c. may limit the application of the unconscionable term to avoid an unconscionable result.
    **Applies to all types of contracts.

C. **Test for Unconscionability:** Two elements must be present (however it is a sliding scale) for the court to determine that a contract or clause of the contract was unconscionable:

1. Procedural Unconscionability: the absence of a meaningful choice by one of the parties; AND

2. Substantive Unconscionability: the terms of the contract are unreasonably favorable to one party.
*[Walker-Thomas].
**When looking at the "meaningful choice" element, it usually does not matter if the plaintiff should not have entered into the transaction.

D. **G/R:** Tests for Unconscionability: other tests of unconscionability that support, or can be used along with the *Walker-Thomas Test*:
1. 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 [UCC §2-302 cmt. 1].
2. Whether the terms are so extreme as to appear unconscionable according to the mores and business practices of the time and place [Corbin].
3. In determining reasonableness or fairness the primary concern must be with the terms of the contract considered in light of the circumstances when the contract was made [Walker-Thomas].

E. **G/R:** Factors for determining unconscionability: there are three main factors the court considers in determining whether a contract or term of a contract was unconscionable:
1. the manner in which the contract was entered into;
2. the meaningfulness of choice with respect to the bargaining power of the parties; and
3. whether the contract was a form contract.
*[Walker-Thomas].

F. **G/R:** Unconscionability is a matter of law to be determined by a judge, rather than a factual issue to be tried by the trier of fact.
1. Unconscionability is an equitable legal doctrine (matter of law) to be determined by the judge because it is used as a safety valve to make egregious contracts unenforceable.

G. **G/R:** Price Unconscionability: Excessive price may be a basis for unconscionability [Rst. (2) §208 cmt. c].
1. Generally, courts are very hesitant to overturn contracts on the basis of excessive price because consumers usually focus their attention on the price term and there is, more often than not, a meaningful choice for alternatives.
2. Exception: while courts usually do not assess the adequacy of consideration, a finding of gross inadequacy or failure of consideration, combined with other inequitable features, will justify equitable rescission of the agreement [Ahern v. Knecht].
a. Even where there is no actual fraud, courts will relive against hard and unconscionable contracts which have been procured by taking advantage of the condition, circumstances, or necessity of other parties. [Ahern].

§1.5: Public Policy

I. Public Policy Doctrine

A. Cases: (1) *Borelli v. Brusseau:* The P and D, a married couple, entered into a K when the D was sick and dying. D promised P eight pieces of property if she would care for him because he disliked hospitals and P agreed to take of him. P cared for D but when he died he only left her one piece of property and a small amount of money. P filed suit to have the K enforced but the court refused because the K was against public policy. (2) *R.R. v. M.H. & Another:* The P and D entered into a surrogacy K in which the D was supposed to give birth to the baby and give up all parental rights in consideration for money. After becoming pregnant D decided she wanted to keep the baby; and P sued to have the K enforced. The court refused holding that surrogacy agreements are void for public policy reasons.

B. **G/R:** Public Policy Rule: A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms [Rst. (2) §178(1)].

1. In weighing the interest in the enforcement of the term, account is taken of:
    a. the parties justified expectations;
    b. any forfeiture that would result if enforcement was denied;
    c. any special public interest in the enforcement of the term.
    *[Rst. (2) §178(2)(a)-(c)].
2. In weighing public policy against enforcement of a term, account is taken of:
    a. the strength of that policy as manifested by legislation or judicial decisions;
    b. the likelihood that a refusal to enforce the term will further that policy;
    c. the seriousness of any misconduct involved and the extent to which it was deliberate; and
    d. the directness of the connection between that misconduct and the term.
    *[Rst. (20§178(3)(a)-(d)].

C. **G/R:** Under the public policy doctrine, sometimes courts will not enforce a contract, or term thereto, because it is clearly against public policy. Some things are against public policy per se and clearly unenforceable because they are against public policy:

1. Contracts made illegally or involving illegal activity.
2. Unreasonable restraints of trade.
    a. In employee/employer relationship, contracts involving restraints of trade were held unenforceable because they were against public policy [Karlin v. Weinberg].
3. Public Policy is a means by which courts will not enforce the illegality of some action.
4. Sometimes a court will not enforce a contract on grounds of public policy even though, it is not illegal and the law recognizes freedom of contract, because there are some things the law will not enforce because it is detrimental to society.
    a. Ex: Surrogacy contracts, although surrogacy contracts are not illegal, a party cannot have the contract enforced by a court.

5. Public Policy doctrine is a balancing test between (a) freedom of contract and (b) public interests in the given action.

D. **G/R:** Marriage Contracts: A marriage contract differs from other contractual relationships because there exists a definite and vital public interest in reference to the marriage relation [Borelli].

1. Rule: personal performance of a personal duty created by the contract of marriage does not constitute a new consideration supporting the indebtedness of one marriage partner to another because it is against public policy as defined by statute (in most states) [Borelli].

a. There is a longstanding rule that a spouse is not entitled to compensation for support, apart from rights to community property and the like that arise from the marital relation itself. Performance of this duty does not constitute a new consideration for services rendered [Borelli].

2. Rule: A contract is unenforceable in which one spouse contracts to provide services that arise out of the marriage contract itself. A spouse has a pre-existing duty to provide care and support to the other spouse so therefore the contract lacks consideration.

a. Oral contracts for services rendered between spouses are even more susceptible to be void against public policy because if it is a "death-bed" gift there is a higher potential for fraud by the succeeding spouse. *[Borelli].

E. **G/R:** Surrogacy Contracts: A contract affecting the custody of a child is unenforceable on grounds of public policy unless it is consistent with the best interests of the child. This is consistent with the view that termination of parental rights in exchange for money is against public policy.

§2: JUSTIFICATION FOR NONPERFORMANCE

§2.1: Mistake

I. Overview of Mistake

A. Generally: There are two types of mistakes which the law recognizes which may justify nonperformance of a contract: (a) mutual mistake; and (b) unilateral mistake.

1. Usually, it must be a mutual mistake to justify nonperformance, and it is much harder to enforce a unilateral mistake.

2. Rescinding a contract on the basis of mistake is an uphill battle for the defendant because changed circumstances with respect to the contract is usually not a justification for nonperformance. In fact, that is why is the contract is entered into in the first place—to protect the parties against nonperformance in the event of changed circumstances.

II. Mutual Mistake Doctrine

A. Cases: *Lenawee County Board of Health v. Messerly:* A third party, the Pickles, sued D for mistake, inter alia. The Pickles purchased a tract of land with an apartment building on it from D; a few days later the Pickles went to visit the land and found raw sewage seeping up from the ground and shortly thereafter the County Board of Health condemned the land. The Pickles sued to rescind the K on the ground of mutual mistake because neither party knew that sewage was about seep out of the ground, however, the court found for D holding that the Pickles assumed the risk of a mistake when the signed the K with an "as is" clause.

A. **G/R:** Classical Mutual Mistake Rule: If there was a mutual mistake as to the nature of the item contracted for then the contract was rescindable, however, if there was a mutual mistake as to the value or quality of the item contracted for then the contract was not rescindable [Sherwood v. Walker (cow case)].

1. *Walker* case has been basically overruled, or at least limited to its specific facts, for the modern approach adopted by the Restatements.

B. **G/R:** Contractual Mistake: a contractual mistake is a belief that is not in accord with the facts [Rst. (2) §151].

1. The erroneous belief of one or both parties must relate to a fact in existence at the time the contract was executed.
2. The belief which is found to be in error may not be, in substance, a predication as to a future occurrence or non-occurrence.
3. A contract may be rescinded for mutual mistake of the parties but this remedy is granted at the discretion of the trial court.

C. **G/R:** Modern Mutual Mistake Rule: WHEN A MISTAKE OF BOTH PARTIES MAKES A CONTRACT VOIDABLE [Rst. (2) §152]:

1. Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party *unless* he bears the risk of the mistake under Rst. (2) §154 [Rst. (2) §152(1)].
2. In determining whether the mistake has a material effect on the agreed exchange of performances, account is taken of any relief by way of reformation, restitution, or otherwise [Rst. (2) §152(2)].

D. **G/R:** When a Party Bears the Risk of Mistake: [Rst. (2) §154]: A party bears the risk of mistake when:

1. the risk is allocated to him by agreement of the parties (such as signing an "as is" clause);
2. he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient (i.e. conscious ignorance); OR
3. the risk is allocated to him by the court on the ground that it is reasonable under the circumstances to do so.

*[Rst. (2) §154(a)-(c)].

E. **Mutual Mistake Test:** A contract is voidable for mutual mistake when:
1. There is a mistake of both parties;
2. at the time the contract was formed;
3. as to a basic assumption which;
4. material affects the agreed exchange of performances; AND
5. the affected party has not assumed the risk of mistake.
*[Messerly].

F. **G/R:** In a case of mistake between two innocent parties, the court has to determine which blameless party should assume the loss resulting for the mistake they shared. This can only be done by drawing upon the courts' own notions of what is fair and reasonable under the circumstances.

G. **Policy:** (1) As between two innocent parties; it is more fair that the party who assumes the risk should bear the loss; (2) courts are divided on whether boiler-plate "as is" clauses are sufficient to assume the risk in a purchasing contract; (3) it is sometimes more fair to shift the loss to the buyer because they have the ability to request a warranty on the inspected property; (4) under the Restatement, the courts considerations of what is fair and just play a role in allocating the loss.

II. Unilateral Mistake

A. Cases: *Wil-Fred's Inc. v. Metro Sanitary District:* The P and D entered into contract in which the D was a sub-contractor for a construction job that P was commencing and D was the lowest bidder for the job. Shortly after D submitted its bid, D withdrew it requesting to be released from the K and asking for the deposit back because D made a mistake in reliance on its sub-contractor's in making its bid (i.e. a mistake) and the court allowed the D to rescind the contract because the mistake, or error in bidding, occurred notwithstanding the exercise of reasonable care.

B. **G/R:** Unilateral Mistake: Relief will ordinarily not be granted if there is unilateral mistake by one party to the contract.

C. **G/R:** When a Mistake by One Party Makes a Contract Voidable: [Rst. (2) §153]: In addition to the elements of Rst. (2) §152 (except for mutuality) the party making the unilateral mistake must demonstrate two more elements [the elements that must be satisfied, including those from §152 are as follows]:
1. A contract is voidable due to unilateral mistake when:
    a. there is a mistake by one party [§153(1)];
    b. at the time the contract was formed [§152];
    c. as to a basic assumption which [§152];
    d. materially affects the agreed exchange of performances [§152];
    e. the effected party must not have assumed the risk of mistake [§152]; AND
    f. the effect of the mistake would be unconscionable (unconscionable means severe and unfair to the parties) [§153(a)]; OR

g. the other party had reason to know of the mistake OR the other parties' actions caused the mistake [§153(b)].

D. **Unilateral Mistake Test:** A party who makes a unilateral mistake must satisfy four conditions in order for the contract to be rescinded:

1. the mistake relates to a material feature of the contract;
2. the mistake occurred notwithstanding the exercise of reasonable care;
3. the mistake is of such grave consequences enforcement of the contract would be unconscionable (severe enough to cause substantial loss); and
4. the other party can be placed in the status quo (restored to its original position). *[Wil-Fred].

E. **G/R:** A mistaken parties fault in failing to know or discover the facts before making the contract does not bar him form avoidance or reformation of the contract; his conduct does not need to be non-negligent, it just cannot fall below the level of good faith and fair dealing [Rst. (2) §157].

§2.2: Changed Circumstances: Impossibility, Impracticability, and Frustration of Purpose.

I. Overview

A. Generally: the doctrines of impossibility, impracticability, and frustration of purpose deal with events that happen *AFTER* a contract is formed; whereas with the mistake doctrine the event has to be present at the time the contract was formed.

1. Ex: Two consumers enter into a contract for the sale of a ski store. Two hours before, unbeknownst to the parties the store is destroyed by an avalanche.
    a. In the aforementioned hypothetical the contract could be rescinded under the doctrine of mistake.
    b. Impracticability would come into play if the store was destroyed two hours after the contract was formed.
2. Assumption of risk is always a possibility and relevant in the doctrines.

II. Doctrine of Impossibility

A. Cases: *Taylor v. Caldwell*: P sued D for non-performance of a contract and breach because he relied on a contract to rent a music hall for promotional expenses related to a musical he was going to put on in the hall. However, before the scheduled musical the hall burned down. The court absolved D from liability holding that because the hall itself was "essential" to the performance of the contract and the parties had contracted on the basis of its continued existence.

B. **G/R:** Impossibility: When a thing, personal service, or specific good, is necessary for the performance of an agreement, or contract, and the parties contracted on the basis of its continued existence is destroyed or damaged, dies or is incapacitated, the duty of performance is excused.

C. **G/R:** Death or Incapacity of Person Necessary for Performance: If the existence of a particular person is necessary for the performance of a duty, his death or incapacity, which was *not* a basic assumption of the contract, excuses the duty of performance [Rst. (2) §262].

D. **G/R:** Destruction, Deterioration or Failure to Come into Existence of Thing Necessary for Performance: If the existence of a specific thing is necessary for the performance of a duty, its failure to come into existence, destruction, or such deterioration as makes performance impracticable, which was *not* a basic assumption of the contract, excuses the duty of performance [Rst. (2) §163].

E. **G/R:** Casualty to Identified Goods: Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party, to duty of performance is excused [UCC §2-613].

III. Impracticability

A. Cases: (1) *Karl Wendt v. International Harvester*: P sued D for breach of a "dealers agreement," a K entered into between P and D, in which D manufactured farm equipment and P sold the goods. After a recession in the agricultural industry D sold out to a third party, the third party fired P, and P sued D for breach of the dealer's agreement. D alleged it was impracticable to comply with the K because of market conditions and court held that changes in the market condition do not fall under the doctrine of impracticability. (2) *Harriscom Svenska v. Harris Corp (RF Systems)*: P entered into a K with D for the sale of certain radio parts. P was supposed to supply the parts to D who sold them to a company in Iran. The US government put an embargo on products being sold to Iran so P stopped supplying the parts to D. D sued for breach of K and court held that embargo was a supervening cause beyond P's control so his performance was excused under the K.

B. **G/R:** Impracticability: Even if performance is not literally impossible, a parties duty to perform may be excused when performance of the contract is substantially different from what the parties had contemplated at the time of contract making the performance impracticable [Mineral Park Land Co. v. Howard].

C. **G/R:** Discharge by Supervening Impracticability: where a contract is made a party's performance is made impracticable without his fault by the occurrence of an event (and the non-occurrence of the event was a basic assumption on which the contract was made) his duty to render that performance is discharged unless the language or circumstances indicate the contrary [Rst. (2) §261].

D. **G/R:** The doctrine of impossibility is a valid defense not only when performance is impossible, but also when supervening circumstances make performance impracticable [Karl Wendt].

E. **G/R:** Market Changes: The mere lack of profit under the contract is insufficient to raise the defense of impracticability. A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials or costs of construction, unless *well beyond* the normal range, do not amount to impracticability since it is this sort or risk that a fixed price contract is intended to cover [Rst. (2) §261 cmt. d].

1. A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either cause a marked increase in cost or prevents its performance altogether may bring the case within the impracticability doctrine [Rst. (2) §261 cmt. d].
2. In order for a supervening event to discharge a duty under the doctrine of impracticability the non-occurrence of that event must have been a basic assumption on which both parties made the contract. The shifts in the market or financial stability of one of the parties is ordinarily *not* a basic assumption so that mere market shifts or financial inability usually do not affect the duty of the party to perform under the contract [Rst. (2) cmt. b].

F. **G/R:** Governmental Orders: compliance with domestic or foreign governmental orders is a basis for excuse under the doctrine of impracticability (if the governmental regulation or order is an event the non-occurrence of which was a basic assumption of the contract) [Rst. (2) §264; Harriscom].

1. The UCC has a similar provision which makes specific mention of compliance in good faith with any applicable foreign or domestic governmental regulation or order as a basis for relief [UCC §2-615(a)].

G. **G/R:** Impracticability in a Contract for the Sale of Goods: UCC §2-615(a) excuses a seller from timely delivery of goods contracted for, where his performances has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting.

1. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance [§2-615 cmt. 4].
2. A rise or collapse in the market itself does not excuse performance under commercial impracticability because that is exactly the type of business risk which business contracts made at fixed prices are intended to cover [§2-615 cmt. 4].
3. A severe shortage of raw materials or supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either cause a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance is within the doctrine of impracticability [§2-615 cmt. 4].

H. **G/R:** Force Majeure Clauses: a force majeure clause is a clause that absolves one party from liability in the event of a force beyond its control, such as a greater irresistible force like acts of god, government intervention, war, riots, etc…and other things the parties agree to that will excuse nonperformance of the contract. The clause is usually

inserted in a contract to protect the parties in the event that part of the contract cannot be performed due to causes outside the control of the parties.

1. Rule: Like commercial impracticability, a force majeure clause, in a contract excuses non-performance when circumstances beyond the control of the parties prevent performance.
2. Because most modern contracts contain a force majeure clause, it may make the impracticability doctrine less applicable.
3. ejusdem generis rule: (of the same kind): under this rule it assumed the parties intended to include only events similar to the ones mentioned or enumerated; therefore, if the contract does not state "whether or not mentioned" this rule can be used to circumvent the force majeure clause unless the supervening event was specifically listed or of a similar nature.

IV. Frustration of Purpose

A. Cases: (see supra §2.2, III(A), p. 18) *Karl Wendt, Harriscom.*

B. **G/R:** Classical Frustration of Purpose Rule: When a supervening change in extrinsic circumstances occurs and the contract loses all value the duty to perform may be excused under frustration of purpose [Krell v. Henry (English coronation case)].

C. **G/R:** Modern Frustration of Purpose Rule: Where after a contract is made, a party's principle purpose is substantially frustrated without fault by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or circumstances indicate to the contrary [Rst. (2) §265].

D. **G/R:** The defense of frustration requires the establishment of three factors:

1. the purpose frustrated by the supervening event must have been the principal purpose of the party making the contract;
    a. It is not enough that the contracting party had in mind a specific object without which he would not have made the contract.
    b. The object must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense.
2. the frustration must be substantial;
    a. It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss.
    b. The frustration must be so severe that is not fairly to regarded as the risk he assumed under the contract.
    c. The fact that performance has become so economically burdensome or unattractive is not sufficient to excuse performance.
3. the frustrating event must have been an event that the non-occurrence of which was a basic assumption on which the contract was made.

E. **G/R:** Rst. (2) §265: 3 prong test: For the defense of frustration to prevail, the first task is to find the purpose of the contract. Then the frustrating event must:

a. Frustrate the principle purpose of the contract;
b. the frustration has to be substantial; and
c. the frustrating event cannot be a *not* a basic assumption of the contract. Or the event that the non-occurrence of which was a basic assumption of the contract.

F. **G/R:** Like the doctrine of impracticability, the doctrine of frustration is an equitable doctrine which meant to fairly apportion risks between parties in light of unforeseen circumstances. It is essentially an implied term which is meant to apportion risk as the parties would have if the necessity had occurred to them.

G. **G/R:** Differences Between frustration and impracticability:
1. Frustration: the defendant is sued after contract is formed and after contract is completed.
2. Impracticability: the defendant is sued after contract is formed and the plaintiff cannot complete his duty of performance under the contract.

H. **G/R:** The doctrines of impossibility, impracticability, and frustration of purpose are matters of law [Rst. (2) Chap. 11 Intro. Notes; Karl Wendt] (majority view).
1. Minority view: the doctrines of changed circumstances should be a matter for the trier of fact as a question of fact which could go to the jury.

J. Note: Courts often recognize frustration in theory but hardly ever grant relief under its rubric. The courts have been reluctant to impose the doctrine of frustration even for war, natural disasters, and other unforeseen consequences.

§2.3: Modification

I. Doctrine of Modification of Contracts

A. Cases: (1) *Alaska Packers' Ass'n v. Domenico*: P, a fishing company, contracted with D, inter alia, to go from San Fran to Alaska to fish during the summer fishing season. When D arrived in Alaska they stopped work and demanded more money. P's agent, without proper authority, signed a second K giving D more money. D then fished the fishing season and returned back and demanded the money from the second K, however, the court held the second K was unenforceable because D had a pre-existing duty to perform the original K. (2) *Kelsey Hayes v. Galtaco Redlaw Co.*: P sued D for breach of a requirements K. P and D entered into a requirements K whereby D was to sell brake castings to P who put them into brake assemblies and sold them to Ford and Chrysler. D ran into financial trouble and was going to close down unless P agreed to a price increase for the temporary supplies of castings. P was under pressure to accept D's prince increase offer because if it did not have the castings to put into the brake assemblies they would be in breach of their K with Ford. P then offset the amount of the price increase by not paying for the final 84 castings and went to court seeking a declaratory judgment were the court held that the K was improperly modified. (3) *Brookside Farms v. Mama Rizzo's Inc.*: P and D entered into a requirements K for the sale of basil leaves for a year. The parties entered into three K modifications, the first was an oral agreement to remove

stems. The second and third were oral price increases. D bounced its payment check to P and then said modifications were unenforceable because of "NOM" clause; court held that because the parties acted like a modification had taken place the K modification was enforceable.

B. **G/R:** Classical Pre-Existing Duty Rule: a party to a contract cannot recover if, after entering into a contract, the party refuses to perform, thereby coercing the other party to contract to pay him an increased compensation for doing that which he is legally entitled to do, because the new contract lacks consideration [Alaska Packers].

1. One party cannot enter into a new contract for the same services they had already contracted to unless "fresh consideration" is supplied [Alaska Packers].
    a. In other words, a promise to pay a man for doing that which he is already under contract to do, is without consideration and unenforceable.
2. **Exception:** if one party can provide "fresh consideration" because they did not get what they bargained for the contract may be modified [Alaska Packers].
3. **Exception:** Unforeseen Difficulties Rule: where a party refusing to complete his contract does so by reason of some unforeseen and substantial difficulties in the performance of the contract, which were not known or anticipated by the parties when the contract was entered into, and which case upon him a burden not contemplated by the parties, and the opposite party promises him extra pay or benefits if he will complete his contract, and has so promised, the promise to pay is supported by valid consideration.

C. **G/R:** Modern Modification Rule: a modification to a pre-existing contract will be enforced if:

1. Circumstances changed; and
2. The parties acted in good faith.

D. **G/R:** Modern Pre-Existing Duty Rule: performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration for a new promise [Rst.(2) §73].

E. **G/R:** Exceptions to Modern Pre-Existing Duty Rule: MODIFICATION OF AN EXECUTORY CONTRACT: a promise modifying a duty under a contract not fully performed on either side is binding:

1. If the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or
2. To the extent provided by statute; or
3. To the extent that justice requires enforcement in view of material change or position in reliance on a promise.
    a. This exception is another basis for modifying the agreement despite the absence of fresh consideration on one side: the possibility that the modification will induce a material change of position, so that injustice will result if enforcement is not forthcoming.

*[Rst. (2) §89(a)-(c)].

** In other words, fresh consideration is needed to enforce the contract unless one of the exceptions is met.

F. **G/R:** Modification of a Contract for the Sale of Goods: UCC §2-209: (1) An agreement modifying a contract for the sale of goods needs no consideration; however the modification must be made in good faith [UCC §2-209 cmt. 2].

1. The statute of frauds (UCC §2-201) must be complied with if the modification for the sale of goods is over $500 [UCC §2-209(3)].
2. §2-209 requires *both* parties to act in good faith.
3. Bad Faith: the effective use of bad faith to escape performance on the original contract terms is barred. Bad faith includes economic duress and a colorable impracticability defense (i.e. shifts in the market or financial distress).
    a. If the UCC does not address a topic the court will default to the common law; that is why in *Kelsey Hayes* the court used the doctrine of economic distress in deciding the modification was unenforceable, however, the court could have decided the case under the UCC "bad faith" comment [cmt. 2] because bad faith is essentially the same as economic duress.
4. Good Faith: the test of "good faith" between merchants includes the observance of reasonable commercial standards of fair dealing in the trade [§2-103] and may in some situations require an objectively demonstrable reason for seeking the modification.

H. **G/R:** Test for whether to Apply the UCC or Restatement: the court will look at what the predominant purpose of the whole contract was to determine whether to apply the UCC or the Restatement.

1. If the predominant purpose of the contract was to provide services then the Restatement rules will be used and consideration must be supplied to modify the contract unless there is an exception under Rst (2) §89.
2. If the predominant purpose of the contract was the sale of goods then the UCC rules will be used and no fresh consideration needs to be supplied to modify the contract.

I. **G/R:** Economic Duress and Contract Modification: a contract, or contract modification, is voidable if a party's manifestation of assent is induced by (a) an improper threat by another party which, (b) leaves the victim no reasonable alternative [Rst. (2) §175].

1. In other words, economic duress can exist in the absence of an illegal threat; the threat must merely be wrongful. Even acts lawful and non-tortious may be wrongful depending on the circumstances [Kelsey Hayes].
2. A threat by one party to breach a contract by not delivering required items is wrongful [Kelsey Hayes].
3. **G/R:** In order to state a claim of economic duress, a buyer coerced into executing a modification to an existing agreement must at least display some protest against the higher price in order to put the seller on notice that the modification is not freely entered into [Kelsey Hayes].

4. **G/R:** Entering into a superceding inconsistent agreement covering the same subject matter rescinds an earlier contract and operates as a waiver of an claim for breach of the earlier contract not *expressly* reserved (or even if the party does not expressly reserve the right to object to the modifications it must object enough to put the other party on notice that it is not entering into the modification on its own free will).

a. However, a subsequent contract or modification is invalid and does not supercede the earlier contract when the subsequent contract was entered into under duress.

5. **Test for Economic Duress:** (a) a party may in good faith seek a modification when unforeseen economic exigencies exist which would prompt an ordinary merchant to seek a modification in order to avoid a loss on the contract; (b) even where circumstances do justify asking for a modification, it is nevertheless bad faith conduct to attempt to coerce one, by threatening breach [Roth].

J. **G/R:** N.O.M. Clauses: "No Oral Modifications" clauses are fairly common in modern contracts and state that all contract modifications must be in writing and usually comply with the statute of frauds.

K. **G/R:** Statute of Frauds and Modifications: A contract for the sale of goods $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indication that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought [UCC §2-201].

1. The statute of frauds requirement applies equally to modifications of contracts.
2. **Exceptions:** (1) The party against whom enforcement is sought promises to put the modification in writing and the other party relies; or (2) if the parties act like a modification was formed then the modification can be enforced.
*[Brookside Farms].
3. Oral agreements that materially modify a written agreement within the statute of frauds are not enforceable [Brookside Farms].

a. If the oral changes do not materially alter the underlying obligations they are not barred.

b. An oral modification that would not itself form a binding contract in the absence of the statute of frauds considerations can be binding on the parties to a sale of goods over $500 insofar as the specific goods have been shipped, received, and accepted.

c. The parties must modify the contract in accordance with the UCC "good faith" standards.

§3: CONSEQUENCES OF NONPERFORMANCE

§3.1: Material Breach

I. Overview: Promise and Condition

A. **G/R:** Promise: A promise is a manifestation of intention to act or refrain form acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made [Rst. (2) §2(1)].

1. A promise communicates that the promisor is under a duty to perform.
2. *Shall, will, agrees to, has a duty to, has a duty not to do,* are terms that are commonly used to indicate a promise.
3. A legally enforceable promise creates duties. However a party is not in breach for not acting as promised unless that duty is immediately performable. Often some event must occur before a duty is immediately performable, such an event is called a condition.

B. **G/R:** Condition: A condition is an event, not certain to occur, which must occur unless its non-occurrence is excused, before performance under a contract becomes due [Rst. (2) §224].

1. A condition is an *event*, as opposed to a promised performance.
2. The mere passage of time cannot be a condition.
3. Promissory condition: if the party has promised to bring about an event that must occur before performance by the other party is due, then the party has created a promissory condition.
    1. If the party controls the occurrence has a duty to make it occur then there is a promissory condition.
4. In determining a promise and condition it is important to identify:
    a. the performance that is due,
    b. the event that makes performance conditional, and
    c. who has control over the occurrence of an event.
5. *If, on the condition that, in the event that,* or *subject to* are words that indicate contractual provisions containing conditions.

C. **G/R:** Condition Precedent: where an event must occur before a party becomes liable, the condition is precedent.

D. **G/R:** Condition Subsequent: where the party is already liable and will be relieved from liability on the happening of an event, the condition is subsequent.

E. **G/R:** Which party is to perform first: In the absence of an understanding to the contrary, the performances of a contract are due simultaneously.

1. Where all or part of the performances to be exchanged under an exchange of promises can be rendered simultaneously, they are to that extent due simultaneously, unless the language or the circumstances indicate to the contrary [Rst. (2) §234(1)].
2. Except as stated in subsection (1), where performance of only party under such an exchange requires a period of time, his performance is due at an earlier time than that of the other party, unless the language or circumstances indicate to the contrary [Rst. (2) §234(2)].

F. **G/R:** If one party does not perform, must the other party perform: If the promises are dependent upon one another, then if one party fails to perform, the other parties duty to perform is excused. If the promises are independent of one another, then if one party does not perform, the other party still has a duty to perform but may seek damages in court for the formers failure to perform.

1. In the absence of a statute or the parties expressed intent, courts will determine whether one party's performance is conditional on the other's performance.
    a. Courts have long held that one each party's performance is a condition of the other's duty to perform. This is known as constructive conditions of exchange.

G. **G/R:** Constructive Conditions of Exchange: a material failure of performance, including defective performance as well as an absence of performance, operates as the non-occurrence of a condition [Rst. (2) §237 cmt. a].

1. The rule of constructive conditions is premised on the idea that the parties expect an exchange of performances. The rule then fairly carries out the reasonable expectations of the parties.
2. Because a court will infer a constructive condition of exchange in most circumstances, it is not always necessary for the parties to make the condition express. The express the contrary, the parties must be clear.

H. **G/R:** Implied Conditions: when the parties do not expressly provide that a duty is conditional on an event, a condition may be supplied by the court which is an implied condition.

I. **G/R:** Nonperformance by one party excusing performance by the other party: when the court is determining whether a particular term is a promise or condition, it looks to the materiality of the term.

1. Breach of an immaterial term will not be treated as a failure to bring about an event that is a condition of performance by the other party.
2. Breach of a material term will excuse the other party from performing.
3. In order to have a term enforced as a condition the drafter must state it unambiguously because if the term is ambiguous the court may interpret it as promise rather than a condition.
4. **G/R:** Express conditions will be strictly enforced.
    a. **Exceptions:** unconscionability, good faith and fair dealing, substantial performance, interpretation, waiver, estoppel, discharge, acceptance of performance, impossibility, and excuse to avoid forfeiture.

J. **G/R:** Circumstances Significant in Determining whether failure is material: In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

1. the extent to which the injured party will be deprived of the benefit he reasonably expected;
2. the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;

3. the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
4. the likelihood the party failing to perform or to offer to perform will cure his failure;
5. the extent to which the behavior of the party failing to perform comports with the standards or fair dealing and good faith.

II. Doctrine of Material Breach

A. Cases: (1) *Jacob & Youngs, Inc. v. Kent*: P entered in a K with D to build a house. The K was very specific down to the specific brand of pipe to be used. After moving into the house D found that P did not use a specific brand of pipe called for in the K and suspended his duty to perform (i.e. pay P for the work) and court held that because P had substantially performed D had to fulfill his duty to pay. (2) *Sackett v. Spindler*: D owned and operated a newspaper and tried to sell his stock to P. D and P entered into a K to sell the stock which would be paid incrementally. After making the first payment P became late on the payments and continued promising D that he would make the payments. After a couple of months D sold his stock to another party and both parties went to court claiming the other party breached the K and the court found that P materially breached the K by failing to perform his promises to pay.

B. **G/R:** Constructive Conditions of Exchange: mutually dependant promises (or constructive conditions of exchange) are terms implied into a contract which make promises dependant on each other.
1. Almost all promises in bilateral contracts are constructive conditions of exchange.
2. After the court implies dependent promises, it must determine which party has to perform first.

C. **G/R:** Order of Performance: If a contract can be performed simultaneously then the performances are due simultaneously [Rst. (2) §234(1); see §3.1(F) supra].
1. If performances cannot be rendered simultaneously performance must be completed before tender is made [Rst. (2) §234(2)].
a. The order of performance in a contract can be changed by stating a different order of performance in the contract. This is usually done by making periodic payments.
2. Performance by one party is a constructive condition on making the other party exchange his promise.

D. **G/R:** Failure by one party to perform: express conditions in a contract are strictly enforced, therefore, failure to perform an express condition excuses the other party from performing.
2. In constructive conditions of exchange a material breach must occur before it will excuse the other parties non-performance.

E. **G/R:** Substantial Performance: each parties duty of performance is implicitly conditioned on there being no uncured material failure of performance by the other party [Rst. (2) §237].

1. A minor or immaterial deviation from the contractual provisions do not amount to a failure of a condition to the other party's duty to perform. That is, if there is substantial performance by one party (even if it is a minor breach) the other party must still perform [Jacob & Youngs].
    a. Caveat: the party who was subject to the breach may still collect damages.
2. If a contract has been substantially performed there can be no material breach, if there is a material breach there can be no substantial performance [Jacob & Youngs].

F. **G/R:** Criteria for Determining Substantial Performance:

1. The purpose to be served by the contractual provision;
2. the desire to be gratified by the contractual provision;
3. excuse for deviation from the contractual provision; and
4. Cruelty of enforced adherence (if the contractual provision is enforced what is the detriment to the parties).

*[Jacob and Youngs].

G. **G/R:** Material Breach: when a total or partial uncurable breach of the contract occurs, the other parties performance is discharged.

H. **G/R:** Determining when a failure to render or offer performance is material: the following factors determine when the failure to render performance is material:

1. how much will the injured party be deprived of the benefit of the bargain;
2. the extent to which the injured party can be adequately compensated for part of the benefit he was deprived;
3. the extent to which the party failing to perform will suffer forfeiture;
4. the likelihood that the party failing to perform or to offer performance will cure his failure, taking into account all circumstances;
5. the extent to which the behavior of the party failing to perform of to offer performance comports with the standards of good faith and fair dealing.

*[Rst. (2) §241(a)-(e)].

**If all these elements are met the injured party may suspend performance.

***This constitutes a partial breach of the contract.

I. **G/R:** Determining when Remaining duties are discharged: in determining when after a material breach the other party's duty to render performance is discharged the following factors are to be considered:

1. Factors in §241, that is when a material breach occurs [above];
2. the extent to which the delay will prevent the injured party from making substitute arrangements; and

3. the extent to which the agreement provides for performance without delay; that is, being late on performance or payment is not necessarily a total breach unless circumstances and language of the contract provide otherwise.
*[Rst. (2) §242(a)-(c)].
**If all these elements are met the injured party may terminate the contract.
***This constitutes a total breach of the contract.

§3.2: Anticipatory Repudiation

I. Doctrine of Anticipatory Repudiation

A. Cases: (1) *Truman L. Flatt v. Schupf*: D and P entered into a K that was conditioned upon D obtaining a zoning change for an asphalt plant. When D did not get the zoning change they offered a lower price for the asphalt plant and P declined the offer, then D decides he will take original deal and the seller, P, says no because he believed D repudiated the K and the court held even if P had repudiated it retracted the repudiation in sufficient time so the K was enforced. (2) *Hornell Brewing Co. v. Spry:* P and D enter into a K which allowed for D to distribute P's goods in Canada. D falls behind in his payments and demands assurances from D that he can perform his promises, D then provides some assurances and asks for more money. P then finds out D's company was a sham so P asked for further assurances and D never provided any so P terminates K and goes to court seeking declaratory judgment in which the court finds for him.

B. **G/R:** Classical Anticipatory Repudiation Rule: when one party says it cannot perform the contract, the repudiation gives rise to a breach of contract and the injured party can sue [Hochster v. De La Tour].

C. **G/R:** Repudiation: a repudiation is:
1. a statement by the obligor indicating he will commit a breach that would of itself give the obligee a claim for damages; or
2. a voluntary affirmative act which renders the obigor unable or apparently unable to perform without such a breach.
[Rst. (2) §250]
3. Language under a fair reading amounts to a statement of intention not to perform except on conditions which go beyond the contract constitutes a repudiation [UCC §2-610; Rst. (2) §250].
4. A suggestion for a modification of the contract does not amount to a repudiation; or a request for a change of the price term of a contract does not constitute a repudiation [Truman L. Flatt].

D. **G/R:** Modern Anticipatory Repudiation Rule: Rst. (2) §253:
1. Where an obligor (the party whose performance is due) repudiates a duty before he has committed a breach by non-performance and before he has received the agreed exchange for it, his repudiation alone gives rise to a claim for damages for total breach.

2. Where performances are to be exchanged under an exchange of promises, one party's repudiation of a duty to render performance discharges the other party's remaining duties to render performance.

E. **G/R:** A repudiation must be clear and unequivocal [Sackett].

1. **Policy:** because courts are not eager to find a repudiation, they want to make the contract work. Thus, courts look for a definite action or statement of repudiation.

F. **G/R:** Anticipatory Repudiation Rule: the doctrine of anticipatory repudiation requires a clear manifestation of an intent *NOT* to perform the contract on the date of performance.

1. That intention must be a definite and unequivocal manifestation that he will not render performance when the time fixed for it in the contract arrives.
2. Doubtful and indefinite statements that performance may or may not take place are not enough to constitute anticipatory repudiation.
*[Truman L. Flatt].

II. Retraction of an Anticipatory Repudiation

A. **G/R:** Retraction of a Repudiation: the repudiating party has the power of retraction unless the injured party ahs brought suit or otherwise materially changed his position [Truman L. Flatt].

1. The effect of a statement as constituting a repudiation under §250 or the basis for repudiation under §251 is nullified by a retraction of the statement if notification of the retraction comes to the attention of the injured party before he materially changes his position in reliance on the repudiation or indicates to the other party that he considers the repudiation to be final [Rst. (2) §256(1)].

B. **G/R:** Retraction of an Anticipatory Repudiation: until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has cancelled or materially changed his position or otherwise indicated that he considers the repudiation final [UCC §2-611].

1. The repudiating party can prevent the injured party from treating the contract as terminated by retracting before the injured party acted in response to it [Farnsworth].
2. On who has anticipatorily repudiated his contract has the power of retraction until the aggrieved party has materially changed his position in reliance on the repudiation. The assent of the aggrieved party in necessary for retraction only when the repudiation is no longer merely anticipatory but has become an actual breach at the time performance was due [Corbin].
3. Anticipatory repudiation can be retracted by the repudiating party unless the other party has, before the withdrawal, manifested an election to rescind the contract, or changed his position in reliance on the repudiation [Williston].

C. **G/R:** After an anticipatory repudiation, the aggrieved party is entitled to choose to treat the contract as:

1. rescinded or terminated; or
2. to treat the anticipatory repudiation as a breach by bringing suit or otherwise changing its position; or
3. to await the time for performance.

*[UCC §2-610].

III. Grounds for Insecurity and Assurances

A. **Analytical Frame Work:** UCC §2-609; Rst. (2) §251:

1. ARE THERE REASONABLE GROUNDS FOR INSECURITY?
    a. If NO, each party must perform their contractual duties.
    b. If YES, go to #2

2. IF PARTY HAS REASONABLE GROUNDS FOR INSECURITY THE INSECURE PARTY CAN DEMAND REASONABLE ASSURANCES AND SUSPEND PERFORMANCE (request for assurances should be in writing or at least an unequivocal demand and insecure party has to wait 30 days [under UCC] or reasonable time [under Rst.] before taking action.)

3. WERE THE ASSURANCES RECEIVED BY THE INSECURE PARTY?
    1. If YES, both parties continue contract;
    2. If NO, insecure party is excused from performance because the other party has repudiated.

B. **G/R:** Reasonable Grounds for Insecurity: UCC §2-609(1) authorizes one party upon reasonable grounds for insecurity to demand adequate assurance of due performance. Until he receives such assurances, if commercially reasonable, he may suspend performance.

1. Whether a seller has reasonable grounds for insecurity is an issue of fact that depends on various factors, including the buyer's exact words or actions, the course of dealings and performance between the parties, and the nature of the sales contract and the industry [Hornell Brewing].
2. Reasonable grounds for insecurity can arise from the sole fact the buyer has fallen behind in his account with the seller, even where items involved have to do with separate and legally distinct contracts, because this impairs the seller's expectation of due performance [§2-609 cmt. 2].
3. Factors that will give another party reasonable grounds for insecurity:
    1. Significant financial difficulties;
    2. Failure to perform important obligations under the contract;
    3. Failure to perform obligations under related contracts.

C. **G/R:** Reasonable Assurances: UCC §2-609(2) defines both reasonableness and adequacy by commercial rather than legal standards. Once the seller correctly determines

that it has reasonable grounds for insecurity, it must properly request assurances from the buyer.

1. This request has to be in writing under the UCC (although courts have not strictly adhered to this formality as an unequivocal demand is made).
2. After demanding assurance, the seller must determine the proper and adequate assurance.
3. What constitutes adequate and proper assurance of due performance is subject to the same test of commercial reasonableness and factual conditions.
4. UCC §2-609 cmt. 4: indicates that an adequate assurance may range form a mere verbal guarantee to the posting of a bond, depending on the facts and circumstances.
    a. A demand for assurances must be made in good faith.
5. Under the UCC, after a justified demand for adequate assurances the demanding party must wait a reasonable time not to exceed 30 days (the Rst has a reasonable time requirement but no maximum time period).
    a. If the insecure party receives the assurances in that time period, then absent a further change of circumstances, the party who demanded the assurances is bound to proceed with the contract.
    b. If the adequate assurances are not received within the given time, the insecure party may treat the failure to respond as an anticipatory repudiation which entitles the seller to suspend and/or terminate the agreement.

§3.3: Express Conditions

I. Doctrine of Express Conditions

A. Cases: (1) *Oppenheimer & Co. v. Opp., Appel, Dixon, & Co.*: P and D entered into sublease K for the 33rd floor of building; P put in an express condition in the K requiring a letter from the landlord on certain date that wiring would be installed, when D called and said the landlord approved rather then giving it to P in writing, P terminated the K for breach of an express condition and the court agreed holding substantial performance exception does not apply to express conditions in Ks. (2) *JNA Reality Corp. v. Cross Bay Chelsea Inc.*: D was assigned a lease from a third party in which P was the landlord. D had access to lease which provided the date which it was to renew the lease, after D violated the express condition D terminated the lease, the court, however, held that the excuse doctrine precluded P from strictly enforcing the express condition. (3) *Morion Bldg. Products Co. v. Baystone Construction:* D hired P as a subcontractor to instill siding on a building, the K had a satisfaction clause and P refused to perform its duty of paying P because it stated that P breached the satisfaction clause, however, the court held that an objective standard is used on non-artistic works and enforced the K despite the express condition.

B. **G/R:** Condition: a condition is an event not certain to occur, which must occur unless its non-occurrence is excused before performance under the contract becomes due [Rst. (2) §224.

1. An event equals a condition (X=condition; Y=duty/performance).
    a. If *X* occurs then *Y* must occur.
    b. If *X* does not occur then *Y* does not have to occur.
2. The passage of time cannot be a condition.
3. Ex: If house burns down, insurance company will pay $50K.
    a. Condition=house burning down; the house has to burn down before the insurance companies duty to pay arises.
4. The buyer/purchaser can waive a condition.

C. **G/R:** Express conditions v. implied conditions: Express conditions are strictly enforced [Oppenhiemer].

1. **Analytical Framework:**
    a. Must find the express condition (unless, until, if, on the condition that, if this then…, are common words and phrases that indicate an express condition).
    b. After finding express condition, find out if it was met.
    c. If the condition was not met, find out if it was a material condition.
    d. If it was a material condition it will probably be enforced.
    e. If it was not a material condition, see if any exceptions apply.

2. A condition precedent is an act or event, other than a lapse of time, which, unless the condition is excused, must occur before the duty to perform a promise in the agreement arises [Rst. (2) §224].
    a. Most condition precedents describe acts or events which must occur before a party is obliged to perform a promise made pursuant to an existing contract, a situation distinguished conceptually from a condition precedent to the formation or existence of the contract itself.
3. Conditions can be express or implied. Express conditions are those agreed to and imposed by the parties themselves. Implied or constructive conditions are those implied by law to do justice.
4. Express conditions must be literally performed, whereas, constructive conditions, which ordinarily arise from the language of the promise, are subject to the precept that substantial compliance is sufficient.
    a. **G/R:** substantial performance does not apply to express conditions precedent [Oppenhiemer].

D. **G/R:** In determining whether a particular agreement makes an event a condition courts will interpret doubtful language as embodying a promise or constructive condition rather than an express condition.

1. This interpretive preference is especially strong when a finding of an express condition would increase the risk of forfeiture by the obligee.
*[Rst. (2) §227(1)].
2. Interpretation as a means of reducing the risk of forfeiture cannot be employed if the occurrence of an event as a condition is expressed in unmistakable language [Rst. (2) §229].

a. Nonetheless, the non-occurrence of the condition may be excused by waiver, breach, or forfeiture. To the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange [Oppenhiemer].

E. **G/R:** If the parties have made an event a condition of their agreement there is no mitigating standard of materiality or substantiality applicable to the non-occurrence of the event [Rst. (2) §237].

a. Substantial performance in this context is not sufficient, and if relief is to be had under the contract, it must be through the excuse of the non-occurrence of the condition to avoid forfeiture [Oppenhiemer].

b. Substantial performance is ordinarily not applicable to excuse the non-occurrence of an express condition precedent.

i. When a contract requires a written notice be given within a specified time, the notice is ineffective unless the writing is actually received within the time prescribed [Oppenhiemer].

F. Generally: Almost all modern courts in practice will insist on strict performance of conditions only when the conditioning events are material to the agreement of the parties and the risks created thereby. Conditions that are merely "technical" that is, not related in substance to the real reason for the defendant's nonperformance but asserted solely for the purpose of defeating the plaintiff's claim—are generally excused under various theories such as (1) adverse interpretation; (2) waiver; (3) prevention; (4) avoidance; or (5) forfeiture [Childress].

1. In other words, the rule should be stated that: only material conditions should be strictly enforced.

G. **G/R:** Waiver: waiver is an intentional relinquishment of a known right [Rst. (2) §84(1)].

1. An obligor whose duty is expressly dependant on a condition may be under a duty to perform despite the non-occurrence of that condition, if the court finds he has, by word or conduct, "waived" the right to insist on fulfillment of the condition before performing the duty.

2. A waiver is effective without either consideration or reliance, but only if the condition waived was not a material part of the performance that the obligor was to receive in exchange or a material part of the risk assumed [Rst. (2) §84(1)].

3. A waiver can also be retracted by written notice; however, if the condition at issue a non-material one the timing of the retraction may be important. If the waiver is made seasonably the retraction will be effective [Rst. (2) §84(2)].

H. **Test for Excusing the Non-Performance of an Express Condition:** to the extent that the non-occurrence of a condition would cause any of the following factors the court may excuse the non-occurrence of the condition:

1. the obligee would suffer forfeiture;

2. the obligee's failure to perform the condition was mere negligence or a mistake;
3. the non-occurrence of the condition does not prejudice the obligor.
*[Rst. (2) §229; JNA Reality].

I. **G/R:** A tenant or mortgager should not be denied equitable relief from the consequences of his own neglect or inadvertence if forfeiture would result [JNA Reality].

1. This rule applies even though the tenant or mortgager, by his inadvertence, has neglected to perform an affirmative duty and thus breached a covenant within the agreement.
2. Equitable relief may be denied where there has been a willful or gross neglect.

J. **G/R:** Satisfaction Clauses: a satisfaction clause is clause stating that payment will not be tendered unless the party who hired the other party to perform the work is satisfied with the performance rendered.

1. Majority Rule: if it is practicable to determine whether a reasonable person in the position of the obligor would be satisfied, an interpretation is preferred under which the condition (that the obligor be satisfied with the obligee's performance) occurs if such a reasonable person in the position of the obligor would be satisfied [Rst. (2) §228].
    a. The reasonable person standard is employed when the contract involves commercial quality, operative fitness, or mechanical utility which other knowledgeable persons can judge.
    b. The standard of good faith is employed when the contract involves personal aesthetics of fancy (like a painting).
2. Minority Rule: if the contract provides that the seller's performance must be to the buyer's satisfaction, his rejection—however unreasonable—of the seller's performance is not a breach of the contract unless the rejection is made in bad faith.

§4: EXPECTATION DAMAGES

§4.1: Computing the Value of the Plaintiff's Expectation

I. Overview

A. **G/R:** Expectation Interests: there are three basic interests that the law may seek to protect in fashioning remedies for breach of contract:

1. Restitution Interest: the plaintiff in reliance on the promise of the defendant conferred some value on the defendant. The defendant fails to perform his promise. The court may then force the defendant to disgorge the value he received from the plaintiff.
    a. In other words, the prevention of unjust enrichment by the defendant.
2. Reliance Interest: the plaintiff has in reliance on the promise of the defendant changed his position. The court may award damages to the plaintiff for the purpose of undoing the harm which his reliance on the defendant's promise has

caused. The court object is put the plaintiff as in good as position as he was in before the promise was made.

3. Expectation Interest: without insisting on reliance by the promisee or enrichment of the promisor, the court may seek to give the promisee the value of the expectancy which the promise created.

a. In a suit for specific performance, the court may compel the defendant to render the promised performance to the plaintiff, or

b. in a suit for damages may make the defendant pay the money value of this performance.

c. The object is to put the plaintiff in as good as position as he would have occupied had the defendant performed his promise.

**Rst (2) §344 adopts this terminology.

B. **G/R:** Benefit of the Bargain Rule: both reliance and restitution interests can be, and often are, a basis for assessing damages against a breaching defendant. It has long been the policy, however, for the court in a breach of contract suit to attempt, if possible, to compute and award damages so as to give the plaintiff the expectation of gain under the contract: the benefit of the bargain that the plaintiff would have realized had the agreement been fully performed [Rst. (2) §347].

1. This strong preference for expectation damages means that an award may be revised on appeal if it appears that the court below has awarded the plaintiff less then the value of his lost expectation.

2. On the other hand, it may also be a reversible error to render judgment for more than the injury to the plaintiff's expectation.

II. Computing the Plaintiff's Expectation

A. Expectation Interest: the remedy aims to put the injured party in as good of condition as if the contract had been fully performed (i.e. benefit of the bargain).

1. The expectation interest can be contrasted to the reliance interest which puts the injured party in as good of position as if the contract had never been entered into; back to the status quo (promissory estoppel for breach of contract); and with

2. Restitution interests which make the contract breacher repay all the money that he was unjustly enriched by (gives the injured party back what he paid out).

**Usually expectation damages are the highest amount.

B. **G/R:** Plaintiff's Expectation: the expectation the court seeks to protect in its award of contract damages is the gain the plaintiff would have realized if the contract between the plaintiff and the defendant had been fully performed, as promised by both parties.

1. Where the plaintiff has fully performed his obligation under a contract and the only unperformed obligation of the defendant is to pay a stated amount of money in return, the injury to the plaintiff's expectation is ordinarily the defendant's failure to pay the promised sum; that amount (perhaps with interest) is therefore a sufficient award of damages to compensate the injury to the plaintiff's expectation.

C. **Formula:** General Measure = *loss in value + other loss – cost avoided – loss avoided.*

C(1). General Measure: a claim for total breach may have four elements because the breach may affect an injured party in four ways.

C(2). Loss In Value: the difference in value between what a party should have received and what he actually received. The difference between the gross expectation and what was actually received.

1. The breach may cause the injured party a loss by depriving that party, at least to some extent, of the performance expected under the contract.
    a. The difference between the value to the injured party of the performance that should have been received and the value to that party of what, if anything, was actually was received is the loss in value.
2. Loss in value applies whether the breach was total or partial.

C(3). Other Loss: incidental damages (cost incurred to mitigate loss) and consequential damages (damages that result from the breach of contract, i.e. physical injuries or property damages).

1. The breach may cause the injured party loss other than loss in value, and the party is also entitled to recovery for this, subject again to limitations such as foreseeability.
2. *Incidental Damages:* include additional costs incurred after the breach in a reasonable attempt to avoid loss, even if the attempt is unsuccessful.
3. *Consequential Damages:* include such items as injury to the person or property caused by the breach.
4. Other loss applies whether the breach is total or partial.

C(4). Cost Avoided: occurs if the non-breaching party terminates the contract before full performance.

1. If the injured party terminates and claims damages for total breach, the breach may have a beneficial effect on that party by saving it further expenditure that would have otherwise been incurred. This saving is cost avoided.
2. Cost avoided applies only to a total breach of contract.

C(5). Loss Avoided: is essentially mitigation damages (resale of goods, finding other jobs, etc…)

1. If the injured party terminates and claims damages for total breach, the breach may have a further beneficial effect on that party by allowing it to avoid some loss by salvaging and reallocating some or all of the resources that otherwise it would have had to devote to performance of the contract. The saving is loss avoided.
2. Loss avoided only applies to total breach of contract.

**Cost avoided and Loss avoided are controlled by the non-breaching party, but that party has incentive to avoid the loss because of the doctrine of mitigation.

D. **G/R:** Real Property Breach of Contract Formula: a vendor is entitled to the difference between the contract price and the fair market value of the property at the time of the breach which is the loss in value, or general damages. In addition, the vendor may recover special damages, if any, that arise out of the breach of contract in order to compensate the vendor for any loss or injury actually sustained by reason of the vendee's breach. These special damages though, must be within the reasonable contemplation of both parties, at the time the contract was made.

1. *Buyer Breach:* Seller's Damages = (contract price) – (market value of the property at time of the breach).
2. *Seller Breach:* Buyer's Damages = (market value of the property at the time of the breach) – (contract price).

**In reality the market value of the property and the contract price do not change that much.

3. There are two approaches for awarding a buyer damages when the seller breaches:
    a. English Rule: if seller breaches the buyer gets deposit money back and out of the contract with costs of title (classical rule).
    b. American Rule: uses the expectation damage formula (above) for any unexcused failure to convey (modern rule).
4. Alternative Approach: [UCC §2-708]: damages for breach of contract of real estate may also be measured by difference between the contract price and the resale price (because the market price usually does not go up or down).
5. Consequential and Incidental Damages: there usually is no loss in value when the market price is subtracted from the contract price; however, if the non-breaching party had to rent another home or buy a different one then there is consequential and/or incidental damages.
    a. Requirements and Limitations on incidental or consequential damages:
        (i) Damages are recoverable only if they were reasonably foreseeable at the time of the contract;
        (ii) the prohibition on speculative damages (i.e. the damages must be proven with reasonable certainty); and
        (iii) the duty to mitigate damages (i.e. damages may not be recovered to the extent that they could have been avoided or minimized by reasonable efforts).

*[Turner v. Benson].

E. **G/R:** Employment Breach of Contract Damages: when the employee is in breach of an employment contract, the employer can recover the difference between the cost of the breaching employee and the cost of the replacement. In other words, the cost of obtaining other services equivalent to that promised but not performed plus consequential damages that are foreseeable.

1. An employer may recover damages from an employee who has failed to perform an employment contract.
2. Damages in breach of contract cases are ordinarily measured by the expectations of the parties.

3. The non-breaching party is entitled to full compensation for the loss of his bargain—that is, losses necessarily flowing from the breach which are proven to a reasonable certainty and were within the contemplation of the parties when the contract was made.
4. Thus, damages for breach of an employment contract include the cost of obtaining other services equivalent to that promised but not performed, *plus* any foreseeable consequential damages.
5. The injured party must take all reasonable steps to mitigate damages.
6. Specific performance is never granted as damages in breach of employment contracts.
7. Most employees are employees-at-will so the issue of damages does not arise.
*[Handicapped Children Edu. Board v. Lukazewski].

F. **G/R:** Damages for Breach of a Construction Contract: the cost of completion is the normal rule in construction contracts: where performance has been defective or incomplete the plaintiff is entitled to the reasonable cost of replacement or completion.

1. The general rule of damages for breach of a construction contract is that the injured party may recover those damages which are the direct, natural, and immediate consequence of the beach and which can reasonably be said to have been in contemplation of the parties when the contract was made.

a. In the usual cases where the contractor's performance has been defective or incomplete, the reasonable cost of replacement or completion is the measure for damages.

2. **Policy:** freedom of contract; one can do with his property as he pleases; benefit of the bargain; gives the contractor incentive to complete contract as specified.
*[Rst. (2) §346].

F(1). **Exception:** Diminution in Value Rule: when there has been substantial performance of the contract (a) made in good faith; (b) which would result in economic waste; (c) then the damages can be measured between the value of the property as constructed and the value if performance had been properly completed.

1. The economic waste of the type which calls for the diminution in value rule generally entails defects in construction which are irremediable or which may not be repaired without a substantial tearing down of the structure.

a. Where, however, the breach is of a covenant which in only incidental to the main purpose of the contract and completion would be disproportionately costly, courts have applied the diminution in value rule even where not destruction of the work is entailed.

(i) However, disparity in relative economic benefits is not the equivalent of the economic waste.

F(2). **Alternatives to Loss in Value of Performance:** [Rst. (2) §348(2)(a) and (b)]: if a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on:

(a) the diminution in the market price of the property caused by the breach, or

(b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him.

*Rst. (2) §348(2) adopts the diminution in value as the general rule although at common law it is the exception; it reverses the order.

F(3) **G/R:** it is the general rule in building and construction cases that a contractor who would ask the court to apply the diminution in value rule as instrument of justice must not have breached the contract intentionally and must show substantial performance made in good faith.

**[American Standard v. Schectmant (all F rules)].

G. **G/R:** Rule of Hadley v. Braxendale: (classical): where two parties have made a contract which one of them has broken, the damages which the other party out to receive in respect of such breach of contract is that what may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things from the breach of contract itself (general damages); 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 probable result of the breach (consequential damages).

1. The rule applies to all contracts.

G(1). **G/R:** (a) *General Damages:* general damages are those that arise naturally from the breach and are independent of the particular circumstances of the injured party. The plaintiff need not make any special showing to recover general damages. (b) *Consequential Damages:* consequential (sometimes called special) damages are those that flow from the specific circumstances of the injured party. The most important type of consequential damages in commercial cases is lost profits arising from collateral contracts.

G(2). **G/R:** Modern Rule of Hadley [**Rst. (2) §351**]: (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 probable result of the breach because it follows from the breach:

(a) in the ordinary course of events (general damages); or

(b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know (special damages).

G(3). **UCC §2-715(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.

G(4). **Factors:** The modern formulation of the Hadley Rule in Rst. (2) §351 and UCC §2-715 is state in terms of foreseeability of loss. There are serve aspects of the foreseeablity standard:

1. the recoverability of consequential damages depends on whether such *damages were in contemplation of the parties at the time the contract was made*;
2. it is only necessary that the type of loss be foreseeable, not the manner in which the loss occurs;
3. the focus of foreseeability is on the breaching party;
4. the standard for foreseeablity is at least in party objective;
5. the breaching party is liable for losses about which it had reason to know; and
6. the loss must be foreseeable as a probable result of the breach.

**Liability is not limited to losses that are necessary or inevitable, but it does not extend to remote losses.

H. **G/R:** Amount of Damages in Lost Profit Cases: the issue in every lost profit cases is, after the contract is terminated, how does court ascertain how much profits will be made.

1. It is usually done by exert testimony stating the amount of profits of the business based on its past history.

H(1). **G/R:** Uncertainty as a Limitation on Damages: [**Rst. (2) §352**]: Damages are not recoverable for loss beyond an amount hat the evidence permits to be established with *reasonable certainty*.

H(2). **G/R:** Determining Amount of Future Profits: the loss of future anticipated profits (i.e. the loss of expected monetary gain) is recoverable in a breach of contract case if:

1. the loss is within the contemplation of the parties at the time the contract was made;
2. the loss can be said to have caused directly or proximately from the breach; and
3. if the loss is capable of reasonable accurate measurement or estimate.

**An award in the form of lost profits, in fact, is generally considered a common measure of damages for breach of contract, it frequently represents fulfillment of the non-breaching parties expectation interest, and often closely approximates the goal of placing the innocent party in the same position as if the contract had been fully performed.

H(3). **G/R:** not party to a contract may recover more in damages for a breach of contract than might have been gained by full performance.

H(4). **G/R:** the legal principle is that before lost profit damages are recoverable it must be adequately shown such profits were *reasonably* certain to have been made by the non-breaching party absent breach.

1. In order for damages to be recoverable for breach of contract they must be *clearly ascertainable*, in both their nature and origin, and it msut be made to appear that they are the natural and proximate consequence of the breach and not speculative or contingent.

a. It is not necessary however for the recovery of lost profits shown to have been caused by a breach of contract that the profits be established with absolute certainty and barring any possibility of failure, but in is only required that it be established with *reasonable certainty* that profits would be made if the contract had not been breached.

2. In essence, what a plaintiff must show for recovery of lost profits is sufficient certainty that a reasonable mind might believe from a preponderance of the evidence that such damages were actually suffered.

H(5). **G/R:** New Business Rule: if it is a new business claiming lost profits, there is no certainty that the business would or will ever make profits therefore recovering lost profits for a new business venture is difficult.

H(6). **Generally:** it is very common for parties to use contractual disclaimers or limitations of liability for consequential damages and will usually be given effect if they are not conspicuous.

**[Florafax v. GTE].

§4.2: The Doctrine of Mitigation of Damages

I. Mitigation and Avoidable Consequences

A. **G/R:** Avoidability as a Limitation on Damages: [**Rst. (2) §350**]: damages are not recoverable for loss that the injured party could avoided without undue risk, burden or humiliation.

1. Exception: the injured party is not precluded form recovery if he has made reasonable but unsuccessful efforts to avoid loss.

B. **G/R:** Mitigation of Damages: after a non-breaching party receives notice of a breach, the non-breaching party has a duty to do nothing to increase the damages following therefrom.

1. The non-breaching parties remedy is to treat the contract as breached when he receives notice, and sue for recovery of such damages as he may have sustained from the breach, including an profit which he would have realized upon performance, as well as any other losses (consequential or incidental damages).
2. **Policy:** (a) not reason to pile up damages after a contract is breached; (b) economic waste: there is no reason to have contract fulfilled because it will not benefit anyone; (c) the non-breaching party is not harmed by the doctrine of mitigation (either way, finished project or partially finished project the palitniff still comes out in the same position.

*[Rockingham County v. Luten Bridge Co].

C. **G/R:** Duty to Mitigate: after an absolute repudiation or refusal to perform by one party to the contract, the other party cannot continue to perform and recover damages based on full performance.

1. This rule is only a particular application of the general damages rule that a plaintiff cannot hold a defendant liable for damages which need not have been incurred; or, as it is often stated, the plaintiff must, so for as he can without loss to himself, mitigate damages caused by the defendant's wrongful act.
    a. In other words, the "duty" to mitigate is not really a *duty*, one cannot be counterclaimed against, under FRCP 13(b), for breach of a duty to mitigation, it is only a deduction from the damages.

*[Luten Bridge Co.].

D. **G/R:** Measure of Damages (un-reimbursed expenses): the measure of a plaintiff's damage, upon repudiation of the contract by the breaching party in construction cases is an amount sufficient to compensate plaintiff for labor and material expended and expense incurred in the part performance of the contract prior to the repudiation, plus the profit that would have been realized if the contract had been carried out in accordance with its terms [Luten Bridge Co].

II. Mitigation in Employment Contracts

A. **G/R:** Measure of Damages: the measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service minus the mitigation of damages by the employee [Boehm v. ABC].

B. **G/R:** Mitigation in Employment Contracts: absent special circumstances, an employer's potential back-pay liability ceases to accrue at the time the claimant rejects an employer's unconditional offer of either the same job, or one *substantially equivalent* to the job from which the claim arose.

1. Similarly, the employee does not have to take a job from another employer unless is *substantially equivalent* to the job from which he was terminated.
2. The employer has the burden of proving that a substantially equivalent position was offered; or that the employee did not use reasonable efforts to obtain another job.
    a. **Policy:** the defendant is required to prove and carries the burden because:
        (i) it is considered an affirmative defense under the FRCP [Rule 8(b)]; and
        (ii) the employer would know about jobs in the field.

C. **G/R:** Wrongful Termination: an employee who has been wrongfully terminated through reasonable efforts to achieve other employment.

1. The general rule is that the measure of recovery by a wrongfully terminated 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 for other employment.
    a. Caveat: However, the failure to accept offers of employment is significant in consideration of mitigation only if the former employer

shows the other employment was comparable, substantially similar, to that of which the employee has been deprived.

(i) Thus, the employer bears the burden of proving that comparable or substantially similar employment was available to the employee; the employee is not required to prove mitigation.

2. If wrongfully discharged employee actually take a different and inferior job it will be subtracted from the damages.

3. If a wrongfully discharged employee takes a job that is inferior but would not have interfered or conflicted with another job; the money does not have to be subtracted (i.e. had a day job as a librarian and then took night job as a clerk, the money does not have to be subtracted.

D. **G/R:** Procedural Posture: the former employee is required to establish that the plaintiff failed to accept an unconditional offer to a job substantially equivalent to the one denied.

1. It is only when the employer carries this initial burden that the plaintiff must establish special circumstances justifying rejection of the offer.

2. An employees failure to seek other available employment, or rejection of such employment, is justified if the other available employment is different or inferior to the job he held with the ex-employer.

II. Lost Volume Contracts and Mitigation

A. **G/R:** the purpose of awarding damages is make a party whole by restoring that party to the position he was in prior to the breach.

1. The injured party should be placed, so far as can be done by a money award, in the same position that he would have occupied if the contract had been performed.

B. **G/R:** Lost Profits: profits may be recoverable as damages. The general rule is that loss of profits resulting from a breach of contract may be recovered as damages when such profits are proved with reasonable certainty, and when they may be reasonably be considered to be in contemplation of the parties at the time of the contract.

1. Recovery for lost profits caused by a breach of contract depends on the facts and circumstances of each particular cases.

C. **G/R:** Mitigation: a general rule of contract law is that one injured by reason of breach of contract by another is under a duty to exercise reasonable care to avoid loss or to mitigate and minimize the resulting damage.

1. The injured party is bound to protect himself if he can do so with reasonable exertion or at trifling expense, and can recover for the breaching party only such damages as he could not, with reasonable effort, have avoided.

D. **G/R:** Lost Volume Seller Rule: the loss volume seller measure of damages refers to the lost volume of a business the non-breaching seller incurs on the buyer's breach.

1. When the seller resells the entity he expected to sell to the original buyer, he usually deprives himself of something of value—the sale to a new buyer of another similar entity.

2. **Lost Volume:** the mere fact that an injured party can make arrangements for the disposition of goods or services that he was to supply under the contract does not necessarily means that by doing so he will avoid loss. If he would have entered into both transactions but for the breach, he has lost volume as result of the breach [Rst. (2) §350 cmt. d].
3. Whether a subsequent transaction is a substitute for the broken contract is sometimes raises a difficult question of fact. If the injured party could and would have entered into the subsequent contract, even if the contract had not been broken, and could have had the benefit of both, he can be said to have *lost volume* and the subsequent transaction is not a substitute for the broken contract. The injured parties damages are then based on the net profit that he as a result of the broken contract [Rst. (2) §347 cmt. f].

E. **G/R:** Establishing a Lost Volume Seller: in order for the plaintiff to establish status as a lost volume seller, the plaintiff must prove:
1. that it possessed the capacity to make additional sales;
2. that it would have profitable for it to make additional sales; and
3. that it probably would have made an additional sale absent the buyers breach.

F. **G/R:** Mitigating Contracts: in order for the breaching party to obtain a deduction form its damage liability for income received by the plaintiff from another contract, the breaching party must show that the other contract was a *mitigating contract*, that is, a contract that the plaintiff was able to perform only because the defendant's breach freed the plaintiff form the obligation to perform the original contract.
1. If the court finds the new contract is an *additional contract* rather than a mitigating one, however, the plaintiff is entitled to the net profit from both contracts, and the defendant will not have the benefit of any deduction from its damage liability.

G. **G/R:** Personal Service Contracts: if the contract is one for personal services, a new contract entered into after the breach will generally be considered a mitigating one because an individual has a limited capacity to perform personal services.
1. Caveat: in some cases, however, it may be possible for the employee or other provider of services to perform both contracts; in that case the contract will not be considered a mitigating one.
2. If the contract does not require personal services, a second contract entered into after breach of the first contract will not be considered a mitigating one if the provider of services has the capacity to perform both contracts.
3. If the new contract is viewed as an additional contract rather than a mitigating one, the plaintiff is entitled to his lost profit from the original contract without deduction of the amount received from the new contract.

**[Jet Services v. Salina].

§4.3: Nonrecoverable Damages for Breach of Contract

A. **Generally:** Damages not recoverable for breach of contract:

1. Attorney's fees;
2. Emotional Distress/ Mental Anguish [Rst. (2) §353];
3. Punitive Damages [Rst. (2) §355].

I. Attorney's Fees

A. **G/R:** American Rule: the general rule is to prohibit successful litigants from recovering attorney's fees and expenses except in a very limited class of cases.

1. The traditional approach is to prohibit recovery of attorney's fees and expenses in civil cases in the absence of either an agreement between the parties, or a statute or rule to the contrary and this rule is usually applied in declaratory judgments.
2. **Policy:** since litigation is at best uncertain, one should not be penalized for merely defending or prosecuting a lawsuit and the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for the losing included the fees of their opponents counsel.
    a. Also, the time, expense, and difficulties of proof inherent in litigating the question or what constitutes reasonable attorney's fees would pose substantial burdens for the judicial process.
    b. Encourages settlements;
    c. Encourages parties to bring more meritorious cases
3. **Exception:** there is an exception to the general rule disallowing attorney's fees and expenses when the owner of a insurance policy has successfully established in a declaratory judgment the insurer's duty to defend under the policy.
    a. **Policy:** a *special relationship* exists between an insurer and the insured under a policy.
    b. Some of the main areas in which statute provide for the recovery of attorney's fees are:
        (i) civil rights;
        (ii) environmental cases;
        (iii) consumer protection;
        (iv) employment law; and
        (v) securities regulation.

*[Preferred Mutual v. Gamache].

II. Emotional Distress and Mental Anguish

A. **G/R:** Loss Due to Emotional Disturbance: [**Rst. (2) §353**]: 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 will likely result.

1. **Exception:** the breach also caused bodily harm or the contract or breach is such a kind that serious emotional disturbance will likely result.
    a. Ex: *Bodily Harm:* breach of plastic surgery contract which disfigured face allowed for recovery of emotional disturbance [Sullivan v. O'Connor].

b. Ex: *Breach*: funeral home director loses body and breaches contract, emotional distress damages would be recoverable.

2. The focus in determining damages is on the *nature* of the *contract* and not the type of breach.

a. Thus, most courts have generally limited emotional distress damages to contracts uniquely intended to protect some personal interest or security and which are incapable of compensation by reference to the terms of the contract.

B. **G/R:** Employment Contracts: (majority rule) the traditional common law rule provides that tort damages for breach of an employment contract are not recoverable [Gaglidari v. Denny's].

1. *Minority Rule:* emotional distress damages should be recoverable for breach of an employment contract where the employee can demonstrate that the employer's conduct was wanton or reckless, and the emotional distress was a foreseeable result of the breach.

III. Punitive Damages

A. **G/R:** Punitive Damages: [**Rst. (2) §355**]: 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.

B. **G/R:** There are three main reasons why punitive damages are not available for breach of contract:

1. Contract damages are designed to compensate the plaintiff for harm actually caused and therefore the law should not put the injured party in a better position than he would have occupied if the contract had been performed.
2. Breach of contract is not based on fault; rather, it is based on a type of strict liability—if a part breaches they pay for the damage caused.
3. It would eliminate efficient breaches which are better sound economically.

C. **G/R:** Majority View: there has to be an independent tort duty to give raise to punitive damages for breach of contract, even if the contact is breached in bad faith [Freeman and Mills v. Belcher Oil].

D. **G/R:** Efficient Breach: if the breaching party stands to gain more from breaching the contract then the other party will gain and it is cheaper for the breaching party to terminate the contract and to compensate the non-breaching party, then it is more efficient and the law should not penalize the breaching party for more then the damages caused by the breach.

1. This is better for the economy because the breaching party is making more money and the non-breaching party was not harmed beyond the breach, which it will be fully compensated for.
2. If punitive damages were allowed, and damages for emotional distress, then it would the theory of efficient breach into a skew.

§5: RELIANCE DAMAGES

§5.1: Reliance Damages

A. **G/R:** there are three main types of damages that are recoverable for breach of a contract (listed in decreasing order of amount of recovery usually awarded):

1. Expectation Damages: put the party in as good a position as he would have been had there been no breach.

2. Reliance Damages: put the non-breaching party in the same position as if he hand not entered into the contract.

3. Restitution Damages: repay the non-breaching party any benefit that he conferred on the breaching defendant.

B. **Formula:** Reliance Damages = (un-reimbursed expenses) + (materials) – (resale).

C. **G/R:** Reliance Damages: ordinarily, profits lost due to a breach of contract are recoverable. Where anticipated profits are too speculative to be determined, money spent in part performance, in preparation for or in reliance on the contract are recoverable [Wartzman v. Hightower].

D. **G/R:** Damages Based on Reliance Interest: [**Rst. (2) §349**]: As an alternative to the measure of damages in §347 [expectation interest], 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 reasonably certainty the injured party would have suffered had the contract been performed.

E. **G/R:** Measure for Reliance Damages: the non-breaching party may recovery any costs made in reliance on the contract, less mitigation and foreseeable damages.

F. **G/R:** Limitations on Recovery for Reliance Interests: recovery based upon reliance interest is not without limitation. If it can be shown that full performance would have resulted in a net loss, the plaintiff cannot escape the consequences of his bad bargain by falling back on his reliance interests.

1. Where the breach has prevented an anticipated gain and made proof of loss difficult to ascertain, the injured party has a right to damages based upon his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that would have suffered had the contract been performed.
2. The Restatement expressly authorizes the breaching party to prove any loss that the injured party would have suffered had the contract been performed [Rst. (2) §349].

G. **G/R:** the promisee may recover his outlay in preparation for the performance, subject to the privilege of the promisor to reduce it by as much as he can show that the promisee would have lost if the contract had been performed.

1. The very nature of reliance damages is that they cannot be measured with any degree of reasonable certainty.

H. **G/R:** Equal Opportunity Exception to Mitigation: the party who is in default may not mitigate his damages by showing that the other party could have reduced those damages by expending large amounts of money or incurring substantial obligations.

1. The doctrine of mitigation does not apply where both parties have an equal opportunity to mitigate damages.

I. **Note:** the doctrine of reliance damages are limited by the doctrines of mitigation and foreseeable damages, however, they can still be more then the contract price in certain situations.

J. **G/R:** Promissory Estoppel: [**Rst (2) §90**]: a promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person is binding if injustice can be avoided only by enforcement of the promise.

1. The remedy granted for breach may be limited as justice requires. A promise binding under promissory estoppel is a contract, and full-scale enforcement by normal remedies are often appropriated.
2. But the same factors which bear on whether any relief should be granted als bear on the character and extent of the remedy. *In particular, relief may be sometimes limited restitution damages or specific relief measured by the promisee's reliance rather than by the terms of the promise* [Rst. (2) §90 cmt. d].
3. When a promise is enforced pursuant to §90 the remedy granted may be limited, as justice requires. Relief may be limited to damages measured by the promisee's reliance.
4. Further, relief may be limited to the party's out-of-pocket expenses made in reliance on the promise.

K. **G/R:** Measure of Out-of-Pocket Expenses: out-of-pocket expenses are measured by the difference between the actual value and the amount paid for the property.

§6: RESTITUTIONARY DAMAGES

§6.1: Restitution Damages

A. **Generally:** in some cases, usually construction cases, it may be better to get restitution damages.

1. Ex: A contracts with B; A is going to lose money on the contract; and then (luckily enough) B breaches. A can get the reasonable value of services performed and not expectation damages (which would have been a loss).

B. **G/R:** Measure of Restitution Interest: [**Rst. (2) §371**]: 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 form 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 interests advanced.

C. **G/R:** Restitution in Favor of Party in Breach: [**Rst (2) §374**]: (1) If any party justifiably refuses to perform on the ground that his remaining duties of performance have been discharged by the other party's breach, the party in breach is entitled to restitution for any benefit that he has conferred by way of part performance or reliance in excess of the loss that he caused by his own breach.

(2) **Exception:** to the extent that, under the manifested assent of the parties, a party's performance is to be retained in the case of breach, that party is not entitled to restitution if the value of the performance as liquidated damages is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss.

D. **G/R:** Quantum Meriut: [not contract price; restitution for services]: the non-breaching party can recover for the reasonable value of services performed with no diminished value for lost expectancy.

1. **Policy:** (a) don't want to reward party in breach by giving them the benefit of the bargain; (b) if breaching party ahs to pay more, it okay because he is getting penalized for the breach; (c) the courts are trying to prevent unjust enrichment so after the contract is breached, the contract no longer exists and therefore don't need to look to the contract anymore.
2. *Majority Rule:* non-breaching party gets reasonable value of services performed undiminished (puts all the loss on the plaintiff).
3. *Minority Rule:* Pro-Rata System: use the contract as probative value of the reasonable value of services; and if a certain percentage of the contract is completed, then the non-breaching party can only recover that percentage of damages (splits loss between plaintiff and defendant).
4. **Exception:** Full Performance Exception: if the non-breaching party has fully performed his obligations under the contract and all the other party has do is pay a sum of money, the non-breaching party may not elect a restitutionary recover but is limited to expectation damages [Rst. (2) §373(2)].

G. **G/R:** it is an accepted principle of contract law, and is often applied in construction cases, that the promisee upon breach has the option to forego any suit on the contract and claim on the reasonable value of his services (restitution damages) [U.S. v. Algernon Blair].

H. **G/R:** the impact of quantum meriut (restitution) is to allow the promisee to recover the value of services he gave to the defendant irrespective of whether he would have lost money on the contract and been unable to recover in a suit on the contract.

1. Measure of Recovery: the measure of recovery for quantum meriut is the reasonable value of performance and recovery is undiminished by any loss which would have been incurred by complete performance.
2. While the contract price may be evidence of the reasonable value of services, it does not measure the value of performance or limit recovery. Rather, the standard for measuring the reasonable value of the services rendered is the amount for which services could have been purchased from one in the plaintiff's position at the time and place the services were rendered.

I. **G/R:** Classical Restitutionary Damage Rule: (minority view) the common law rule prohibits a defaulting (or breaching party) from recovering for breach of contract.

1. **Policy:** (a) the party who breaches should not be allowed to recover for his own wrong; (b) allowing recovery invites contract breaking and rewards morally unworthy conduct; (c) discourages freedom of contract because too many people can gent out of contracts and *recover*; (d) no deterrence effect; (e) less litigation.

J. **G/R:** Modern Restitutionary Damage Rule: (majority view): [Rst. (2) §374(1)(2)]: the breaching party is entitled to recovery for the breach of contract less the damage caused by the breach.

1. **Policy:** (a) the goal of contract law is to restore the parties to essentially the same position as they would have been had the breach not occurred; (b) contract breacher is not a criminal; (c) don't want to give windfall to the plaintiff; (d) efficient breaches are more economically beneficial; and the modern rule doesn't discourage economic breach.

K. **G/R:** Unjust Enrichment: the basic contours of the law of quantum meriut or unjust enrichment are:

1. an action for unjust enrichment may be based on:
    a. failure of consideration;
    b. fraud;
    c. mistake; and
    d. situations where it would be morally wrong for one party to enrich himself at the expense of another.
2. However, a claim of unjust enrichment does not lie simply because one party benefits from the efforts or obligations of another, but instead lies where one party was unjustly enriched in the sense that the term unjustly could mean illegally or wrongfully.

*[Titan Sports v. Ventura].

***NOTE: **look for something of this sort on the exam because the contract can be voided for one of the doctrines we've studied (fraud, mistake, minor, incapacity) but the non-breaching party can still recover restitution.**

L. **G/R:** Quantum Meriut: quantum meriut is not available simply because the breaching party may have been in breach. Where an express contract exists, there can be no implied (in law) contract with respect to the same subject matter.

1. If an existing contract does not address the benefit for which recover is sought, quantum meriut is available regarding those items about which the contract is silent.
    a. As corollary of this rule is that quantum meriut is available if the benefit is conferred unknowingly, but not if the benefit is conferred merely as part of a bad bargain.
2. It is fundamental that proof of an express contract precludes recovery in quantum meriut.
3. It is well established that unjust enrichment and quantum meriut may arise from fraud or several other predicates.
    a. However, nothing in the law requires *all* elements of a cause of action for fraud must be proved in order to use fraud as a stepping stone for quantum meriut.

§7: CALCULATING DAMAGES

§7.1: Calculating Damages for Expectation, Reliance, and Restitution Damages

A. **Expectation Damages:** *Expectation Damages* = (loss in value) + (other cost) – (cost avoided) – (loss avoided).

__Goal:__ put the plaintiff in the position he would have been in had the contract been fully performed.

***Rst. (2) §347

B. **Reliance Damages:** *Reliance Damages* = (expenditures in preparation) + (expenditures in performance) – (loss if contract is performed) – (loss avoided).
    1. Alternatively: *Reliance Damages* = (cost of part performance) + (cost in preparation) – (loss if contract is performed) – (loss avoided).

__Goal:__ put the plaintiff in as good as position as he was before the contract was made.

***Rst. (2) §349

C. **Restitution:** *Restitution Damages* = (value to the defendant of the plaintiff's performance [reasonable value of plaintiff's performance]) – (loss avoided).

__Goal:__ to have the defendant pay the plaintiff an amount equal to the benefit which the defendant has received from the plaintiff's performance (prevent unjust enrichment).

***Rst. (2) §§370-377

D. **Calculation Future Unknown Damages:** if there is an indefinite damages into the future all that you have to put on the test is:
    1. The damages will have to be discounted; and

2. This will have to be figured out by hiring an EXPERT WITNESS.

§8: SPECIFIC PERFORMANCE

§8.1: Specific Performance

I. Restatement Provisions [Rst. (§§359-367]

A. **Rst. (2) §359:** Effect of Adequacy of Damages: (1) Specific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the party.

1. In other words, if money can be awarded, it should be the remedy.

B. **Rst. (2) §360:** Factors Affecting Adequacy of Damages: in determining whether the remedy in damages would be adequate, the following circumstances are significant:

(a) the difficulty of proving damages with reasonable certainty;
(b) the difficulty of procuring a suitable substitute performance by means of money awarded as damages; and
(c) the likelihood that an award of damages could not be collected.

C. **Rst. (2) §362:** Effect of Uncertainty of Terms: specific performance or an injunction will *NOT* be granted unless the terms of the contract are sufficiently certain to provide a basis for an appropriate remedy.

D. **Rst. (2) §364(1):** Effect of Unfairness: specific performance will be refused if such relief would be unfair because:

(a) the contract was induced by mistake or by unfair practices;
(b) the relief would cause unreasonable hardship or loss to the party in breach *or third persons*; or
(c) the exchange is grossly inadequate or the terms of the contract are otherwise unfair.

E. **Rst. (2) §367:** Contracts for Personal Service or Supervision: (1) A promise to render personal service will not be specifically enforced.

II. Specific Performance in Contracts that are Not Employment Contracts

A. **G/R:** A party cannot have a contract specifically enforced unless that party can demonstrate that money damages are inadequate compensation.

1. Ex: a contract for the sale of land.

B. **G/R:** Specific Performance of a Land Contract:

1. **Classical Rule:** (majority rule): an option contract to purchase property which contains a provision that the price would be agreed upon later is specifically enforceable.

a. When a contract has been partly performed by the plaintiff, and the defendant has received the benefit thereof, and the plaintiff would be virtually remediless unless the contract were enforced the court does not regard the fact the agreement was not complete.

2. **G/R:** a contract for the sale of land is more likely to be specifically enforced because money damages are considered inadequate because each piece of land is considered unique.

*[City Stores v. Ammerman].

C. **G/R:** Specific Performance of Construction Contracts: were specific performance for contracts for the construction of buildings has be granted the essential criterion has not been the nature or subject of the contract, but rather the inadequacy of legal remedies.

1. Rule: contracts involving interests in land or unique chattels are more likely to be specifically enforced because of the clear inadequacy of damages at law for breach of contract.

a. Thus, a contract should be specifically enforced where the damages are inadequate or impracticable.

2. Rule: some courts are opposed to the granting of specific enforcement of construction of buildings and other contracts requiring extensive supervision by the court.

*[City Stores v. Ammerman].

D. **Modern Trend:** where specific performance is practical and can be ordered, the courts should order the contract to be specifically enforced.

1. *City Stores v. Ammerman* is a landmark case for specific performance because it started the modern trend that construction contracts may be specifically enforced, despite the fact that court may have to supervise construction.

a. It is probably limited, however, to construction contracts where the party completing the construction also has an interest in the land, thus insuring they will complete the job adequately.

E. **G/R:** Unreasonable Hardship Rule: if the defendant will suffer substantial hardship if the contract is specifically enforced then the maxim that equity will not grant specific performance if the hardship to the defendants is greater than the potential benefit to the plaintiff's applies.

III. Specific Performance of Employment Contracts *[ABC v. Wolf]

A. **G/R:** Employment Contracts: in employment settings, the court will not grant specific performance to complete the contract.

1. **Policy:** (a) Involuntary servitude is prohibited by the 13th Amend to the Constitution; (b) courts do not like to force a party to do something; (c) it is hard to supervise and measure performance; (d) personal autonomy is threatened; (e) there is no reason for the employee to perform on the job, that is, he may not work hard or even show up.

B. **G/R:** Specific Performance of an Employment Contract: courts have historically refused to order an individual to perform a contract for personal services.

1. **Exception:** Negative Specific Enforcement: where an employee refuses to render services to an employer in violation of an existing contract, and the *services are unique or extraordinary*, an injunction may be issued to prevent the employee from furnishing those services to another person for the duration of the contract.

a. Such negative specific enforcement was initially only available when the employee has expressly stipulated not to compete with the employer for the term of the contract (i.e. agreed to an anti-competitive clause).

b. Later cases, however, have permitted injunctive relief where the circumstances justified implication of a negative covenant.

(i) BUT see also Rst. (2) §367(2).

C. **G/R:** Anticompetitive Covenants: a court normally will not decree specific enforcement of an employee's anticompetitive covenant unless necessary to protect trade secrets, customer lists, or the good will of the employer's business, or perhaps when the employer is exposed to special harm because of the *unique nature* of the employee's services.

1. An otherwise valid covenant will not be enforced if it is unreasonable in time, space, or scope or would operate in a harsh and oppressive manner.

2. There is, in short, general judicial disfavor of anticompetitive covenants contained in employment contracts

a. **Policy:** once the term of an employment contract has expired the general public policy favoring robust and uninhibited competition should not give way merely because a particular employer wishes to insulate itself from competition. It may also hamper a man's livelihood.

D. **Application:** Specific performance of personal service contracts thus initially turns on whether the term of the contract has expired.

1. If the employee refuses to perform during the period of employment, was furnishing unique services, has expressly or by clear implication agreed not to compete for the duration of the contract and the employer is exposed to irreparable injury, it may be appropriate to restrain the employee from competing until the agreement expires.

2. Once the employment contract has terminated, by contrast, equitable relief (specific performance) is potentially available only to prevent injury from unfair competition or similar tortious behavior to enforce an express anticompetitive covenant.

3. In the absence of such circumstances, the general policy of unfettered competition should prevail.

§9: Agreed Remedies

§9.1: Liquidated Damages

A. **Generally:** the agreed remedy provision (often referred to as liquidated damages clauses, where a fixed or determinable sum of money has been specified in advance as the remedy for a particular type of breach) has not been warmly received in the courts.

1. Despite the obvious advantages that such terms can have for the parties, and the court system, they are subject to judicial scrutiny and will not be enforced unless they meet certain traditional tests.
2. Courts make a distinction between a term aimed at compensation, and therefore enforceable, and clause intended to penalize and therefore unenforceable.

B. **UCC §2-718(1):** Liquidation or Limitation of Damages: 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 loss caused by the breach and the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy.

C. **Rst. (2) §356(1):** Liquidated Damages as Penalties: damages for breach by either party may be liquidated in the agreement but only at an amount which that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on the grounds of public policy as a penalty.

D. **G/R:** Liquidated Damages: liquidated damages (enforceable) and penalties (unenforceable) are the terms used to reflect legal conclusions as to the enforceability and non-enforceability of stipulated damage clauses.

1. **Liquidated Damages:** is the sum a party to a contract agrees to pay if it breaks some promise, and which, having been arrived at by a good faith effort to estimate in advance the actual damages that will probably ensue form the breach, is legally recoverable as agreed damages if the breach occurs.
2. **Penalty:** is the sum the party agrees to pay in the event of a breach, but which is fixed, not as a pre-estimate of probable actual damages, but as a punishment, the threat of which is designed to prevent the breach.
3. **Rule:** the parties to a contract may not fix a penalty for the contracts breach. *[Wasserman v. Middletown].

E. **G/R:** a stipulated damage clause must constitute a reasonable forecast of the provable injury resulting form the breach; otherwise, the clause will be unenforceable as a penalty and the non-breaching party will be limited to conventional damage measures.

1. Reasonableness is the standard for deciding the validity of stipulated damage clauses.

F. **G/R:** Test for Validity: there is a three prong test for determining the validity of a clause that provides for agreed remedies:

1. the damages to be anticipated from the breach must be uncertain in amount or difficult to prove;
2. the parties must have intended the clause to liquidated damages rather than operate as a penalty; and

3. the amount set in the agreement must be a reasonable forecast of just compensation for the harm flowing from the breach (i.e. the amount must be reasonable).

a. Test for determining if the amount is reasonable:

(i) *Classical Rule:* courts determine the enforceability of the stipulated damage clause as of the time the contract was formed;

(ii) *Modern Rule:* courts assess the reasonableness of the stipulated damage clause *either* at the time the contract was formed, or at the time of breach.

b. Actual damages reflect on the reasonableness of the parties' prediction of the damages. If the damages provided for in the contract are grossly disproportionate to the actual harm sustained, the courts will usually conclude that the parties' original expectations were unreasonable.

G. **G/R:** the parties' own characterization of the sum as "liquidated damages" or as "penalty" is not controlling. The courts rely on the circumstances of the case and not on the words used by the parties in determining the enforceability of stipulated damages.

H. **G/R:** Burden of Proof: stipulated damage clauses will be presumed presumptively reasonable and the party challenging such a clause should bear the burden of proving its unreasonableness.

1. Thus, the party challenging the stipulated damage clause must establish that its application amounts to a penalty.

2. The decision of whether a stipulated damage clause is enforceable is a matter of law.

I. **G/R:** Purpose: the purpose of a stipulated damage clause is not to compel the promisor to perform, but to compensate the promisee for non-performance. Accordingly, provisions for liquidated damages are enforceable only to the amount fixed if it is a reasonable forecast of just compensation for the harm that is caused by the breach.

§10: UCC ARTICLE 2: WARRANTIES AND REMEDIES

§10.1: Overview

A. **Generally:** the purpose of a warranty is to determine what it is that the seller has in essence agreed to sell [UCC §2-313 cmt. 4].

1. UCC warranty law applies only to transactions in goods [§2-102].

a. Goods are anything that is movable at the time of the contract [§2-105(1)].

B. The UCC provides for a number of warranties and remedy limitations:

1. Express Warranties [§2-313];

2. Implied Warranties:

a. Implied Warranty of Merchantability [§2-314];

b. Implied Warranty of Fitness of Purpose [§2-315].

3. Warranty Disclaimers:
    a. Express Warranty Disclaimer [§2-316(1)];
    b. Implied Warranty Disclaimer [§2-316(2), (3)].
4. Remedy Limitations [§2-719].

C. **G/R:** if the transaction involves a mixture of goods and services then use the following test:

1. Predominant Factor Test: if the goods are the predominant factor in the transaction, the UCC is applicable.
    a. The relative cost of the goods and services is an important factor

§10.2: Express Warranties [UCC §2-313]

A. **G/R:** Express warranties are easy to make. They require no magic words and no intention on the part of the seller to make them.

B. **UCC §2-313(1)(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 promises.

C. **G/R:** Express warranties may arise from:
1. Oral representations;
2. written representations;
3. description of goods;
4. any sample or model shown;
5. plans or blue prints;
6. technical specifications;
7. reference to a market or official standard;
8. quality of goods sent to the buyer in the past; or
9. brochures and advertisements.

D. **G/R:** Warranties are affirmations of fact or promises, and not opinions.

1. **Exception: §2-313(2):** a statement of the seller's opinion or commendation of the goods does not create a warranty (puffery). There are four main factors in deciding if the seller's statement is one of puffery or an affirmation of fact which would give rise to an express warranty:
    a. the specificity of the representations;
    b. the degree to which the seller qualifies or hedges his statements;
    c. the experimental nature of the product; and
    d. the buyer's knowledge, including any expertise the buyer might have.

E. **G/R:** Basis of the Bargain: for an express warranty to be created it must be a part of the basis of the bargain.

1. Representations that are made during the negotiations but are not included in the original contract may be excluded because of the parol evidence rule.
2. Other warranties may be excluded because they were not relied upon.

3. Other warranties may be excluded because they were not made at a time which is deemed to constitute the bargain.

§10.3: Implied Warranty of Merchantability [UCC 2-314].

A. **§2-314(1):** unless excluded or modified [in §2-316 (disclaimers)] 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.

B. **G/R:** the implied warranty of merchantability when the goods a merchantable. For goods to be merchantable they must be fit for the ordinary purpose for which such goods are used.

1. Most of the §2-314 cases in which courts have found breaches of the warranty of merchantability involved goods that because of defects either did not work properly or were unexpectedly harmful.

C. **G/R:** the implied warranty of merchantability only applies if the seller is a merchant.

1. A merchant is defined in the UCC essential as a party who regularly deals in goods of that kind or holds himself out as having particular knowledge about the kind of goods [§2-104(1)

D. **G/R:** <u>Things that Render an Item Un-merchantable:</u>

1. the defect usually has to be relatively major;
2. minor problems usually do not render a product not merchantable.
3. Assuming the buyer is able to establish that there has been a sale of goods that are not merchantable, the buyer must in addition establish that:
    a. the seller is a merchant with respect to goods of that kind; and
    b. the defect in the goods *caused* damage to the plaintiff.

§10.4: Implied Warranty of Fitness for Purpose [UCC §2-315].

A. **§2-315:** where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified [under §2-316] an implied warranty that the goods shall be fit for such purpose.

B. **G/R:** the implied warranty of fitness for purpose is *NOT* limited to merchants but is limited to sales were the seller makes a representation.

1. Thus, the warranty is created only when the buyer relies on the seller's skill or judgment to select suitable goods for the buyer's particular purpose and the seller has reason to know of the reliance.
2. The breach of warranty does not require a showing that the goods are defective in any way—merely that the goods are not fit for the buyer's particular purpose.
    a. If the buyer is insisting on a particular brand, he is not relying on the seller's representations and no warranty results [§2-315 cmt. 5].

§10.5: Disclaimers of Express Warranty [UCC §2-316(1)].

A. **§2-316(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 chapter on parol or extrinsic evidence [§2-202] negation or limitation is inoperative to the extent that such construction is unreasonable.

B. **G/R:** express warranties that are part of the basis of the bargain are hard to disclaim. Thus, under §2-316(1) language creating a warranty and language disclaiming a warranty should be construed as consistent; if that is not possible, the warranty is made.

C. **G/R:** Parol Evidence Rule: since the warranties may be created orally or by one of several writings, the existence of an express warranty may turn on the application of the parol evidence rule.

1. If an express warranty is made during negotiations and the document embodying the final agreement of the parties disclaims all express warranties, then the disclaimer is probably effective because of the parol evidence rule.
2. If the statement was made during negotiations, but an integrated agreement did not contain the statement, it is not part of the bargain. This protects the seller against the buyers fraudulent claims and against statements of its own salesmen.

§10.6: Disclaimers of Implied Warranties [UCC §2-316(2),(3)].

A. **G/R:** Disclaimer of Implied Warranty of Merchantability: under §2-316(2) to dicalim the implied warranty of merchantability the language must (1) mention merchantability; and (2) in the case of a writing must be conspicuous.

1. Many courts have routinely invalidated disclaimers that do not use the word *merchantability* even if the disclaimer employs equivalent language.
2. **Test for Conspicuous:** under UCC §1-201(10) the test for conspicuous is whether a reasonable person against whom it is to operate ought to have noticed it.
    a. Use of capital letters, contrasting color, location of the clause (whether it is on the front or back), and sophistication of the parties are all factors in determining whether a disclaimer is conspicuous.

B. **G/R:** Use of a General Disclaimer: [**UCC §2-316(3)(a)**]: Notwithstanding §2-316(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 make plain that there is no implied warranty.

1. Unlike §2-316(2), §2-316(3) does not include a conspicuous requirement, but most courts agree that one should be implied to carry out the sections purpose of avoiding surprise to the buyer (majority view).
    a. A few courts have applied the language literally and do not require that the disclaimer be conspicuous (minority view).

§10.7: Limitations on Remedies [§2-719].

A. **Generally:** very often a seller does not disclaim all warranties, instead the seller gives a warranty but limits the buyer's remedies under the warranty. The most common remedy limitation is to "repair or replace broken parts."

1. In the absence of limitation, the remedies are those found in UCC §2-714(2),(3).

B. **§2-719:** (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 substitution for those provided in this chapter and may limit or alter the measure of damages recoverable under this chapter, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts;

(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.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injry to the person in the case of consumer goods is prima facie unconscionable but limitation of damages wehre the loss is commercial is not.