CASES IN CONTRACT

Case 1: Sufficiency of Consideration

Batsakis v. Demotsis

COURT OF CIVIL APPEALS OF TEXAS, EL PASO
226 S.W.2d 673 (1949)

OPINION BY: McGILL, Justice.

This is an appeal from a judgment of the 57th judicial District Court of Bexar County. Appellant was plaintiff and appellee was defendant in the trial court. The parties will be so designated.

Plaintiff sued defendant to recover $2,000 with interest at the rate of 8% per annum from April 2, 1942, alleged to be due on the following instrument, being a translation from the original, which is written in the Greek language:

> *"Peiraeus*
> *April 2, 1942*
> *"Mr. George Batsakis, Konstantinou Diadohou #7, Peiraeus*
>
> *"Mr. Batsakis:*
>
> *"I state by my present (letter) that I received today from you the amount of two thousand dollars ($2,000.00) of United States of America money, which I borrowed from you for the support of my family during these difficult days and because it is impossible for me to transfer dollars of my own from America.*
>
> *"The above amount I accept with the expressed promise that I will return to you again in American dollars either at the end of the present war or even before in the event that you might be able to find a way to collect them (dollars) from my representative in America to whom I shall write and give him an order relative to this. You understand until the final execution (payment) to the above amount an eight per cent interest will be added and paid together with the principal.*
>
> *"I thank you and I remain yours with respects.*
>
> *"The recipient,*
>
> *(Signed) Eugenia The. Demotsis."*

Trial to the court without the intervention of a jury resulted in a judgment in favor of plaintiff for $750.00 principal, and interest at the rate of 8% per annum from April 2, 1942 to the date of judgment, totaling $1163.83, with interest thereon at the rate of 8% per annum until paid. Plaintiff has perfected his appeal.

The court sustained certain special exceptions of plaintiff to defendant's first amended original answer on which the case was tried, and struck therefrom paragraphs II, III and V. Defendant excepted to such

action of the court, but has not cross-assigned error here. The answer, stripped of such paragraphs, consisted of a general denial contained in paragraph I thereof, and of paragraph IV, which is as follows:

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

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

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

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

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

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

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

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

The transaction amounted to a sale by plaintiff of the 500,000 drachmas in consideration of the execution of the instrument sued on, by defendant. It is not contended that the drachmas had no value. Indeed, the judgment indicates that the trial court placed a value of $750.00 on them or on the other consideration which plaintiff gave defendant for the instrument if he believed plaintiff's testimony. Therefore, the plea of want of consideration was unavailing. A plea of want of consideration amounts to a contention that the instrument never became a valid obligation in the first place . . .

Mere inadequacy of consideration will not void a contract . . .

Nor was the plea of failure of consideration availing. Defendant got exactly what she contracted for according to her own testimony. The court should have rendered judgment in favor of plaintiff against defendant for the principal sum of $2,000.00 evidenced by the instrument sued on, with interest as therein provided. We construe the provision relating to interest as providing for interest at the rate of 8% per annum. The judgment is reformed so as to award appellant a recovery against appellee of $2,000.00 with interest thereon at the rate of 8% per annum from April 2, 1942. Such judgment will bear interest at the rate of 8% per annum until paid on $2,000.00 thereof and on the balance interest at the rate of 6% per annum. As so reformed, the judgment is affirmed.

Reformed and affirmed

Batsakis v. Demotsis: COMMENTS AND QUESTIONS

1. An exception to the rule of consideration stated in the last paragraph of the opinion is that a small sum of money pledged in consideration for a larger sum of money is not an enforceable contract. How does that rule affect Batsakis v. Demotsis?

2. What reasons can you think of (none are stated in the opinion) why the appellate judge did not apply that rule in this case?

3. It is of interest to see how courts in different states perform. At the time of Batsakis, Texas courts were pretty backward. Imagine the lower court judge handing down a verdict of $750 plus interest-- what on earth could he have been thinking about? Certainly there is no theory of contract damage measurement that supports such an award. On the issue of how courts perform, keep in mind where an opinion is being generated as you read it. Good ones are the usual product of New York and especially California courts. You will get a chance to explore the output of Mississippi, Oklahoma and Montana along the way, as well.

Case 2. Consideration or Intent as Basis of Enforcement?

Hamer v. Sidway
COURT OF APPEALS OF NEW YORK
124 N.Y. 538 (1891)

SYLLABUS: S., defendant's testator, agreed with W., his nephew, plaintiff's assignor, that if he would refrain from drinking liquor, using tobacco, swearing and playing cards or billiards for money until he should become twenty-one years of age he would pay him $5,000. W. performed his part of the agreement; he became of age in 1875. Soon thereafter he wrote to S. advising him of such performance, stating that the sum specified was due him, and asking payment. S. replied admitting the agreement and the performance and stating that he had the money in bank, set apart, which he proposed to hold for W. until the latter was capable of taking care of it. It was thereupon agreed between the parties that the money should remain in the hands of S. on interest. In an action upon the agreement, held, that it was founded upon a good consideration and was valid and enforceable.

It is not essential in order to make out a good consideration for a promise to show that the promisor was benefited or the promisee injured; a waiver on the part of the latter of a legal right is sufficient.

S. died in 1887 without having paid any portion of the sum agreed upon. Held, that under the agreement made in 1875, the relation of the parties thereafter was not that of debtor and creditor, but of trustee and *cestui que trust*; and that, therefore, the claim was not barred by the Statute of Limitations. It did not appear upon the face of the complaint that the original agreement was not in writing, and so prohibited by the Statute of Frauds, because not to be performed within a year. Held, that as no such defense was set up in the answer, it was not available.

Also held, that the statements of S., subsequent to the date of final performance on the part of the promisee, was a waiver of such defense.

This action was brought upon an alleged contract.

The plaintiff presented a claim to the executor of William E. Story, Sr., for $5,000 and interest from the 6th day of February 1875. She acquired it through several mesne assignments from William E. Story, 2d. The claim being rejected by the executor, this action was brought. It appears that William E. Story, Sr., was the uncle of William E. Story, 2d; that at the celebration of the golden wedding of Samuel Story and wife, father and mother of William E. Story, Sr., on the 20th day of March 1869, in the presence of the family and invited guests he promised his nephew that if he would refrain from drinking, using tobacco, swearing and playing cards or billiards for money until he became twenty-one years of age he would pay him a sum of $5,000. The nephew assented thereto and fully performed the conditions inducing the promise. When the nephew arrived at the age of twenty-one years and on the 31st day of January 1875, he wrote to his uncle informing him that he had performed his part of the agreement and had thereby become entitled to the sum of $5,000. The uncle received the letter and a few days later and on the sixth of February, he wrote and mailed to his nephew the following letter:

"Buffalo, Feb. 6, 1875.
"W. E. Story, Jr.:

"Dear Nephew -- Your letter of the 31st ult. came to hand all right, saying that you had lived up to the promise made to me several years ago. I have no doubt but you have, for which you shall have five thousand dollars as I promised you. I had the money in the bank the day you was 21 years old that I intend for you, and you shall have the money certain. Now, Willie I do not intend to interfere with this money in any way till I think you are capable of taking care of it and the sooner that time comes the better it will please me. I would hate very much to have you start out in some adventure that you thought all right and lose this money in one year. The first five thousand dollars that I got together cost me a heap of hard work. You would hardly believe me when I tell you that to obtain this I shoved a jackplane many a day, butchered three or four years, then came to this city, and after three months' perseverence I obtained a situation in a grocery store. I opened this store early, closed late, slept in the fourth story of the building in a room 30 by 40 feet and not a human being in the building but myself. All this I done to live as cheap as I could to save something. I don't want you to take up with this kind of fare. I was here in the cholera season '49 and '52 and the deaths averaged 80 to 125 daily and plenty of smallpox. I wanted to go home, but Mr. Fisk, the gentleman I was working for, told me if I left then, after it got healthy he probably would not want me. I stayed. All the money I have saved I know just how I got it. It did not come to me in any mysterious way, and the reason I speak of this is that money got in this way stops longer with a fellow that gets it with hard knocks than it does when he finds it. Willie, you are 21 and you have many a thing to learn yet. This money you have earned much easier than I did besides acquiring good habits at the same time and you are quite welcome to the money; hope you will make good use of it. I was ten long years getting this together after I was your age. Now, hoping this will be satisfactory, I stop. One thing more. Twenty-one years ago I bought you 15 sheep. These sheep were put out to double every four years. I kept track of them the first eight years; I have not heard much about them since. Your father and grandfather promised me that they would look after them till you were of age. Have they done so? I hope they have. By this time you have between five and six hundred sheep, worth a nice little income this spring. Willie, I have said much more than I expected to; hope you can make out what I have written. To-day is the seventeenth day that I have not been out of my room, and have had the doctor as many days. Am a little better to-day; think I will get out next week. You need not mention to father, as he always worries about small matters.

Truly Yours,

"W. E. STORY.

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

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

COUNSEL: H. J. Swift for appellant. The letter coupled with the assent of the nephew that the money should remain in the uncle's hands on interest, made defendant's testator a depositary or a trustee of an established trust. If there was a sufficient consideration for the original contract between plaintiff's assignor and defendant's testator, then the promises in the letter were in settlement of a legal obligation, are founded upon sufficient consideration and are binding . . . The letter interpreted by surrounding circumstances established a trust and made the uncle self-appointed trustee of the $5,000 . . . If the uncle did not constitute himself a trustee by the letter he certainly made himself a depositary of the money which belonged to the

nephew, and if this is so the plaintiff is just as much entitled to recover as though the uncle had made himself a trustee, for the only bearing which the trusteeship has upon the question is as to whether the Statute of Limitations applies or not . . . The claim that inasmuch as the assignment from the nephew to his wife is declared void under the Bankrupt Act, therefore the plaintiff cannot maintain this action, is unsound.

Adelbert Moot for respondent. The court should have decided with the defendant upon the facts . . . There is no consideration to support the promise to pay the nephew $5,000. If the nephew was required to do something that would injure him, or something that would benefit the uncle, and did so with the assent of his father, then there would be a consideration for the payment of the $5,000. Simply failing to play cards or billiards for money, or drink liquor, or use tobacco, would not benefit the uncle; would not, and did not, injure the nephew . . . Neither William E. Story, Sr., nor any other person, ever held this $5,000 in trust for William E. Story, Jr., therefore, plaintiff cannot recover this action . . . and there was no consideration flowing to him from William E. Story, 2d, to support a trust . . . As plaintiff's claim rests upon contract, it is barred by the Statute of Limitations . . .

JUDGES: Parker, J. All concur.

The question which provoked the most discussion by counsel on this appeal, and which lies at the foundation of plaintiff's asserted right of recovery, is whether by virtue of a contract defendant's testator William E. Story became indebted to his nephew William E. Story, 2d, on his twenty-first birthday in the sum of five thousand dollars. The trial court found as a fact that "on the 20th day of March 1869, . . . William E. Story agreed to and with William E. Story, 2d, that if he would refrain from drinking liquor, using tobacco, swearing, and playing cards or billiards for money until he should become 21 years of age then he, the said William E. Story, would at that time pay him, the said William E. Story, 2d, the sum of $5,000 for such refraining, to which the said William E. Story, 2d, agreed," and that he "in all things fully performed his part of said agreement."

The defendant contends that the contract was without consideration to support it, and, therefore, invalid. He asserts that the promisee by refraining from the use of liquor and tobacco was not harmed but benefited; that that which he did was best for him to do independently of his uncle's promise, and insists that it follows that unless the promisor was benefited, the contract was without consideration. A contention, which if well founded, would seem to leave open for controversy in many cases whether that which the promisee did or omitted to do was, in fact, of such benefit to him as to leave no consideration to support the enforcement of the promisor's agreement. Such a rule could not be tolerated, and is without foundation in the law. The Exchequer Chamber, in 1875, defined consideration as follows: "A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." Courts "will not ask whether the thing which forms the consideration does in fact benefit the promisee or a third party, or is of any substantial value to anyone. It is enough that something is promised, done, forborne or suffered by the party to whom the promise is made as consideration for the promise made to him." (*Anson's Prin. of Con*. 63.)

"In general a waiver of any legal right at the request of another party is a sufficient consideration for a promise." (*Parsons on Contracts*, 444.)

"Any damage, or suspension, or forbearance of a right will be sufficient to sustain a promise." (Kent, vol. 2, 465, 12th ed.)

Pollock, in his work on contracts, page 166, after citing the definition given by the Exchequer Chamber already quoted, says: "The second branch of this judicial description is really the most important

one. Consideration means not so much that one party is profiting as that the other abandons some legal right in the present or limits his legal freedom of action in the future as an inducement for the promise of the first."

Now, applying this rule to the facts before us, the promisee used tobacco, occasionally drank liquor, and he had a legal right to do so. That right he abandoned for a period of years upon the strength of the promise of the testator that for such forbearance he would give him $5,000. We need not speculate on the effort which may have been required to give up the use of those stimulants. It is sufficient that he restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle's agreement, and now having fully performed the conditions imposed, it is of no moment whether such performance actually proved a benefit to the promisor, and the court will not inquire into it, but were it a proper subject of inquiry, we see nothing in this record that would permit a determination that the uncle was not benefited in a legal sense. Few cases have been found which may be said to be precisely in point, but such as have been support the position we have taken.

In Shadwell v. Shadwell (9 C. B. [N. S.] 159), an uncle wrote to his nephew as follows:

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

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

In Lakota v. Newton, an unreported case in the Superior Court of Worcester, Mass., the complaint averred defendant's promise that "if you (meaning plaintiff) will leave off drinking for a year I will give you $100," plaintiff's assent thereto, performance of the condition by him, and demanded judgment therefor. Defendant demurred on the ground, among others, that the plaintiff's declaration did not allege a valid and sufficient consideration for the agreement of the defendant. The demurrer was overruled.

In Talbott v. Stemmons . . . the step-grandmother of the plaintiff made with him the following agreement: "I do promise and bind myself to give my grandson, Albert R. Talbott, $500 at my death, if he will never take another chew of tobacco or smoke another cigar during my life from this date up to my death, and if he breaks this pledge he is to refund double the amount to his mother." The executor of Mrs. Stemmons demurred to the complaint on the ground that the agreement was not based on a sufficient consideration. The demurrer was sustained and an appeal taken therefrom to the Court of Appeals, where the decision of the court below was reversed. In the opinion of the court it is said that "the right to use and enjoy the use of tobacco was a right that belonged to the plaintiff and not forbidden by law. The abandonment of its use may have saved him money or contributed to his health, nevertheless, the surrender of that right caused the promise, and having the right to contract with reference to the subject-matter, the abandonment of the use was a sufficient consideration to uphold the promise." Abstinence from the use of intoxicating liquors was held to furnish a good consideration for a promissory note in Lindell v. Rokes (60 Mo. 249).

. . .

In further consideration of the questions presented, then, it must be deemed established for the purposes of this appeal, that on the 31st day of January 1875, defendant's testator was indebted to William E. Story, 2d, in the sum of $5,000, and if this action were founded on that contract it would be barred by the Statute of Limitations which has been pleaded, but on that date the nephew wrote to his uncle as follows:

> "Dear Uncle -- I am now 21 years old to-day, and I am now my own boss, and I believe, according to agreement, that there is due me $5,000. I have lived up to the contract to the letter in every sense of the word."

A few days later, and on February sixth, the uncle replied [in the letter printed above]. The trial court found as a fact that "said letter was received by said William E. Story, 2d, who thereafter consented that said money should remain with the said William E. Story in accordance with the terms and conditions of said letter." And further, "That afterwards, on the first day of March 1877, with the knowledge and consent of his said uncle, he duly sold, transferred and assigned all his right, title and interest in and to said sum of $5,000 to his wife Libbie H. Story, who thereafter duly sold, transferred and assigned the same to the plaintiff in this action."

We must now consider the effect of the letter, and the nephew's assent thereto. Were the relations of the parties thereafter that of debtor and creditor simply, or that of trustee and *cestui que trust*? If the former, then this action is not maintainable, because barred by lapse of time. If the latter, the result must be otherwise. No particular expressions are necessary to create a trust. Any language clearly showing the settler's intention is sufficient if the property and disposition of it are definitely stated. (Lewin on Trusts, 55.)

A person in the legal possession of money or property acknowledging a trust with the assent of the *cestui que trust*, becomes from that time a trustee if the acknowledgment be founded on a valuable consideration. His antecedent relation to the subject, whatever it may have been, no longer controls . . . If before a declaration of trust a party be a mere debtor, a subsequent agreement recognizing the fund as already in his hands and stipulating for its investment on the creditor's account will have the effect to create a trust . . .

It is essential that the letter interpreted in the light of surrounding circumstances must show an intention on the part of the uncle to become a trustee before he will be held to have become such; but in an effort to ascertain the construction which should be given to it, we are also to observe the rule that the language of the promisor is to be interpreted in the sense in which he had reason to suppose it was understood by the promisee. . . . At the time the uncle wrote the letter he was indebted to his nephew in the sum of $5,000, and payment had been requested. The uncle recognizing the indebtedness, wrote the nephew that he would keep the money until he deemed him capable of taking care of it. He did not say "I will pay you at some other time," or use language that would indicate that the relation of debtor and creditor would continue. On the contrary, his language indicated that he had set apart the money the nephew had "earned" for him so that when he should be capable of taking care of it he should receive it with interest . . . Certainly, the uncle must have intended that his nephew should understand that the promise not "to interfere with this money" referred to the money in the bank which he declared was not only there when the nephew became 21 years old, but was intended for him. True, he did not use the word "trust," or state that the money was deposited in the name of William E. Story, 2d, or in his own name in trust for him, but the language used must have been intended to assure the nephew that his money had been set apart for him, to be kept without interference until he should be capable of taking care of it . . .

The learned judge who wrote the opinion of the General Term, seems to have taken the view that the trust was executed during the life-time of defendant's testator by payment to the nephew, but as it does not

appear from the order that the judgment was reversed on the facts, we must assume the facts to be as found by the trial court, and those facts support its judgment.

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

Hamer v. Sidway: QUESTIONS AND COMMENTS

1. Suppose a contract is viewed as an agreement instead of a bargain: two people want to bind each other and each other's heirs or successors to a course of action, and that course of action does not violate any law or inflict harm on any third party. If a contract were so viewed, would it have been necessary for the court to search at such length for an element of "consideration" before simply declaring the contract should be executed?

2. If contracts were viewed as in Question 1 above, instead of as exchanges of value, would courts necessarily become embroiled in the enforcement of unilateral promises?

3. What evidence does the record contain that convinces you (or makes you doubt) that the uncle indeed intended that his nephew have the promised sum of money, and that the nephew indeed lived up to his promise?

Case 3:
Detrimental Reliance and Reliance Loss Damages

Goodman v. Dicker
UNITED STATES COURT OF APPEALS, DISTRICT OF COLUMBIA
169 F.2d 684 (1948)

OPINION: PROCTOR, Associate Justice.

This appeal is from a judgment of the District Court in a suit by appellees for breach of contract.

Appellants are local distributors for Emerson Radio and Phonograph Corporation in the District of Columbia. Appellees, with the knowledge and encouragement of appellants, applied for a "dealer franchise" to sell Emerson's products. The trial court found that appellants by their representations and conduct induced appellees to incur expenses in preparing to do business under the franchise, including employment of salesmen and solicitation of orders for radios. Among other things, appellants represented that the application had been accepted; that the franchise would be granted, and that appellees would receive an initial delivery of thirty to forty radios. Yet, no radios were delivered, and notice was finally given that the franchise would not be granted.

The case was tried without a jury. The court held that a contract had not been proven but that appellants were estopped from denying the same by reason of their statements and conduct upon which appellees relied to their detriment. Judgment was entered for $1500, covering cash outlays of $1150 and loss of $350, anticipated profits on sale of thirty radios.

The main contention of appellants is that no liability would have arisen under the dealer franchise had it been granted because, as understood by appellees, it would have been terminable at will and would have imposed no duty upon the manufacturer to sell or appellees to buy any fixed number of radios. From this it is argued that the franchise agreement would not have been enforceable (except as to acts performed thereunder) and cancellation by the manufacturer would have created no liability for expenses incurred by the dealer in preparing to do business. Further, it is argued that as the dealer franchise would have been unenforceable for failure of the manufacturer to supply radios appellants would not be liable to fulfill their assurance that radios would be supplied.

We think these contentions miss the real point of this case. We are not concerned directly with the terms of the franchise. We are dealing with a promise by appellants that a franchise would be granted and radios supplied, on the faith of which appellees with the knowledge and encouragement of appellants incurred expenses in making preparations to do business. Under these circumstances we think that appellants cannot now advance any defense inconsistent with their assurance that the franchise would be granted. Justice and fair dealing require that one who acts to his detriment on the faith of conduct of the kind revealed here should be protected by estopping the party who has brought about the situation from alleging anything in opposition to the natural consequences of his own course of conduct . . . In Dickerson v. Colgrove, . . . the Supreme Court, in speaking of equitable estoppel, said: "The law upon the subject is well settled. The vital principle is that he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is sternly forbidden. . . This remedy is always so applied as to promote the ends of justice." . . .

In our opinion the trial court was correct in holding defendants liable for moneys which appellees expended in preparing to do business under the promised dealer franchise. These items aggregated $1150. We think, though, the court erred in adding the item of $350 for loss of profits on radios promised under an initial order. The true measure of damage is the loss sustained by expenditures made in reliance upon the assurance of a dealer franchise. As thus modified, the judgment is

Affirmed.

Goodman v. Dicker: COMMENTS AND QUESTIONS

1. This case nicely serves two points (and how wonderfully brief and to the points it is!) First, it illustrates the purpose of promissory estoppel, the rationale for which is illustrated in the quote from the Supreme Court opinion in Dickerson v. Colgrove. Another name for promissory estoppel is "detrimental reliance." Properly speaking, when detrimental reliance has occurred, promissory estoppel can be invoked. Second, it correctly states, without explanation, that anticipated profits on sale of radios is not properly part of the judgment, in effect arguing that reliance loss and not expectation loss is the proper measure of damages in this case.

2. Suppose in fact that the lower court awarded expectation losses to the plaintiff. Would the $350 in lost sales profits by the plaintiffs have been the correct amount to award?

Case 4: Reasonableness Standard in Acceptability of Performance

Morin Building Products Inc. v. Baystone Construction Inc.
UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT
717 F. 2d 413 (1983)

OPINION BY: POSNER

This appeal from a judgment for the plaintiff in a diversity suit requires us to interpret Indiana's common law of contracts. General Motors, which is not a party to this case, hired Baystone Construction, Inc., the defendant, to build an addition to a Chevrolet plant in Muncie, Indiana. Baystone hired Morin Building Products Company, the plaintiff, to supply and erect the aluminum walls for the addition. The contract required that the exterior siding of the walls be of "aluminum type 3003, not less than 18 B & S gauge, with a mill finish and stucco embossed surface texture to match finish and texture of existing metal siding." The contract also provided "that all work shall be done subject to the final approval of the Architect or Owner's [General Motors] authorized agent, and his decision in matters relating to artistic effect shall be final, if within the terms of the Contract Documents"; and that "should any dispute arise as to the quality or fitness of materials of workmanship, the decision as to acceptability shall rest strictly with the Owner, based on the requirement that all work done or materials furnished shall be first class in every respect. What is usual or customary in erecting other buildings shall in no wise enter into any consideration or decision."

Morin put up the walls. But viewed in bright sunlight from an acute angle the exterior siding did not give the impression of having a uniform finish, and General Motors' representative rejected it. Baystone removed Morin's siding and hired another subcontractor to replace it. General Motors approved the replacement siding. Baystone refused to pay Morin the balance of the price ($23,000) and Morin brought this suit for the balance, and won.

The only issue on appeal is the correctness of a jury instruction which, after quoting the contractual provisions requiring that the owner (General Motors) be satisfied with the contractor's (Morin's) work, states: "Notwithstanding the apparent finality of the foregoing language, however, the general rule applying to satisfaction in the case of contracts for the construction of commercial buildings is that the satisfaction clause must be determined by objective criteria. Under this standard, the question is not whether the owner was satisfied in fact, but whether the owner, as a reasonable person, should have been satisfied with the materials and workmanship in question." There was much evidence that General Motors' rejection of Morin's exterior siding had been totally unreasonable. Not only was the lack of absolute uniformity in the finish of the walls a seemingly trivial defect given the strictly utilitarian purpose of the building that they enclosed, but it may have been inevitable; "mill finish sheet" is defined in the trade as "sheet having a nonuniform finish which may vary from sheet to sheet and within a sheet, and may not be entirely free from stains or oil." If the instruction was correct, so was the judgment. But if the instruction was incorrect -- if the proper standard is not whether a reasonable man would have been satisfied with Morin's exterior siding but whether General Motors' authorized representative in fact was -- then there must be a new trial to determine whether he really was dissatisfied, or whether he was not and the rejection therefore was in bad faith.

Some cases hold that 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 in bad faith . . . But most cases conform to the position stated in section 228 of the Restatement (Second) of Contracts (1979): 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.". . .[This majority position has been adopted] as the law of Indiana.

We do not understand the majority position to be paternalistic; and paternalism would be out of place in a case such as this, where the subcontractor is a substantial multistate enterprise. The requirement of reasonableness is read into a contract not to protect the weaker party but to approximate what the parties would have expressly provided with respect to a contingency that they did not foresee, if they had foreseen it. Therefore the requirement is not read into every contract, because it is not always a reliable guide to the parties' intentions. In particular, the presumption that the performing party would not have wanted to put himself at the mercy of the paying party's whim is overcome when the nature of the performance contracted for is such that there are no objective standards to guide the court. It cannot be assumed in such a case that the parties would have wanted a court to second-guess the buyer's rejection. So "the reasonable person standard" is employed when the contract involves commercial quality, operative fitness, or mechanical utility which other knowledgeable persons can judge . . . The standard of good faith is employed when the contract involves personal aesthetics or fancy . . .

We have to decide which category the contract between Baystone and Morin belongs in. The particular in which Morin's aluminum siding was found wanting was its appearance, which may seem quintessentially a matter of "personal aesthetics," or as the contract put it, "artistic effect." But it is easy to imagine situations where this would not be so. Suppose the manager of a steel plant rejected a shipment of pig iron because he did not think the pigs had a pretty shape. The reasonable-man standard would be applied even if the contract had an "acceptability shall rest strictly with the Owner" clause, for it would be fantastic to think that the iron supplier would have subjected his contract rights to the whimsy of the buyer's agent. At the other extreme would be a contract to paint a portrait, the buyer having reserved the right to reject the portrait if it did not satisfy him. Such a buyer wants a portrait that will please him rather than a jury, even a jury of connoisseurs, so the only question would be his good faith in rejecting the portrait. Gibson v. Cranage, 39 Mich. 49 (1878).

This case is closer to the first example than to the second. The building for which the aluminum siding was intended was a factory -- not usually intended to be a thing of beauty. That aesthetic considerations were decidedly secondary to considerations of function and cost is suggested by the fact that the contract specified mill-finish aluminum, which is unpainted. There is much debate in the record over whether it is even possible to ensure a uniform finish within and among sheets, but it is at least clear that mill finish usually is not uniform. If General Motors and Baystone had wanted a uniform finish they would in all likelihood have ordered a painted siding. Whether Morin's siding achieved a reasonable uniformity amounting to satisfactory commercial quality was susceptible of objective judgment; in the language of the Restatement, a reasonableness standard was "practicable."

But this means only that a requirement of reasonableness would be read into this contract if it contained a standard owner's satisfaction clause, which it did not; and since the ultimate touchstone of decision must be the intent of the parties to the contract we must consider the actual language they used. The contract refers explicitly to "artistic effect," a choice of words that may seem deliberately designed to put the contract in the "personal aesthetics" category whatever an outside observer might think. But the reference appears as number 17 in a list of conditions in a general purpose form contract. And the words "artistic effect" are immediately followed by the qualifying phrase, "if within the terms of the Contract Documents," which suggests that the "artistic effect" clause is limited to contracts in which artistic effect is one of the things the buyer is aiming for; it is not clear that he was here. The other clause on which Baystone

relies, relating to the quality or fitness of workmanship and materials, may seem all-encompassing, but it is qualified by the phrase, "based on the requirement that all work done or materials furnished shall be first class in every respect" -- and it is not clear that Morin's were not. This clause also was not drafted for this contract; it was incorporated by reference to another form contract (the Chevrolet Division's "Contract General Conditions"), of which it is paragraph 35. We do not disparage form contracts, without which the commercial life of the nation would grind to a halt. But we are left with more than a suspicion that the artistic-effect and quality-fitness clauses in the form contract used here were not intended to cover the aesthetics of a mill-finish aluminum factory wall.

If we are right, Morin might prevail even under the minority position, which makes good faith the only standard but presupposes that the contract conditioned acceptance of performance on the buyer's satisfaction in the particular respect in which he was dissatisfied. Maybe this contract was not intended to allow General Motors to reject the aluminum siding on the basis of artistic effect. It would not follow that the contract put Morin under no obligations whatsoever with regard to uniformity of finish. The contract expressly required it to use aluminum having "a mill finish . . . to match finish . . . of existing metal siding." The jury was asked to decide whether a reasonable man would have found that Morin had used aluminum sufficiently uniform to satisfy the matching requirement. This was the right standard if, as we believe, the parties would have adopted it had they foreseen this dispute. It is unlikely that Morin intended to bind itself to a higher and perhaps unattainable standard of achieving whatever perfection of matching that General Motors' agent insisted on, or that General Motors would have required Baystone to submit to such a standard. Because it is difficult -- maybe impossible -- to achieve a uniform finish with mill-finish aluminum, Morin would have been running a considerable risk of rejection if it had agreed to such a condition, and it therefore could have been expected to demand a compensating increase in the contract price. This would have required General Motors to pay a premium to obtain a freedom of action that it could not have thought terribly important, since its objective was not aesthetic. If a uniform finish was important to it, it could have gotten such a finish by specifying painted siding.

All this is conjecture; we do not know how important the aesthetics were to General Motors when the contract was signed or how difficult it really would have been to obtain the uniformity of finish it desired. The fact that General Motors accepted the replacement siding proves little, for there is evidence that the replacement siding produced the same striped effect, when viewed from an acute angle in bright sunlight, that Morin's had. When in doubt on a difficult issue of state law it is only prudent to defer to the view of the district judge, . . . here an experienced Indiana lawyer who thought this the type of contract where the buyer cannot unreasonably withhold approval of the seller's performance.

Lest this conclusion be thought to strike at the foundations of freedom of contract, we repeat that if it appeared from the language or circumstances of the contract that the parties really intended General Motors to have the right to reject Morin's work for failure to satisfy the private aesthetic taste of General Motors' representative, the rejection would have been proper even if unreasonable. But the contract is ambiguous because of the qualifications with which the terms "artistic effect" and "decision as to acceptability" are hedged about, and the circumstances suggest that the parties probably did not intend to subject Morin's rights to aesthetic whim.

AFFIRMED.

Morin Building Products Inc. v. Baystone Construction Inc.: COMMENTS AND QUESTIONS

1. Morin stands in interesting contrast to the case that follows next. Try to identify all the salient differences between the two, and form an opinion as to the reasonableness of the two decisions.

2. This opinion says much about how contracts ought to be enforced in light of the economic objectives that they serve. See particularly the language on the question of "reasonableness" in the last several paragraphs. Summarize those comments.

Case 5:
Performance Variation From Terms

Jacob & Youngs, Inc. v. Kent
COURT OF APPEALS OF NEW YORK
230 N.Y. 239 (1921)

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

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract -- that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture . . . Some promises are so plainly independent that they can never by fair construction be conditions of one another . . . Others are so plainly dependent that they must always be conditions. Others, though dependent and thus conditions when there is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant . . . Considerations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another. The simple and the uniform will call for different remedies from the multifarious and the intricate. The margin of departure within the range of normal expectation upon a sale of common chattels will vary from the margin to be expected upon a contract for the construction of a mansion or a "skyscraper." There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason in the implication of a like condition when the subject-matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.

Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier. The decisions in this state commit us to the liberal view, which is making its way, nowadays, in jurisdictions slow to welcome it . . . Where the line is to be drawn between the important and the trivial cannot be settled by a formula . . . The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract . . . There is no general license to install whatever, in the builder's judgment, may be regarded as "just as good" . . . The question is one of degree, to be answered, if there is doubt, by the triers of the facts . . . and, if the inferences are certain, by the judges of the law . . . We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfilment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression . . . For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong . . .

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure . . . The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. "There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable.". . . The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

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

HISCOCK, Ch. J., HOGAN and CRANE, JJ. , concur with CARDOZO, J.; POUND and ANDREWS, JJ., concur with MCLAUGHLIN, J.

Order affirmed, etc.

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

Under its contract it obligated itself to use in the plumbing only pipe (between 2,000 and 2,500 feet) made by the Reading Manufacturing Company. The first pipe delivered was about 1,000 feet and the plaintiff's superintendent then called the attention of the foreman of the subcontractor, who was doing the plumbing, to the fact that the specifications annexed to the contract required all pipe used in the plumbing to be of the Reading Manufacturing Company. They then examined it for the purpose of ascertaining whether this delivery was of that manufacture and found it was. Thereafter, as pipe was required in the progress of the work, the foreman of the subcontractor would leave word at its shop that he wanted a specified number of feet of pipe, without in any way indicating of what manufacture. Pipe would thereafter be delivered and installed in the building, without any examination whatever. Indeed, no examination, so far as appears, was made by the plaintiff, the subcontractor, defendant's architect, or any one else, of any of the pipe except the first delivery, until after the building had been completed. Plaintiff's architect then refused to give the certificate of completion, upon which the final payment depended, because all of the pipe used in the plumbing was not of the kind called for by the contract. After such refusal, the subcontractor removed the covering or insulation from about 900 feet of pipe which was exposed in the basement, cellar and attic, and all but 70 feet was found to have been manufactured, not by the Reading Company, but by other manufacturers, some by the Cohoes Rolling Mill Company, some by the National Steel Works, some by the South Chester Tubing Company, and some which bore no manufacturer's mark at all. The balance of the pipe had been so installed in the building that an inspection of it could not be had without demolishing, in part at least, the building itself.

I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions . . . But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor was any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either "nominal or nothing." Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been "just as good, better, or done just as well." He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed . . . The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application . . .

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

I am of the opinion the trial court did not err in ruling on the admission of evidence or in directing a verdict for the defendant. For the foregoing reasons I think the judgment of the Appellate Division should be reversed and the judgment of the Trial Term affirmed.

Jacob & Youngs, Inc. v. Kent: QUESTIONS AND COMMENTS

1. Suppose a court is concerned only with efficiency: maximing the value from resource use in society. Would such a court order specific performance? (Replacement of the pipe?)

2. Suppose the intent is to "let the punishment fit the crime": to award damages commensurate with the damages suffered. What measure of damages is appropriate for the case in question?

3. Use your imagination to answer this: under what circumstances, or why, might a person care what the name is that appears at intervals along the pipe, buried deep in the ground, through which his family sewage flows? In my personal view, such a concern is evidence of a malfunctioning mind. But if a court is not concerned that benefits flow from contracts, and instead is concerned only with upholding agreements, such a question is not of any consequence. Having a morbid fondness for Reading pipe would not serve a homeowner well in an eminent domain proceeding: "I cannot accept a market value offer for my house, because I know the septic system contains only Reading pipe, and the thought of living in a different house for which that is not true simply makes me crazy." Relate that fanciful testimony to the role of subjective value in eminent domain.

4. Could the Reading Pipe Clause have been inserted into the contract opportunistically? (I the homeowner know that you the builder are unaccustomed to monitoring the manufacture of the sewer pipe you use, and maybe I can entrap you into a contract breach if I can find a piece of pipe of other manufacture in your job.) If so, how should that affect a court's holding?

Case 6: Formation Defenses: Coercion, or Absence of Consideration?

Alaska Packers Assn. v. Domenico
U.S. Circuit Court of Appeals, Ninth Circuit
117 F. 99 (1902)

ROSS, Circuit Judge. . . . .

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

On the 15th day of April 1900, 21 of the libelants signed shipping articles by which they shipped as seamen on the Two Brothers, a vessel chartered by the appellant for the voyage between San Francisco and Pyramid Harbor, and also bound themselves to perform the same work for the appellant provided for by the previous contract of March 26th; the appellant agreeing to pay them therefor the sum of $60 for the season, and two cents each for each red salmon in the catching of which they should respectively take part. Under these contracts, the libelants sailed on board the Two Brothers for Pyramid Harbor, where the appellant had about $150,000 invested in a salmon cannery. The libelants arrived there early in April of the year mentioned, and began to unload the vessel and fit up the cannery. A few days thereafter, to wit, May 19th, they stopped work in a body, and demanded of the company's superintendent there in charge $100 for services in operating the vessel to and from Pyramid Harbor, instead of the sums stipulated for in and by the contracts; stating that unless they were paid this additional wage they would stop work entirely, and return to San Francisco. The evidence showed, and the court below found, that it was impossible for the appellant to get other men to take the places of the libelants, the place being remote, the season short and just opening; so that, after endeavoring for several days without success to induce the libelants to proceed with their work in accordance with their contracts, the company's superintendent, on the 22d day of May, so far yielded to their demands as to instruct his clerk to copy the contracts executed in San Francisco, including the words "Alaska Packers' Association" at the end, substituting, for the $50 and $60 payments, respectively, of those contracts, the sum of $100, which document, so prepared, was signed by the libelants before a shipping commissioner whom they had requested to be brought from Northeast Point; the superintendent, however, testifying that he at the time told the libelants that he was without authority to enter into any such contract, or to in any way alter the contracts made between them and the company in San Francisco. Upon the return of the libelants to San Francisco at the close of the fishing season, they demanded pay in accordance with the terms of the alleged contract of May 22d, when the company denied its validity, and refused to pay other than as provided for by the contracts of March 26th and April 5th, respectively. Some of the libelants, at least, consulted counsel, and, after receiving his advice, those of them who had signed the shipping articles before the shipping commissioner at San Francisco went before that officer, and received the amount due them thereunder, executing in consideration thereof a release in full, and the others being paid at the office of the company, also receipting in full for their demands. On the trial in the court below, the libelants undertook to show that the fishing nets provided by the respondent were defective, and that it was on that account that

they demanded increased wages. On that point, the evidence was substantially conflicting, and the finding of the court was against the libelants, the court saying:

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

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

"Under such circumstances, it would be strange, indeed, if the law would not permit the defendant to waive the damages caused by the libelants' breach, and enter into the contract sued upon-- a contract mutually beneficial to all the parties thereto, in that it gave to the libelants reasonable compensation for their labor, and enabled the defendant to employ to advantage the large capital it had invested in its canning and fishing plant."

Certainly, it cannot be justly held, upon the record in this case, that there was any voluntary waiver on the part of the appellant of the breach of the original contract. The company itself knew nothing of such breach until the expedition returned to San Francisco, and the testimony is uncontradicted that its superintendent at Pyramid Harbor, who, it is claimed, made on its behalf the contract sued on, distinctly informed the libelants that he had no power to alter the original or to make a new contract; and it would, of course, follow that, if he had no power to change the original, he would have no authority to waive any rights thereunder. The circumstances of the present case bring it, we think, directly within the sound and just observations of the supreme court of Minnesota in the case of King v. Railway Co., . . . "No astute reasoning can change the plain fact that the party who refuses to perform, and thereby coerces a promise from the other party to the contract to pay him an increased compensation for doing that which he is legally bound to do, takes an unjustifiable advantage of the necessities of the other party. Surely it would be a travesty on justice to hold that the party so making the promise for extra pay was estopped from asserting that the promise was without consideration. A party cannot lay the foundation of an estoppel by his own wrong, where the promise is simply a repetition of a subsisting legal promise. There can be no consideration

for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their contract. The promise cannot be legally enforced, although the other party has completed his contract in reliance upon it." . . .

To permit plaintiff to recover under such circumstances would be to offer a premium upon bad faith, and invite men to violate their most sacred contracts that they may profit by their own wrong. That a promise to pay a man for doing that which he is already under contract to do is without consideration is conceded by respondents. The rule has been so long imbedded in the common law and decisions of the highest courts of the various states that nothing but the most cogent reasons ought to shake it . . . It is true that as eminent a jurist as Judge Cooley, in Goebel v. Linn, . . . held that an ice company which had agreed to furnish a brewery with all the ice they might need for their business from November 8, 1879, until January 1, 1881, at $1.75 per ton, and afterwards in May 1880, declined to deliver any more ice unless the brewery would give it $3 per ton, could recover on a promissory note given for the increased price. Profound as is our respect for the distinguished judge who delivered the opinion, we are still of the opinion that his decision is not in accord with the almost universally accepted doctrine, and is not convincing; and certainly so much of the opinion as holds that the payment, by a debtor, of a part of his debt then due, would constitute a defense to a suit for the remainder, is not the law of this state, nor, do we think, of any other where the common law prevails . . . What we hold is that, when a party merely does what he has already obligated himself to do, he cannot demand an additional compensation therefor; and although, by taking advantage of the necessities of his adversary, he obtains a promise for more, the law will regard it as nudum pactum, and will not lend its process to aid in the wrong. . . .

The case of Goebel v. Linn, . . . presented some unusual and extraordinary circumstances. But, taking it as establishing the precise rule . . . we think it not only contrary to the weight of authority, but wrong on principle . . .

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

COMMENTS AND QUESTIONS

1. Goebel v. Linn (included in this folio), a finding held in low esteem in the Alaska Packers court, could have been viewed as a commercial impracticability plea had that doctrine been extant in 1888. Is there an analogous "commercial impracticability" dimension of this case? What about those allegedly rotten nets? Had they been conclusively shown to be rotten, would there have been any basis for hope that Domenico and his fellow libelants would have been able to realize their earnings expectations under the earlier contracts? "Libel," incidentally, is a term used to describe a complaint filed in a maritime law court, where the several Alaska Packers cases which arose out of the Pyramid Harbor episode were heard.

2. Did you note the explicitly economic argument employed by the lower court judge and quoted by Judge Ross in his dismissal of the plausibility of the claim that the nets were rotten? (Only a stupid employer would hire men to go to the end of the world and expect them to catch fish profitably with rotten nets.)

3. Be sure to note the exact parallels between Alaska Packers and of Austin Instrument v. Loral Corporation, the next case.

Case 7: Formation Defense of Duress

Austin Instrument, Inc., v. Loral Corporation
COURT OF APPEALS OF NEW YORK
29 N.Y.2d 124 (1971)

OPINION BY: FULD The defendant, Loral Corporation, seeks to recover payment for goods delivered under a contract which it had with plaintiff Austin Instrument, Inc., on the ground that the evidence establishes, as a matter of law, that it was forced to agree to an increase in price on the items in question under circumstances amounting to economic duress.

In July of 1965, Loral was awarded a $ 6,000,000 contract by the Navy for the production of radar sets. The contract contained a schedule of deliveries, a liquidated damages clause applying to late deliveries and a cancellation clause in case of default by Loral. The latter thereupon solicited bids for some 40 precision gear components needed to produce the radar sets, and awarded Austin a subcontract to supply 23 such parts. That party commenced delivery in early 1966.

In May 1966, Loral was awarded a second Navy contract for the production of more radar sets and again went about soliciting bids. Austin bid on all 40 gear components but, on July 15, a representative from Loral informed Austin's president, Mr. Krauss, that his company would be awarded the subcontract only for those items on which it was low bidder. The Austin officer refused to accept an order for less than all 40 of the gear parts and on the next day he told Loral that Austin would cease deliveries of the parts due under the existing subcontract unless Loral consented to substantial increases in the prices provided for by that agreement -- both retroactively for parts already delivered and prospectively on those not yet shipped -- and placed with Austin the order for all 40 parts needed under Loral's second Navy contract. Shortly thereafter, Austin did, indeed, stop delivery. After contacting 10 manufacturers of precision gears and finding none who could produce the parts in time to meet its commitments to the Navy, Loral acceded to Austin's demands; in a letter dated July 22, Loral wrote to Austin that "We have feverishly surveyed other sources of supply and find that because of the prevailing military exigencies, were they to start from scratch as would have to be the case, they could not even remotely begin to deliver on time to meet the delivery requirements established by the Government. . . Accordingly, we are left with no choice or alternative but to meet your conditions."

Loral thereupon consented to the price increases insisted upon by Austin under the first subcontract and the latter was awarded a second subcontract making it the supplier of all 40 gear parts for Loral's second contract with the Navy. Although Austin was granted until September to resume deliveries, Loral did, in fact, receive parts in August and was able to produce the radar sets in time to meet its commitments to the Navy on both contracts. After Austin's last delivery under the second subcontract in July 1967, Loral notified it of its intention to seek recovery of the price increases.

On September 15, 1967, Austin instituted this action against Loral to recover an amount in excess of $ 17,750 which was still due on the second subcontract. On the same day, Loral commenced an action against Austin claiming damages of some $ 22,250 -- the aggregate of the price increases under the first subcontract -- on the ground of economic duress. The two actions were consolidated and, following a trial, Austin was awarded the sum it requested and Loral's complaint against Austin was dismissed on the ground that it was not shown that "it could not have obtained the items in question from other sources in time to meet its commitment to the Navy under the first contract." A closely divided Appellate Division affirmed (35

A D 2d 387). There was no material disagreement concerning the facts; as Justice Steuer stated in the course of his dissent below, "[the] facts are virtually undisputed, nor is there any serious question of law. The difficulty lies in the application of the law to these facts.". . .

The applicable law is clear and, indeed, is not disputed by the parties. A contract is voidable on the ground of duress when it is established that the party making the claim was forced to agree to it by means of a wrongful threat precluding the exercise of his free will . . . The existence of economic duress or business compulsion is demonstrated by proof that "immediate possession of needful goods is threatened" . . . or, more particularly, in cases such as the one before us, by proof that one party to a contract has threatened to breach the agreement by withholding goods unless the other party agrees to some further demand . . . However, a mere threat by one party to breach the contract by not delivering the required items, though wrongful, does not in itself constitute economic duress. It must also appear that the threatened party could not obtain the goods from another source of supply and that the ordinary remedy of an action for breach of contract would not be adequate.

We find without any support in the record the conclusion reached by the courts below that Loral failed to establish that it was the victim of economic duress. On the contrary, the evidence makes out a classic case, as a matter of law, of such duress.

It is manifest that Austin's threat -- to stop deliveries unless the prices were increased -- deprived Loral of its free will. As bearing on this, Loral's relationship with the Government is most significant. As mentioned above, its contract called for staggered monthly deliveries of the radar sets, with clauses calling for liquidated damages and possible cancellation on default. Because of its production schedule, Loral was, in July 1966, concerned with meeting its delivery requirements in September, October and November, and it was for the sets to be delivered in those months that the withheld gears were needed. Loral had to plan ahead, and the substantial liquidated damages for which it would be liable, plus the threat of default, were genuine possibilities. Moreover, Loral did a substantial portion of its business with the Government, and it feared that a failure to deliver as agreed upon would jeopardize its chances for future contracts. These genuine concerns do not merit the label "'self-imposed, undisclosed and subjective"' which the Appellate Division majority placed upon them. It was perfectly reasonable for Loral, or any other party similarly placed, to consider itself in an emergency, duress situation.

Austin, however, claims that the fact that Loral extended its time to resume deliveries until September negates its alleged dire need for the parts. A Loral official testified on this point that Austin's president told him he could deliver some parts in August and that the extension of deliveries was a formality. In any event, the parts necessary for production of the radar sets to be delivered in September were delivered to Loral on September 1, and the parts needed for the October schedule were delivered in late August and early September. Even so, Loral had to "work . . . around the clock" to meet its commitments. Considering that the best offer Loral received from the other vendors it contacted was commencement of delivery sometime in October, which, as the record shows, would have made it late in its deliveries to the Navy in both September and October, Loral's claim that it had no choice but to accede to Austin's demands is conclusively demonstrated.

We find unconvincing Austin's contention that Loral, in order to meet its burden, should have contacted the Government and asked for an extension of its delivery dates so as to enable it to purchase the parts from another vendor. Aside from the consideration that Loral was anxious to perform well in the Government's eyes, it could not be sure when it would obtain enough parts from a substitute vendor to meet

its commitments. The only promise which it received from the companies it contacted was for commencement of deliveries, not full supply, and, with vendor delay common in this field, it would have been nearly impossible to know the length of the extension it should request. It must be remembered that Loral was producing a needed item of military hardware. Moreover, there is authority for Loral's position that nonperformance by a subcontractor is not an excuse for default in the main contract . . . In light of all this, Loral's claim should not be held insufficiently supported because it did not request an extension from the Government.

Loral, as indicated above, also had the burden of demonstrating that it could not obtain the parts elsewhere within a reasonable time, and there can be no doubt that it met this burden. The 10 manufacturers whom Loral contacted comprised its entire list of "approved vendors" for precision gears, and none was able to commence delivery soon enough. As Loral was producing a highly sophisticated item of military machinery requiring parts made to the strictest engineering standards, it would be unreasonable to hold that Loral should have gone to other vendors, with whom it was either unfamiliar or dissatisfied, to procure the needed parts. As Justice Steuer noted in his dissent, Loral "contacted all the manufacturers whom it believed capable of making these parts" . . . , and this was all the law requires.

It is hardly necessary to add that Loral's normal legal remedy of accepting Austin's breach of the contract and then suing for damages would have been inadequate under the circumstances, as Loral would still have had to obtain the gears elsewhere with all the concomitant consequences mentioned above. In other words, Loral actually had no choice, when the prices were raised by Austin, except to take the gears at the "coerced" prices and then sue to get the excess back.

Austin's final argument is that Loral, even if it did enter into the contract under duress, lost any rights it had to a refund of money by waiting until July 1967, long after the termination date of the contract, to disaffirm it. It is true that one who would recover moneys allegedly paid under duress must act promptly to make his claim known . . . In this case, Loral delayed making its demand for a refund until three days after Austin's last delivery on the second subcontract. Loral's reason -- for waiting until that time -- is that it feared another stoppage of deliveries which would again put it in an untenable situation. Considering Austin's conduct in the past, this was perfectly reasonable, as the possibility of an application by Austin of further business compulsion still existed until all of the parts were delivered.

In sum, the record before us demonstrates that Loral agreed to the price increases in consequence of the economic duress employed by Austin. Accordingly, the matter should be remanded to the trial court for a computation of its damages.

The order appealed from should be modified, with costs, by reversing so much thereof as affirms the dismissal of defendant Loral Corporation's claim and, except as so modified, affirmed.

DISSENT BY: BERGAN

DISSENT: Bergan, J. (dissenting). Whether acts charged as constituting economic duress produce or do not produce the damaging effect attributed to them is normally a routine type of factual issue.

Here the fact question was resolved against Loral both by the Special Term and by the affirmance at the Appellate Division. It should not be open for different resolution here.

In summarizing the Special Term's decision and its own, the Appellate Division decided that "the conclusion that Loral acted deliberately and voluntarily, without being under immediate pressure of incurring severe business reverses, precludes a recovery on the theory of economic duress" . . .

When the testimony of the witnesses who actually took part in the negotiations for the two disputing parties is examined, sharp conflicts of fact emerge. Under Austin's version the request for a renegotiation of the existing contract was based on Austin's contention that Loral had failed to carry out an understanding as to the items to be furnished under that contract and this was the source of dissatisfaction which led both to a revision of the existing agreement and to entering into a new one.

This is not necessarily and as a matter of law to be held economic duress. On this appeal it is needful to look at the facts resolved in favor of Austin most favorably to that party. Austin's version of events was that a threat was not made but rather a request to accommodate the closing of its plant for a customary vacation period in accordance with the general understanding of the parties.

Moreover, critical to the issue of economic duress was the availability of alternative suppliers to the purchaser Loral. The demonstration is replete in the direct testimony of Austin's witnesses and on cross-examination of Loral's principal and purchasing agent that the availability of practical alternatives was a highly controverted issue of fact. On that issue of fact the explicit findings made by the Special Referee were affirmed by the Appellate Division. Nor is the issue of fact made the less so by assertion that the facts are undisputed and that only the application of equally undisputed rules of law is involved.

Austin asserted and Loral admitted on cross-examination that there were many suppliers listed in a trade registry but that Loral chose to rely only on those who had in the past come to them for orders and with whom they were familiar. It was, therefore, at least a fair issue of fact whether under the circumstances such conduct was reasonable and made what might otherwise have been a commercially understandable renegotiation an exercise of duress.

The order should be affirmed.

COMMENTS AND QUESTIONS

1. There was an element of "self help" in Loral's behavior toward Austin. What was it? Was it justified, as held by Justice Fuld in his opinion?

2. Can you discern differences between the behavior of Austin, and the behavior of the crew members in the Alaska Packers case?

Case 8: Formation Defense of Undue Influence

Odorizzi v. Bloomfield School District
COURT OF APPEALS OF CALIFORNIA
54 Cal Rptr. 533, (1966)

OPINION BY: FLEMING

Plaintiff Donald Odorizzi was employed during 1964 as an elementary school teacher by defendant Bloomfield School District and was under contract with the district to continue to teach school the following year as a permanent employee. On June 10 he was arrested on criminal charges of homosexual activity, and on June 11 he signed and delivered to his superiors his written resignation as a teacher, a resignation which the district accepted on June 13. In July the criminal charges against Odorizzi were dismissed under Penal Code, section 995, and in September he sought to resume his employment with the district. On the district's refusal to reinstate him he filed suit for declaratory and other relief.

Odorizzi's amended complaint asserts his resignation was invalid because obtained through duress, fraud, mistake, and undue influence and given at a time when he lacked capacity to make a valid contract. Specifically, Odorizzi declares he was under such severe mental and emotional strain at the time he signed his resignation, having just completed the process of arrest, questioning by the police, booking, and release on bail, and having gone for 40 hours without sleep, that he was incapable of rational thought or action. While he was in this condition and unable to think clearly, the superintendent of the district and the principal of his school came to his apartment. They said they were trying to help him and had his best interests at heart, that he should take their advice and immediately resign his position with the district, that there was no time to consult an attorney, that if he did not resign immediately the district would suspend and dismiss him from his position and publicize the proceedings, [publicize] his "aforedescribed arrest" and cause him "to suffer extreme embarrassment and humiliation"; but that if he resigned at once the incident would not be publicized and would not jeopardize his chances of securing employment as a teacher elsewhere. Odorizzi pleads that because of his faith and confidence in their representations they were able to substitute their will and judgment in place of his own and thus obtain his signature to his purported resignation. A demurrer to his amended complaint was sustained without leave to amend.

By his complaint plaintiff in effect seeks to rescind his resignation pursuant to Civil Code, section 1689, on the ground that his consent had not been real or free within the meaning of Civil Code, section 1567, but had been obtained through duress, menace, fraud, undue influence, or mistake. A pleading under these sections is sufficient if, stripped of its conclusions, it sets forth sufficient facts to justify legal relief . . . In our view the facts in the amended complaint are insufficient to state a cause of action for duress, menace, fraud, or mistake, but they do set out sufficient elements to justify rescission of a consent because of undue influence. We summarize our conclusions on each of these points.

1. No duress or menace has been pleaded. Duress consists in unlawful confinement of another's person, or relatives, or property, which causes him to consent to a transaction through fear . . . Duress is often used interchangeably with menace . . . but in California menace is technically a threat of duress or a threat of injury to the person, property, or character of another. . . . We agree with respondent's contention that neither duress nor menace was involved in this case, because the action or threat in duress or menace

must be unlawful, and a threat to take legal action is not unlawful unless the party making the threat knows the falsity of his claim . . . The amended complaint shows in substance that the school representatives announced their intention to initiate suspension and dismissal proceedings under Education Code, sections 13403, 13408 et seq. at a time when the filing of such proceedings was not only their legal right but their positive duty as school officials . . . Although the filing of such proceedings might be extremely damaging to plaintiff's reputation, the injury would remain incidental so long as the school officials acted in good faith in the performance of their duties . . . Neither duress nor menace was present as a ground for rescission.

2. Nor do we find a cause of action for fraud, either actual or constructive . . . Actual fraud involves conscious misrepresentation, or concealment, or non-disclosure of a material fact which induces the innocent party to enter the contract . . . A complaint for fraud must plead misrepresentation, knowledge of falsity, intent to induce reliance, justifiable reliance, and resulting damage. While the amended complaint charged misrepresentation, it failed to assert the elements of knowledge of falsity, intent to induce reliance, and justifiable reliance. A cause of action for actual fraud was therefore not stated . . .

Constructive fraud arises on a breach of duty by one in a confidential or fiduciary relationship to another which induces justifiable reliance by the latter to his prejudice . . . Plaintiff has attempted to bring himself within this category, for the amended complaint asserts the existence of a confidential relationship between the school superintendent and principal as agents of the defendant, and the plaintiff. Such a confidential relationship may exist whenever a person with justification places trust and confidence in the integrity and fidelity of another . . . Plaintiff, however, sets forth no facts to support his conclusion of a confidential relationship between the representatives of the school district and himself, other than that the parties bore the relationship of employer and employee to each other. Under prevailing judicial opinion no presumption of a confidential relationship arises from the bare fact that parties to a contract are employer and employee; rather, additional ties must be brought out in order to create the presumption of a confidential relationship between the two . . . The absence of a confidential relationship between employer and employee is especially apparent where, as here, the parties were negotiating to bring about a termination of their relationship. In such a situation each party is expected to look after his own interests, and a lack of confidentiality is implicit in the subject matter of their dealings. We think the allegations of constructive fraud were inadequate.

3. As to mistake, the amended complaint fails to disclose any facts which would suggest that consent had been obtained through a mistake of fact or of law. The material facts of the transaction were known to both parties. Neither party was laboring under any misapprehension of law of which the other took advantage. The discussion between plaintiff and the school district representatives principally attempted to evaluate the probable consequences of plaintiff's predicament and to predict the future course of events. The fact that their speculations did not forecast the exact pattern which events subsequently took does not provide the basis for a claim that they were acting under some sort of mistake. The doctrine of mistake customarily involves such errors as the nature of the transaction, the identity of the parties, the identity of the things to which the contract relates, or the occurrence of collateral happenings . . . Errors of this nature were not present in the case at bench.

4. However, the pleading does set out a claim that plaintiff's consent to the transaction had been obtained through the use of undue influence.

Undue influence, in the sense we are concerned with here, is a shorthand legal phrase used to describe persuasion which tends to be coercive in nature, persuasion which overcomes the will without convincing the

judgment . . . 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. In this sense, undue influence has been called overpersuasion . . . Misrepresentations of law or fact are not essential to the charge, for a person's will may be overborne without misrepresentation. By statutory definition undue influence includes "taking an unfair advantage of another's weakness of mind, or . . . taking a grossly oppressive and unfair advantage of another's necessities or distress." . . . While most reported cases of undue influence involve persons who bear a confidential relationship to one another, a confidential or authoritative relationship between the parties need not be present when the undue influence involves unfair advantage taken of another's weakness or distress . . . We paraphrase the summary of undue influence given the jury by Sir James P. Wilde in Hall v. Hall . . . : To make a good contract a man must be a free agent. Pressure of whatever sort which overpowers the will without convincing the judgment is a species of restraint under which no valid contract can be made. Importunity or threats, if carried to the degree in which the free play of a man's will is overborne, constitute undue influence, although no force is used or threatened. A party may be led but not driven, and his acts must be the offspring of his own volition and not the record of someone else's.

In essence undue influence involves the use of excessive pressure to persuade one vulnerable to such pressure, pressure applied by a dominant subject to a servient object. In combination, the elements of undue susceptibility in the servient person and excessive pressure by the dominating person make the latter's influence undue, for it results in the apparent will of the servient person being in fact the will of the dominant person.

Undue susceptibility may consist of total weakness of mind which leaves a person entirely without understanding . . . ; or, a lesser weakness which destroys the capacity of a person to make a contract even though he is not totally incapacitated . . . ; or, the first element in our equation, a still lesser weakness which provides sufficient grounds to rescind a contract for undue influence . . . Such lesser weakness need not be longlasting nor wholly incapacitating, but may be merely a lack of full vigor due to age . . . , physical condition, . . . emotional anguish, or a combination of such factors. The reported cases have usually involved elderly, sick, senile persons alleged to have executed wills or deeds under pressure . . .
. . .
Undue influence in its second aspect involves an application of excessive strength by a dominant subject against a servient object. Judicial consideration of this second element in undue influence has been relatively rare, for there are few cases denying persons who persuade but do not misrepresent the benefit of their bargain. Yet logically, the same legal consequences should apply to the results of excessive strength as to the results of undue weakness. Whether from weakness on one side, or strength on the other, or a combination of the two, undue influence occurs whenever there results "that kind of influence or supremacy of one mind over another by which that other is prevented from acting according to his own 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 left to act freely.". . . Undue influence involves a type of mismatch which our statute calls unfair advantage . . .

The difficulty, of course, lies in determining when the forces of persuasion have overflowed their normal banks and become oppressive flood waters. There are second thoughts to every bargain, and hindsight is still better than foresight. Undue influence cannot be used as a pretext to avoid bad bargains or escape from bargains which refuse to come up to expectations. A woman who buys a dress on impulse, which on critical inspection by her best friend turns out to be less fashionable than she had thought, is not legally entitled to set aside the sale on the ground that the saleswoman used all her wiles to close the sale. A

man who buys a tract of desert land in the expectation that it is in the immediate path of the city's growth and will become another Palm Springs, an expectation cultivated in glowing terms by the seller, cannot rescind his bargain when things turn out differently. If we are temporarily persuaded against our better judgment to do something about which we later have second thoughts, we must abide the consequences of the risks inherent in managing our own affairs . . .

However, overpersuasion is generally accompanied by certain characteristics which tend to create a pattern. The pattern usually involves several of the following elements: (1) discussion of the transaction at an unusual or inappropriate time, (2) consummation of the transaction in an unusual place, (3) insistent demand that the business be finished at once, (4) extreme emphasis on untoward consequences of delay, (5) the use of multiple persuaders by the dominant side against a single servient party, (6) absence of third-party advisers to the servient party, (7) statements that there is no time to consult financial advisers or attorneys. If a number of these elements are simultaneously present, the persuasion may be characterized as excessive . . .

The difference between legitimate persuasion and excessive pressure, like the difference between seduction and rape, rests to a considerable extent in the manner in which the parties go about their business. For example, if a day or two after Odorizzi's release on bail the superintendent of the school district had called him into his office during business hours and directed his attention to those provisions of the Education Code compelling his leave of absence and authorizing his suspension on the filing of written charges, had told him that the district contemplated filing written charges against him, had pointed out the alternative of resignation available to him, had informed him he was free to consult counsel or any adviser he wished and to consider the matter overnight and return with his decision the next day, it is extremely unlikely that any complaint about the use of excessive pressure could ever have been made against the school district.

But, according to the allegations of the complaint, this is not the way it happened, and if it had happened that way, plaintiff would never have resigned. Rather, the representatives of the school board undertook to achieve their objective by overpersuasion and imposition to secure plaintiff's signature but not his consent to his resignation through a high-pressure carrot-and-stick technique -- under which they assured plaintiff they were trying to assist him, he should rely on their advice, there wasn't time to consult an attorney, if he didn't resign at once the school district would suspend and dismiss him from his position and publicize the proceedings, but if he did resign the incident wouldn't jeopardize his chances of securing a teaching post elsewhere . . .

We express no opinion on the merits of plaintiff's case, or the propriety of his continuing to teach school . . . , or the timeliness of his rescission . . . We do hold that his pleading, liberally construed, states a cause of action for rescission of a transaction to which his apparent consent had been obtained through the use of undue influence.

The judgment is reversed.

COMMENTS AND QUESTIONS

1. There are several interesting dimensions in this case: the criminality of (some unspecified aspects of) homosexual activity is a comment on the nineteen sixties and before; and the extent to which the California code lays down conditions which define fraud, duress, menace, mistake, and undue influence is a good illustration of the extent to which the law attaches importance to the careful description of inadmissable behavior.

2. Undue influence is a doctrine that arose in equity, as a parallel to the legal doctrine of duress. In the California system, which is code based, an effort is made to distinguish the two as different patterns of behavior, whereas the terms arose historically as an effort of different courts to describe a single pattern of behavior.

3. Case 19 below (Vokes) contains elements of what the California courts would describe as undue influence, and also elements of fraud.

4. From an economic point of view, there is (as the opinion points out) a danger in permitting too much after-the-event mind changing about contracts or market purchases. What would the consequences be if transactions or contracts could be reversed at any time at the request of one party?

Case 9. Formation Defense of Unconscionability

Williams v. Walker-Thomas Furniture Co.
UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT
350 F.2d 445 (1965)

OPINION: J. SKELLY WRIGHT, Circuit Judge:

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

The contract further provided that "the amount of each periodical installment payment to be made by [purchaser] to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by [purchaser] under such prior leases, bills or accounts; and all payments now and hereafter made by [purchaser] shall be credited pro rata on all outstanding leases, bills and accounts due the Company by [purchaser] at the time each such payment is made." . . . [T]he effect of this rather obscure provision was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated. As a result, the debt incurred at the time of purchase of each item was secured by the right to repossess all the items previously purchased by the same purchaser, and each new item purchased automatically became subject to a security interest arising out of the previous dealings.

[O]n April 17, 1962, appellant Williams bought a stereo set of stated value of $514.95. {At the time of this purchase her account showed a balance of $164 still owing from her prior purchases. The total of all the purchases made over the years in question came to $1,800. The total payments amounted to $1,400.} She . . . defaulted shortly thereafter, and appellee sought to replevy all the items purchased since December 1957. The Court of General Sessions granted judgment for appellee. The District of Columbia Court of Appeals affirmed, and we granted appellants' motion for leave to appeal to this court.

Appellants' principal contention, rejected by both the trial and the appellate courts below, is that these contracts, or at least some of them, are unconscionable and, hence, not enforceable. In its opinion . . . the District of Columbia Court of Appeals explained its rejection of this contention as follows:

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

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

We do not agree that the court lacked the power to refuse enforcement to contracts found to be unconscionable. In other jurisdictions, it has been held as a matter of common law that unconscionable contracts are not enforceable . . . While no decision of this court so holding has been found, the notion that an unconscionable bargain should not be given full enforcement is by no means novel. In Scott v. United States, . . . the Supreme Court stated:

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

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. {. . . Inquiry into the relative bargaining power of the two parties is not an inquiry wholly divorced from the general question of unconscionability, since a one-sided bargain is itself evidence of the inequality of the bargaining parties. This fact was vaguely recognized in the common law doctrine of intrinsic fraud, that is, fraud which can be presumed from the grossly unfair nature of the terms of the contract. See the oft-quoted statement of Lord Hardwicke in Earl of Chesterfield v. Janssen . . .

". . . [Fraud] may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under delusion would make . . . "

And cf. Hume v. United States . . . where the Court characterized the English cases as "cases in which one party took advantage of the other's ignorance of arithmetic to impose upon him, and the fraud was apparent from the face of the contracts." . . . The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.

In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can

it be mechanically applied. The terms are to be considered "in the light of the general commercial background and the commercial needs of the particular trade or case." Corbin suggests the test as being whether the terms are "so extreme as to appear unconscionable according to the mores and business practices of the time and place." . . . We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.

Williams v. Walker-Thomas Furniture Co.: COMMENTS AND QUESTIONS

1. As a term to classify behavior, "unconscionable" has weaknesses. It appears in the present context to suggest but not to state something like fraud. Or maybe it is a term introduced by a paternalistic court to undo a contract involving a party that the court thought to be unable to understand what she was doing.

2. Would Ms. Williams have had a good chance to furnish her home in the absence of the kind of contract she was able to get through Walker-Thomas? Would Walker-Thomas have made insecure loans to so poor a person as Ms. Williams? If not, was the contract one-sided or unfair?

Case 10: Commercial Impracticability and Allocation of Uncertainty

Goebel v. Lynn
MICHIGAN COURT OF APPEALS
47 Mich 489 (1882)

Defendants were large brewers and had a contract with an ice company to supply them with ice during the season of 1880 at one dollar and seventy-five cents a ton, or two dollars if the crop was short. The contract was made in November 1879. The following winter was so mild that the ice crop was a failure. In May the defendants were notified by the ice company that no more ice would be furnished them under the contract. Defendants had then on hand a considerable amount of beer that would be spoiled without ice, and under stress of the circumstances they made a new arrangement with the ice company, and agreed to pay three dollars and a half per ton for the ice. At this rate ice was received and paid for afterwards. A note given for ice at this rate in October being sued, defendants disputed its validity, claiming that it was obtained without consideration and under duress. Held (1) that it was entirely competent for the parties to enter into the new arrangement if they saw fit . . . (2) That the note was not without consideration, being given for ice received. (3) That the refusal of the ice company to perform its contract, and the exaction of a higher price, was not legal duress . . . Error to superior court of Detroit.

OPINION BY COOLEY, J. The action in this case is upon a promissory note given by defendants, October 20, 1880, to the Belle Isle Ice Company, and by that company transferred to the plaintiffs after it fell due. The execution of the note is admitted, and the only question in the case is, whether the defendants have established any defence to it. The defence set up is that the note was obtained without consideration, and by means of duress. The facts which are supposed to show duress are the following: November 8, 1879, the Belle Isle Ice Company entered into a contract with the defendants below, who are brewers in the city of Detroit, whereby the company, undertook to furnish defendants at their brewery all the ice they might need for their business from that date until January 1, 1881. The ice was to be delivered on orders, and the price was to be one dollar and seventy-five cents per ton, and in case of the scarcity of ice during the season of 1880, two dollars per ton. Ice was furnished under this contract until May, 1880, when defendants were notified by Mr. Lorman, the manager or president of the ice company, that owing to the failure of the ice crop the preceding winter the company could and would furnish no more at the price stipulated. Other brewers in the city who held similar contracts received the like notification. This led to a meeting of several of the brewers with the president of the company and one of his associates, at which the brewers were informed that instructions were given to the teamsters of the company to deliver no more ice until the parties had agreed to pay more for it. Five dollars a ton was at first demanded, but the company finally agreed to deliver for three dollars and a half. Mr. Goebel who was a witness on behalf of the defendants explained the situation thus: "We had to pay most anything, if they asked $20; if we had no ice one day or two, if we had been without ice, all our stock would have been spoiled; if we hadn't ice for two days, all our stock of beer would have been spoiled, we cannot run our business one day without ice; it would spoil our beer; it cools the cellar and cools the beer. At that time I could not procure ice of anybody; they waited just long enough not to give us a chance to buy ice of anybody else; . . . we would not contract with anybody for ice as there was not any; all ice was contracted for then--all the ice of the icemen right here in the market; there were several men came over who had boat loads to sell and offered us ice; I told Lorman we had a chance to buy ice, and he told us we should not; he would see our contract filled; this was during the spring months, before this conversation. At the time of this conversation no ice was obtainable in this market; not in such large

quantities as we wanted . . . We never had less than 2,000 or 3,000 barrels of beer on hand. At 2,500 at $6 a barrel would be $15,000, which would have been an entire loss, besides ruining the whole business, the whole trade; we could not have had any customers; we could not have brewed any more; the brewing would have stopped also." The consequence was, as he says, that they were forced to assent to the terms imposed upon them. From that time defendants paid $3.50 per ton for the ice as it was delivered to them, up to the first day of January following. Notes were given for the ice at this rate from time to time, and with the exception of the one in suit, paid as they fell due. This statement is a sufficient presentation of the facts for the purposes of a decision. The defendants claim a set-off of the sums paid by them for ice in excess of two dollars a ton. It is very manifest that there is no ground for saying that the note in suit was given without consideration. It was given for ice which was furnished by the payee to the defendants; which was owned by the payee and bought by the defendants, and for which defendants concede their liability to make payment. What the defendants disputed is, the justice of compelling them to pay the sum stipulated in the note when according to their previous contract they ought to have received the ice for a sum much smaller. The defence, therefore, is not that the consideration has failed, but that a note for a sum greater than the contract price has been extorted under circumstances amounting to duress. It is to be observed of these circumstances that if we confine our attention to the very time when the arrangement for an increased price was made the defendants make out a very plausible case. They had then a very considerable stock of beer on hand, and the case they make is one in which they must have ice at any cost, or they must fail in business. If the ice company had the ability to perform their contract, but took advantage of the circumstances to extort a higher price from the necessities of the defendants, its conduct was reprehensible, and it would perhaps have been in the interest of good morals if defendants had temporarily submitted to the loss and bought suit against the ice company on their contract. No one disputes that at their option they might have taken that course, and that the ice company would have been responsible for all damages legally attributable to the breach of its contract. But the defendants did not elect to take that course. They chose for reasons which they must have deemed sufficient at the time to submit to the company's demand and pay the increased price rather than rely upon their strict rights under the existing contract. What these reasons were is not explained to us except as above shown. It is obvious that there might be reasons that would go beyond the immediate injury to the business. Suppose, for example, the defendants had satisfied themselves that the ice company under the very extraordinary circumstances of the entire failure of the local crop of ice must be ruined if their existing contracts were to be insisted upon and must be utterly unable to respond in damages; it is plain that then, whether they chose to rely upon their contract or not, it could have been of little or no value to them. Unexpected and extraordinary circumstances had rendered the contract worthless; and they must either make a new arrangement, or, in insisting on holding the ice company to the existing contract, they would ruin the ice company and thereby at the same time ruin themselves. It would be very strange if under such a condition of things the existing contract, which unexpected events had rendered of no value, could stand in the way of a new arrangement, and constitute a bar to any new contract which should provide for a price that would enable both parties to save their interests. We do not know that the condition of things was as supposed, but that it may have been is plain enough. What is certain is, that the parties immediately concerned and who knew all the facts, joined in making a new arrangement out of which the note in suit has grown. The case of Moore v. Detroit Locomotive Works . . . where a similar case was fully considered, is ample authority for supporting the new arrangement. If unfair advantage was taken of defendants, whereby they were forced into a contract against their interests, it is very remarkable that they submitted to abide by it as they did for nearly eight months without in the meantime taking any steps for their protection. Whatever compulsion there was in the case was to be found in the danger to their business in consequence of the threat made at the beginning of May to cut off the supply of ice; but the force of the threat would be broken the moment they could make arrangement for a supply elsewhere; and there is no showing that such a supply was unattainable. The force of the threat was therefore temporary; and the defendants, as soon as they were able to supply their

needs elsewhere, might have been in position to act independently and to deal with the ice company as freely as they might with any other party who declined to keep his engagements. On any view, therefore, which we may take of the law, the defence must fail. But if our attention were to be restricted to the very day when notice was given that ice would no longer be supplied at the contract price, we could not agree that the case was one of duress. It is not shown to be a case even of a hard bargain; and the price charged was probably not too much under the circumstances. But for the pre-existing contract the one now questioned would probably have been fair enough, and if made with any other party would not have been complained of. The duress is therefore to be found in the refusal to keep the previous engagements. How far this falls short of legal duress was so recently considered by us in Hackley v. Headley . . . that further discussion now would serve no valuable purpose. In that case there was a dispute respecting the amount of a debt. The debtor refused to pay unless the creditor would accept in full the amount conceded by him to be owing. The creditor insisted that a large sum was due him, but being in immediate need of money, the circumstances were such that he felt compelled, as he claimed, to accept the sum offered. Afterwards he repudiated the arrangement, as having been made under duress. This court on a careful examination of the authorities, found no support for the claim in legal principles . . .

Goebel v. Lynn: COMMENTS AND QUESTIONS

1. In the important paragraph in which he holds forth the possibility that the brewer can ruin himself by ruining the ice company, which might happen if the terms of the original contract are upheld, Judge Cooley is making assumptions about the structure of the ice market in Detroit. What assumption (competitive, monopoly seller, oligopolistic and collusive, what?) is he making and is it correct? What evidence have we that he is in fact making that assumption?

2. What is the element of *ex ante* uncertainty that was not addressed in the contract (or actually was addressed, but not adequately) and how, in the opinion of Judge Cooley should the costs of that uncertain event be allocated, given that the contract is insufficiently specific on that point?

3. How exact is the parallel between Goebel v. Linn and Hackley v. Headley?

4. Is there an element in the testimony of the brewer in Goebel that makes his case look stronger against the verdict? He testifies that he had a chance to buy ice from a boat that showed up in Detroit but refrained from that purchase at the urging of the plaintiff. Perhaps that introduces an element of fraud into the proceeding. But we are not told what the price quote on that ice from the second source was.

5. From an economic point of view, what is the most striking difference between Goebel and Alaska Packers, that justifies the opposite findings in the two cases?

6. Goebel is also closely related to the Case 13.

Case 11: Formation Defense of Mutual Mistake

Frigaliment Importing Co. v. B.N.S. International Sales
UNITED STATES DISTRICT COURT, SECOND DISTRICT, NEW YORK
190 F. Supp. 116 (1960)

OPINION: FRIENDLY, Circuit Judge.

The issue is, what is chicken? Plaintiff says "chicken" means a young chicken, suitable for broiling and frying. Defendant says "chicken" means any bird of that genus that meets contract specifications on weight and quality, including what it calls "stewing chicken" and plaintiff pejoratively terms "fowl." Dictionaries give both meanings, as well as some others not relevant here. To support its, plaintiff sends a number of volleys over the net; defendant essays to return them and adds a few serves of its own. Assuming that both parties were acting in good faith, the case nicely illustrates Holmes' remark "that the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs -- not on the parties' having meant the same thing but on their having said the same thing." The Path of the Law, in Collected Legal Papers, p. 178. I have concluded that plaintiff has not sustained its burden of persuasion that the contract used "chicken" in the narrower sense.

The action is for breach of the warranty that goods sold shall correspond to the description, New York Personal Property Law, McKinney's Consol. Laws, c. 41, @ 95. Two contracts are in suit. In the first, dated May 2, 1957, defendant, a New York sales corporation, confirmed the sale to plaintiff, a Swiss corporation, of

"US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated 2 1/2- 3 lbs. and 1 1/2- 2 lbs. each

all chicken individually wrapped in cryovac, packed in secured fiber cartons or wooden boxes, suitable for export

75,000 lbs. 2 1/2- 3 lbs @$33.00
25,000 lbs. 1 1/2- 2 lbs @$36.50
per 100 lbs. FAS New York

scheduled May 10, 1957 pursuant to instructions from Penson & Co., New York." . . .

The second contract, also dated May 2, 1957, was identical save that only 50,000 lbs. of the heavier "chicken" were called for, the price of the smaller birds was $37 per 100 lbs., and shipment was scheduled for May 30. The initial shipment under the first contract was short but the balance was shipped on May 17. When the initial shipment arrived in Switzerland, plaintiff found, on May 28, that the 2 1/2- 3 lbs. birds were not young chicken suitable for broiling and frying but stewing chicken or "fowl"; indeed, many of the cartons and bags plainly so indicated. Protests ensued. Nevertheless, shipment under the second contract was made on May 29, the 2 1/2- 3 lbs. birds again being stewing chicken. Defendant stopped the transportation of these at Rotterdam.

This action followed. Plaintiff says that, notwithstanding that its acceptance was in Switzerland, New York law controls . . . ; defendant does not dispute this, and relies on New York decisions. I shall follow the apparent agreement of the parties as to the applicable law.

Since the word "chicken" standing alone is ambiguous, I turn first to see whether the contract itself offers any aid to its interpretation. Plaintiff says the 1 1/2- 2 lbs. birds necessarily had to be young chicken since the older birds do not come in that size, hence the 2 1/2- 3 lbs. birds must likewise be young. This is unpersuasive - a contract for "apples" of two different sizes could be filled with different kinds of apples even though only one species came in both sizes. Defendant notes that the contract called not simply for chicken but for "US Fresh Frozen Chicken, Grade A, Government Inspected." It says the contract thereby incorporated by reference the Department of Agriculture's regulations, which favor its interpretation; I shall return to this after reviewing plaintiff's other contentions.

The first hinges on an exchange of cablegrams which preceded execution of the formal contracts. The negotiations leading up to the contracts were conducted in New York between defendant's secretary, Ernest R. Bauer, and a Mr. Stovicek, who was in New York for the Czechoslovak government at the World Trade Fair. A few days after meeting Bauer at the fair, Stovicek telephoned and inquired whether defendant would be interested in exporting poultry to Switzerland. Bauer then met with Stovicek, who showed him a cable from plaintiff dated April 26, 1957, announcing that they "are buyer" of 25,000 lbs. of chicken 2 1/2- 3 lbs. weight, Cryovac packed, grade A Government inspected, at a price up to 33 cents per pound, for shipment on May 10, to be confirmed by the following morning, and were interested in further offerings. After testing the market for price, Bauer accepted, and Stovicek sent a confirmation that evening. Plaintiff stresses that, although these and subsequent cables between plaintiff and defendant, which laid the basis for the additional quantities under the first and for all of the second contract, were predominantly in German, they used the English word "chicken"; it claims this was done because it understood "chicken" meant young chicken whereas the German word, "Huhn," included both "Brathuhn" (broilers) and "Suppenhuhn" (stewing chicken), and that defendant, whose officers were thoroughly conversant with German, should have realized this. Whatever force this argument might otherwise have is largely drained away by Bauer's testimony that he asked Stovicek what kind of chickens were wanted, received the answer "any kind of chickens," and then, in German, asked whether the cable meant "Huhn" and received an affirmative response. Plaintiff attacks this as contrary to what Bauer testified on his deposition in March, 1959, and also on the ground that Stovicek had no authority to interpret the meaning of the cable. The first contention would be persuasive if sustained by the record, since Bauer was free at the trial from the threat of contradiction by Stovicek as he was not at the time of the deposition; however, review of the deposition does not convince me of the claimed inconsistency. As to the second contention, it may well be that Stovicek lacked authority to commit plaintiff for prices or delivery dates other than those specified in the cable; but plaintiff cannot at the same time rely on its cable to Stovicek as its dictionary to the meaning of the contract and repudiate the interpretation given the dictionary by the man in whose hands it was put . . . Plaintiff's reliance on the fact that the contract forms contain the words "through the intermediary of: ", with the blank not filled, as negating agency, is wholly unpersuasive; the purpose of this clause was to permit filling in the name of an intermediary to whom a commission would be payable, not to blot out what had been the fact.

Plaintiff's next contention is that there was a definite trade usage that "chicken" meant "young chicken." Defendant showed that it was only beginning in the poultry trade in 1957, thereby bringing itself within the principle that "when one of the parties is not a member of the trade or other circle, his acceptance of the standard must be made to appear" by proving either that he had actual knowledge of the usage or that the usage is "so generally known in the community that his actual individual knowledge of it may be

inferred." . . . Here there was no proof of actual knowledge of the alleged usage; indeed, it is quite plain that defendant's belief was to the contrary. In order to meet the alternative requirement, the law of New York demands a showing that "the usage is of so long continuance, so well established, so notorious, so universal and so reasonable in itself, as that the presumption is violent that the parties contracted with reference to it, and made it a part of their agreement." . . .

Plaintiff endeavored to establish such a usage by the testimony of three witnesses and certain other evidence. Strasser, resident buyer in New York for a large chain of Swiss cooperatives, testified that "on chicken I would definitely understand a broiler." However, the force of this testimony was considerably weakened by the fact that in his own transactions the witness, a careful businessman, protected himself by using "broiler" when that was what he wanted and "fowl" when he wished older birds . . . Necliowski, an officer of one of the companies that had furnished the stewing chicken to defendant, testified that "chicken" meant "the male species of the poultry industry. That could be a broiler, a fryer or a roaster," but not a stewing chicken; however, he also testified that upon receiving defendant's inquiry for "chickens," he asked whether the desire was for "fowl or frying chickens" and, in fact, supplied fowl, although taking the precaution of asking defendant, a day or two after plaintiff's acceptance of the contracts in suit, to change its confirmation of its order from "chickens," as defendant had originally prepared it, to "stewing chickens." Dates, an employee of Urner-Barry Company, which publishes a daily market report on the poultry trade, gave it as his view that the trade meaning of "chicken" was "broilers and fryers." In addition to this opinion testimony, plaintiff relied on the fact that the Urner-Barry service, the Journal of Commerce, and Weinberg Bros. & Co. of Chicago, a large supplier of poultry, published quotations in a manner which, in one way or another, distinguish between "chicken," comprising broilers, fryers and certain other categories, and "fowl," which, Bauer acknowledged, included stewing chickens. This material would be impressive if there were nothing to the contrary. However, there was, as will now be seen.

Defendant's witness Weininger, who operates a chicken eviscerating plant in New Jersey, testified "Chicken is everything except a goose, a duck, and a turkey. Everything is a chicken, but then you have to say, you have to specify which category you want or that you are talking about." Its witness Fox said that in the trade "chicken" would encompass all the various classifications. Sadina, who conducts a food inspection service, testified that he would consider any bird coming within the classes of "chicken" in the Department of Agriculture's regulations to be a chicken. The specifications approved by the General Services Administration include fowl as well as broilers and fryers under the classification "chickens." Statistics of the Institute of American Poultry Industries use the phrases "Young chickens" and "Mature chickens," under the general heading "Total chickens." and the Department of Agriculture's daily and weekly price reports avoid use of the word "chicken" without specification.

Defendant advances several other points which it claims affirmatively support its construction. Primary among these is the regulation of the Department of Agriculture . . . entitled, "Grading and Inspection of Poultry and Edible Products Thereof" . . . which recited:

"Chickens. The following are the various classes of chickens:

(a) Broiler or fryer . . .
(b) Roaster . . .
(c) Capon . . .
(d) Stag . . .
(e) Hen or stewing chicken or fowl . . .

(f) Cock or old rooster . . .

Defendant argues, as previously noted, that the contract incorporated these regulations by reference. Plaintiff answers that the contract provision related simply to grade and Government inspection and did not incorporate the Government definition of "chicken," and also that the definition in the Regulations is ignored in the trade. However, the latter contention was contradicted by Weininger and Sadina; and there is force in defendant's argument that the contract made the regulations a dictionary, particularly since the reference to Government grading was already in plaintiff's initial cable to Stovicek.

Defendant makes a further argument based on the impossibility of its obtaining broilers and fryers at the 33-cent price offered by plaintiff for the 2 1/2- 3 lbs. birds. There is no substantial dispute that, in late April 1957, the price for 2 1/2- 3 lbs. broilers was between 35 and 37 cents per pound, and that when defendant entered into the contracts, it was well aware of this and intended to fill them by supplying fowl in these weights. It claims that plaintiff must likewise have known the market since plaintiff had reserved shipping space on April 23, three days before plaintiff's cable to Stovicek, or, at least, that Stovicek was chargeable with such knowledge. It is scarcely an answer to say, as plaintiff does in its brief, that the 33-cent price offered by the 2 1/2- 3 lbs. "chickens" was closer to the prevailing 35-cent price for broilers than to the 30 cents at which defendant procured fowl. Plaintiff must have expected defendant to make some profit - certainly it could not have expected defendant deliberately to incur a loss.

Finally, defendant relies on conduct by the plaintiff after the first shipment had been received. On May 28 plaintiff sent two cables complaining that the larger birds in the first shipment constituted "fowl." Defendant answered with a cable refusing to recognize plaintiff's objection and announcing "We have today ready for shipment 50,000 lbs. chicken 2 1/2- 3 lbs. 25,000 lbs. broilers 1 1/2- 2 lbs.," these being the goods procured for shipment under the second contract, and asked immediate answer "whether we are to ship this merchandise to you and whether you will accept the merchandise." After several other cable exchanges, plaintiff replied on May 29 "Confirm again that merchandise is to be shipped since resold by us if not enough pursuant to contract chickens are shipped the missing quantity is to be shipped within ten days stop we resold to our customers pursuant to your contract chickens grade A you have to deliver us said merchandise we again state that we shall make you fully responsible for all resulting costs." Defendant argues that if plaintiff was sincere in thinking it was entitled to young chickens, plaintiff would not have allowed the shipment under the second contract to go forward, since the distinction between broilers and chickens drawn in defendant's cablegram must have made it clear that the larger birds would not be broilers. However, plaintiff answers that the cables show plaintiff was insisting on delivery of young chickens and that defendant shipped old ones at its peril. Defendant's point would be highly relevant on another disputed issue - whether if liability were established, the measure of damages should be the difference in market value of broilers and stewing chicken in New York or the larger difference in Europe, but I cannot give it weight on the issue of interpretation. Defendant points out also that plaintiff proceeded to deliver some of the larger birds in Europe, describing them as "poulets"; defendant argues that it was only when plaintiff's customers complained about this that plaintiff developed the idea that "chicken" meant "young chicken." There is little force in this in view of plaintiff's immediate and consistent protests . . .

When all the evidence is reviewed, it is clear that defendant believed it could comply with the contracts by delivering stewing chicken in the 2 1/2- 3 lbs. size. Defendant's subjective intent would not be significant if this did not coincide with on objective meaning of "chicken." Here it did coincide with one of the dictionary meanings, with the definition in the Department of Agriculture Regulations to which the contract made at least oblique reference, with at least some usage in the trade, with the realities of the

market, and with what plaintiff's spokesman had said. Plaintiff asserts it to be equally plain that plaintiff's own subjective intent was to obtain broilers and fryers; the only evidence against this is the material as to market prices and this may not have been sufficiently brought home. In any event it is unnecessary to determine that issue. For plaintiff has the burden of showing that "chicken" was used in the narrower rather than in the broader sense, and this it has not sustained.

This opinion constitutes the Court's findings of fact and conclusions of law. Judgment shall be entered dismissing the complaint with costs.

Frigaliment Importing Co. v. B.N.S. International Sales: COMMENTS AND QUESTIONS

1. Judge Friendly leaves no stone unturned in establishing the mutuality of mistake in this case.

2. What is the magnitude of the economic value at stake in this case? How much do you suppose it cost the litigants for legal services? How much do you suppose it cost the taxpayers of the United States to have the Federal District court tied up with this litigation?

Case 12: Formation Defense of Mutual Mistake

Lenawee County Board of Health v. Messerly
SUPREME COURT OF MICHIGAN
417 Mich 17 (1982)

OPINION BY: RYAN In March of 1977, Carl and Nancy Pickles, appellees, purchased from appellants, William and Martha Messerly, a 600-square-foot tract of land upon which is located a three-unit apartment building. Shortly after the transaction was closed, the Lenawee County Board of Health condemned the property and obtained a permanent injunction which prohibits human habitation on the premises until the defective sewage system is brought into conformance with the Lenawee County sanitation code.

We are required to determine whether appellees should prevail in their attempt to avoid this land contract on the basis of mutual mistake and failure of consideration. We conclude that the parties did entertain a mutual misapprehension of fact, but that the circumstances of this case do not warrant rescission.

The facts of the case are not seriously in dispute. In 1971, the Messerlys acquired approximately one acre plus 600 square feet of land. A three-unit apartment building was situated upon the 600-square-foot portion. The trial court found that, prior to this transfer, the Messerlys' predecessor in title, Mr. Bloom, had installed a septic tank on the property without a permit and in violation of the applicable health code. The Messerlys used the building as an income investment property until 1973 when they sold it, upon land contract, to James Barnes who likewise used it primarily as an income-producing investment.

Mr. and Mrs. Barnes, with the permission of the Messerlys, sold approximately one acre of the property in 1976, and the remaining 600 square feet and building were offered for sale soon thereafter when Mr. and Mrs. Barnes defaulted on their land contract. Mr. and Mrs. Pickles evidenced an interest in the property, but were dissatisfied with the terms of the Barnes-Messerly land contract. Consequently, to accommodate the Pickleses' preference to enter into a land contract directly with the Messerlys, Mr. and Mrs. Barnes executed a quitclaim deed which conveyed their interest in the property back to the Messerlys. After inspecting the property, Mr. and Mrs. Pickles executed a new land contract with the Messerlys on March 21, 1977. It provided for a purchase price of $ 25,500. A clause was added to the end of the land contract form which provides:

"17. Purchaser has examined this property and agrees to accept same in its present condition. There are no other or additional written or oral understandings."

Five or six days later, when the Pickleses went to introduce themselves to the tenants, they discovered raw sewage seeping out of the ground. Tests conducted by a sanitation expert indicated the inadequacy of the sewage system. The Lenawee County Board of Health subsequently condemned the property and initiated this lawsuit in the Lenawee Circuit Court against the Messerlys as land contract vendors, and the Pickleses, as vendees, to obtain a permanent injunction proscribing human habitation of the premises until the property was brought into conformance with the Lenawee County sanitation code. The injunction was granted, and the Lenawee County Board of Health was permitted to withdraw from the lawsuit by stipulation of the parties.

When no payments were made on the land contract, the Messerlys filed a cross-complaint against the Pickleses seeking foreclosure, sale of the property, and a deficiency judgment. Mr. and Mrs. Pickles then counterclaimed for rescission against the Messerlys, and filed a third-party complaint against the Barneses, which incorporated, by reference, the allegations of the counterclaim against the Messerlys. In count one, Mr. and Mrs. Pickles alleged failure of consideration. Count two charged Mr. and Mrs. Barnes with wilful concealment and misrepresentation as a result of their failure to disclose the condition of the sanitation system. Additionally, Mr. and Mrs. Pickles sought to hold the Messerlys liable in equity for the Barneses' alleged misrepresentation. The Pickleses prayed that the land contract be rescinded.

After a bench trial, the court concluded that the Pickleses had no cause of action against either the Messerlys or the Barneses as there was no fraud or misrepresentation. This ruling was predicated on the trial judge's conclusion that none of the parties knew of Mr. Bloom's earlier transgression or of the resultant problem with the septic system until it was discovered by the Pickleses, and that the sanitation problem was not caused by any of the parties. The trial court held that the property was purchased "as is," after inspection and, accordingly, its "negative . . . value cannot be blamed upon an innocent seller." Foreclosure was ordered against the Pickleses, together with a judgment against them in the amount of $ 25,943.09. The parties stipulated that this amount was due on the land contract, assuming that the contract was valid and enforceable.

Mr. and Mrs. Pickles appealed from the adverse judgment. The Court of Appeals unanimously affirmed the trial court's ruling with respect to Mr. and Mrs. Barnes but, in a two-to-one decision, reversed the finding of no cause of action on the Pickleses' claims against the Messerlys . . . It concluded that the mutual mistake between the Messerlys and the Pickleses went to a basic, as opposed to a collateral, element of the contract, and that the parties intended to transfer income-producing rental property but, in actuality, the vendees paid $ 25,500 for an asset without value.

We must decide initially whether there was a mistaken belief entertained by one or both parties to the contract in dispute and, if so, the resultant legal significance.

A contractual mistake "is a belief that is not in accord with the facts." 1 *Restatement Contracts*, 2d, @ 151, p 383. The erroneous belief of one or both of the parties must relate to a fact in existence at the time the contract is executed . . . That is to say, the belief which is found to be in error may not be, in substance, a prediction as to a future occurrence or non-occurrence . . .

The Court of Appeals concluded, after a de novo review of the record, that the parties were mistaken as to the income-producing capacity of the property in question . . . We agree. The vendors and the vendees each believed that the property transferred could be utilized as income-generating rental property. All of the parties subsequently learned that, in fact, the property was unsuitable for any residential use.

Appellants assert that there was no mistake in the contractual sense because the defect in the sewage system did not arise until after the contract was executed. The appellees respond that the Messerlys are confusing the date of the inception of the defect with the date upon which the defect was discovered. . . .

An examination of the record reveals that the septic system was defective prior to the date on which the land contract was executed. The Messerlys' grantor installed a nonconforming septic system without a permit prior to the transfer of the property to the Messerlys in 1971. Moreover, virtually undisputed testimony indicates that, assuming ideal soil conditions, 2,500 square feet of property is necessary to support

a sewage system adequate to serve a three-family dwelling. Likewise, 750 square feet is mandated for a one-family home. Thus, the division of the parcel and sale of one acre of the property by Mr. and Mrs. Barnes in 1976 made it impossible to remedy the already illegal septic system within the confines of the 600-square-foot parcel.

It is crucial to distinguish between the date on which a belief relating to a particular fact or set of facts becomes erroneous due to a change in the fact, and the date on which the mistaken nature of the belief is discovered. By definition, a mistake cannot be discovered until after the contract is executed. If the parties were aware, prior to the execution of a contract, that they were in error concerning a particular fact, there would be no misapprehension in signing the contract. Thus stated, it becomes obvious that the date on which a mistaken fact manifests itself is irrelevant to the determination whether or not there was a mistake.

Appellants do not dispute these underlying facts which give rise to an inference contrary to their contentions.

Having determined that when these parties entered into the land contract they were laboring under a mutual mistake of fact, we now direct our attention to a determination of the legal significance of that finding.

A contract may be rescinded because of a mutual misapprehension of the parties, but this remedy is granted only in the sound discretion of the court . . . Appellants argue that the parties' mistake relates only to the quality or value of the real estate transferred, and that such mistakes are collateral to the agreement and do not justify rescission, citing A & M Land Development Co v Miller, 354 Mich 681 . . .

In that case, the plaintiff was the purchaser of 91 lots of real property. It sought partial rescission of the land contract when it was frustrated in its attempts to develop 42 of the lots because it could not obtain permits from the county health department to install septic tanks on these lots. This Court refused to allow rescission because the mistake, whether mutual or unilateral, related only to the value of the property.

"There was here no mistake as to the form or substance of the contract between the parties, or the description of the property constituting the subject matter. The situation involved is not at all analogous to that presented in Scott v Grow, 301 Mich 226 . . . There the plaintiff sought relief by way of reformation of a deed on the ground that the instrument of conveyance had not been drawn in accordance with the intention and agreement of the parties. It was held that the bill of complaint stated a case for the granting of equitable relief by way of reformation. In the case at bar plaintiff received the property for which it contracted. The fact that it may be of less value than the purchaser expected at the time of the transaction is not a sufficient basis for the granting of equitable relief, neither fraud nor reliance on misrepresentation of material facts having been established." . . .

Appellees contend, on the other hand, that in this case the parties were mistaken as to the very nature of the character of the consideration and claim that the pervasive and essential quality of this mistake renders rescission appropriate. They cite in support of that view Sherwood v Walker, 66 Mich 568 . . . , the famous "barren cow" case. In that case, the parties agreed to the sale and purchase of a cow which was thought to be barren, but which was, in reality, with calf. When the seller discovered the fertile condition of his cow, he refused to deliver her. In permitting rescission, the Court stated:

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

"The court should have instructed the jury that if they found that the cow was sold, or contracted to be sold, upon the understanding of both parties that she was barren, and useless for the purpose of breeding, and that in fact she was not barren, but capable of breeding, then the defendants had a right to rescind, and to refuse to deliver, and the verdict should be in their favor." 66 Mich 577-578.

As the parties suggest, the foregoing precedent arguably distinguishes mistakes affecting the essence of the consideration from those which go to its quality or value, affording relief on a per se basis for the former but not the latter . . .

However, the distinctions which may be drawn from Sherwood and A & M Land Development Co do not provide a satisfactory analysis of the nature of a mistake sufficient to invalidate a contract. Often, a mistake relates to an underlying factual assumption which, when discovered, directly affects value, but simultaneously and materially affects the essence of the contractual consideration. It is disingenuous to label such a mistake collateral. . . .

Appellant and appellee both mistakenly believed that the property which was the subject of their land contract would generate income as rental property. The fact that it could not be used for human habitation deprived the property of its income-earning potential and rendered it less valuable. However, this mistake, while directly and dramatically affecting the property's value, cannot accurately be characterized as collateral because it also affects the very essence of the consideration. "The thing sold and bought [income-generating rental property] had in fact no existence." Sherwood v Walker, 66 Mich 578.

We find that the inexact and confusing distinction between contractual mistakes running to value and those touching the substance of the consideration serves only as an impediment to a clear and helpful analysis for the equitable resolution of cases in which mistake is alleged and proven. Accordingly, the holdings of A & M Land Development Co. and Sherwood with respect to the material or collateral nature of a mistake are limited to the facts of those cases.

Instead, we think the better-reasoned approach is a case-by-case analysis whereby rescission is indicated when the mistaken belief relates to a basic assumption of the parties upon which the contract is

made, and which materially affects the agreed performances of the parties . . . Rescission is not available, however, to relieve a party who has assumed the risk of loss in connection with the mistake . . . The parties have invited our attention to the first edition of the Restatement of Contracts in their briefs, and the Court of Appeals cites to that edition in its opinion. However, the second edition was published subsequent to the issuance of the lower court opinion and the filing of the briefs with this Court. Thus, we take it upon ourselves to refer to the latest edition to aid us in our resolution of this case.

Section 152 delineates the legal significance of a mistake.

"@ 152. When Mistake of Both Parties Makes a Contract Voidable

"(1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in @ 154.

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

n12 "@ 154. When a Party Bears the Risk of a Mistake

"A party bears the risk of a mistake when

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

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

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

All of the parties to this contract erroneously assumed that the property transferred by the vendors to the vendees was suitable for human habitation and could be utilized to generate rental income. The fundamental nature of these assumptions is indicated by the fact that their invalidity changed the character of the property transferred, thereby frustrating, indeed precluding, Mr. and Mrs. Pickles' intended use of the real estate. Although the Pickleses are disadvantaged by enforcement of the contract, performance is advantageous to the Messerlys, as the property at issue is less valuable absent its income-earning potential. Nothing short of rescission can remedy the mistake. Thus, the parties' mistake as to a basic assumption materially affects the agreed performances of the parties.

Despite the significance of the mistake made by the parties, we reverse the Court of Appeals because we conclude that equity does not justify the remedy sought by Mr. and Mrs. Pickles.

Rescission is an equitable remedy which is granted only in the sound discretion of the court . . . A court need not grant rescission in every case in which the mutual mistake relates to a basic assumption and materially affects the agreed performance of the parties.

In cases of mistake by two equally innocent parties, we are required, in the exercise of our equitable powers, to determine which blameless party should assume the loss resulting from the misapprehension they shared. Normally that can only be done by drawing upon our "own notions of what is reasonable and just under all the surrounding circumstances." This risk-of-loss analysis is absent in both A & M Land Development Co and Sherwood, and this omission helps to explain, in part, the disparate treatment in the two cases. Had such an inquiry been undertaken in Sherwood, we believe that the result might have been different. Moreover, a determination as to which party assumed the risk in A & M Land Development Co would have alleviated the need to characterize the mistake as collateral so as to justify the result denying rescission. Despite the absence of any inquiry as to the assumption of risk in those two leading cases, we find that there exists sufficient precedent to warrant such an analysis in future cases of mistake.

Equity suggests that, in this case, the risk should be allocated to the purchasers. We are guided to that conclusion, in part, by the standards announced in @ 154 of the Restatement of Contracts, 2d, for determining when a party bears the risk of mistake . . . Section 154(a) suggests that the court should look first to whether the parties have agreed to the allocation of the risk between themselves. While there is no express assumption in the contract by either party of the risk of the property becoming uninhabitable, there was indeed some agreed allocation of the risk to the vendees by the incorporation of an "as is" clause into the contract which, we repeat, provided:

" Purchaser has examined this property and agrees to accept same in its present condition. There are no other or additional written or oral understandings."

That is a persuasive indication that the parties considered that, as between them, such risk as related to the "present condition" of the property should lie with the purchaser. If the "as is" clause is to have any meaning at all, it must be interpreted to refer to those defects which were unknown at the time that the contract was executed. Thus, the parties themselves assigned the risk of loss to Mr. and Mrs. Pickles.

We conclude that Mr. and Mrs. Pickles are not entitled to the equitable remedy of rescission and, accordingly, reverse the decision of the Court of Appeals.

***Lenawee County Board of Health v. Messerly*: COMMENTS AND QUESTIONS**

1. In his opinion, Justice Ryan takes pains to distinguish his finding from that of Sherwood v. Walker (Text, p. 101.) Three views are possible. Either Sherwood was a wrong decision, or this one was, or it doesn't matter which way outcomes of such cases are found. Which is the correct view from an efficiency standpoint?

2. In describing his reasons for differing from Sherwood, Justice Ryan relies heavily on the clause that the Pickles' agree to accept the property in the condition they found it at time of purchase. Read what the textbook says about latent v. obvious defects in its discussion of Sherwood, and then answer: does Justice Ryan comprehend the difference between latent and obvious defects?

3. Suppose the leaking septic system had been discovered after the land contract was signed but before the Pickles had taken possession of or made any payment on the property. Would that have affected this decision? Should it have? In a sense, the two cases, Sherwood and Messerly, are like a game of Musical Chairs: whoever has the advantage when the music stops gets to retain the advantage.

4. Is there any opportunity for fraud in Sherwood? In Messerly? Should the possibility of fraud affect how such cases represented as mutual mistake are decided?

5. The difficulties adjudicated in Messerly stem from an illegal septic tank installed by a tenant unbeknownst to the owner of the property. Would a contrary finding which overturned the sale contract in favor of the Pickles have generated a worthwhile incentive for owners of land to observe the behavior of their tenants more closely? Initially it appears that Messerly deals only with distributive issues: who gets stuck with a property that is rendered useless by a faulty septic system? But if the finding does fail to create the aforementioned incentives, it deals (badly) with productive issues as well.

Case 13: Impossibility or Commercial Impracticability

Mineral Park Land Co. v. Howard
SUPREME COURT OF CALIFORNIA
172 Cal. 289 (1916)

OPINION BY: SLOSS

The defendants appeal from a judgment in favor of plaintiff for $3,650. The appeal is on the judgment roll alone.

The plaintiff was the owner of certain land in the ravine or wash known as the Arroyo Seco in South Pasadena, Los Angeles County. The defendants had made a contract with the public authorities for the construction of a concrete bridge across the Arroyo Seco. In August 1911, the parties to this action entered into a written agreement whereby the plaintiff granted to the defendants the right to haul gravel and earth from plaintiff's land, the defendants agreeing to take therefrom all of the gravel and earth necessary in the construction of the fill and cement work on the proposed bridge, the required amount being estimated at approximately one hundred and fourteen thousand cubic yards. Defendants agreed to pay five cents per cubic yard for the first eighty thousand yards, the next ten thousand yards were to be given free of charge, and the balance was to be paid for at the rate of five cents per cubic yard.

The complaint was in two counts. The first alleged that the defendants had taken 50,131 cubic yards of earth and gravel, thereby becoming indebted to plaintiff in the sum of $2,506.55, of which only nine hundred dollars had been paid, leaving a balance of $1,606.55 due. The findings support plaintiff's claim in this regard, and there is no question of the propriety of so much of the judgment as responds to the first count.

The second count sought to recover damages for the defendants' failure to take from plaintiff's land any more than the 50,131 yards.

It alleged that the total amount of earth and gravel used by defendants was one hundred and one thousand cubic yards, of which they procured 50,869 cubic yards from some place other than plaintiff's premises. The amount due the plaintiff for this amount of earth and gravel would, under the terms of the contract, have been $2,043.45. The count charged that plaintiff's land contained enough earth and gravel to enable the defendants to take therefrom the entire amount required, and that the 50,869 yards not taken had no value to the plaintiff. Accordingly the plaintiff sought, under this head, to recover damages in the sum of $2,043.45.

The answer denied that the plaintiff's land contained any amount of earth and gravel in excess of the 50,131 cubic yards actually taken, and alleged that the defendants took from the said land all of the earth and gravel available for the work mentioned in the contract.

The court found that the plaintiff's land contained earth and gravel far in excess of one hundred and one thousand cubic yards of earth and gravel, but that only 50,131 cubic yards, the amount actually taken by the defendants, was above the water-level. No greater quantity could have been taken "by ordinary means," or except by the use, at great expense, of a steam-dredger, and the earth and gravel so taken could not have

been used without first having been dried at great expense and delay. On the issue raised by the plea of defendants that they took all the earth and gravel that was available, the court qualified its findings in this way: It found that the defendants did take all of the available earth and gravel from plaintiff's premises, in this, that they took and removed "all that could have been taken advantageously to defendants, or all that was practical to take and remove from a financial standpoint"; that any greater amount could have been taken only at a prohibitive cost, that is, at an expense of ten or twelve times as much as the usual cost per yard. It is also declared that the word "available" is used in the findings to mean capable of being taken and used advantageously. It was not "advantageous or practical" to have taken more material from plaintiff's land, but it was not impossible. There is a finding that the parties were not under any mutual misunderstanding regarding the amount of available gravel, but that the contract was entered into without any calculation on the part of either of the parties with reference to the amount of available earth and gravel on the premises.

The single question is whether the facts thus found justified the defendants in their failure to take from the plaintiff's land all of the earth and gravel required. This question was answered in the negative by the court below. The case was, apparently, thought to be governed by the principle -- established by a multitude of authorities -- that where a party has agreed, without qualification, to perform an act which is not in its nature impossible of performance, he is not excused by difficulty of performance, or by the fact that he becomes unable to perform. . .

It is, however, equally well settled that where performance depends upon the existence of a given thing, and such existence was assumed as the basis of the agreement, performance is excused to the extent that the thing ceases to exist or turns out to be nonexistent . . . Thus, where the defendants had agreed to pasture not less than three thousand cattle on plaintiff's land, paying therefor one dollar for each and every head so pastured, and it developed that the land did not furnish feed for more than 717 head, the number actually put on the land by defendant, it was held that plaintiff could not recover the stipulated sum for the difference between the cattle pastured and the minimum of three thousand agreed to be pastured . . . Similarly, in Brick Co. v. Pond, . . . where the plaintiff had leased all the "good No. 1 fire clay on his land," subject to the condition that the lessees should mine or pay for not less than two thousand tons of clay every year, paying therefor twenty-five cents per ton, the court held that the lessees were not bound to pay for two thousand tons per year, unless there was No. 1 clay on the land in such quantities as would justify its being taken out . . . There are many other cases dealing with mining leases of this character, and the general course of decision is to the effect that the performance of the obligation to take out a given quantity or to pay royalty thereon, if it be not taken out, is excused if it appears that the land does not contain the stipulated quantity. . . .

We think the findings of fact make a case falling within the rule of these decisions. The parties were contracting for the right to take earth and gravel to be used in the construction of the bridge. When they stipulated that all of the earth and gravel needed for this purpose should be taken from plaintiff's land, they contemplated and assumed that the land contained the requisite quantity, available for use. The defendants were not binding themselves to take what was not there. And, in determining whether the earth and gravel were "available," we must view the conditions in a practical and reasonable way. Although there was gravel on the land, it was so situated that the defendants could not take it by ordinary means, nor except at a prohibitive cost. To all fair intents then, it was impossible for defendants to take it. "A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost." (1 Beach on Contracts, sec. 216.) We do not mean to intimate that the defendants could excuse themselves by showing the existence of conditions which would make the performance of their obligation more expensive than they had anticipated, or which would entail a loss upon

them. But where the difference in cost is so great as here, and has the effect, as found, of making performance impracticable, the situation is not different from that of a total absence of earth and gravel.

On the facts found, there should have been no recovery on the second count.

The judgment is modified by deducting therefrom the sum of $2,043.45, and as so modified, it stands affirmed.

Shaw, J., and Lawlor, J., concurred.

Mineral Park Land Co. v. Howard: **COMMENTS AND QUESTIONS**

1. Had Mineral Park been decided in 1888 instead of 1916, is it plausible that Howard would have claimed absence of consideration for the promise to excavate all construction sand and gravel from the Mineral Park holding? Compare this to the foregoing cases of Goebel and Alaska Packers.

2. Nowhere in the appeal record does it say so, but I suspect that Mineral Park Land really wanted a hole dug on its property; that was its first motive, and the sale of gravel was secondary. Maybe they knew of the high water table, and hoped that Howard would be dumb enough to dig the hole anyway, sparing them high costs of excavation. If indeed they were primarily motivated by the prospect of getting the hole dug, would that have been a reason to find in their favor? Under what terms or conditions would it have been appropriate to do so?

Case 14: Anticipatory Breach

AMF Inc. v. McDonald's Corp.
UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT
536 F.2d 1167 (1976)

PRIOR HISTORY:
Appeal from the United States District Court for the Northern District of Illinois, Eastern Division Nos. 72 C 1743, 73 C 1736 RICHARD W. MCLAREN, Judge.

OPINION BY: CUMMINGS

AMF, Incorporated, filed this case in the Southern District of New York in April 1972. It was transferred to the Northern District of Illinois in May 1973. AMF seeks damages for the alleged wrongful cancellation and repudiation of McDonald's Corporation's ("McDonald's") orders for sixteen computerized cash registers for installation in restaurants owned by wholly-owned subsidiaries of McDonald's and for seven such registers ordered by licensees of McDonald's for their restaurants. In July 1972, McDonald's of Elk Grove, Inc. sued AMF to recover the $20,385.28 purchase price paid for a prototype computerized cash register and losses sustained as a result of failure of the equipment to function satisfactorily. Both cases were tried together during a fortnight in December 1974. A few months after the completion of the bench trial, the district court rendered a memorandum opinion and order in both cases in favor of each defendant. The only appeal is from the eight judgment orders dismissing AMF's complaints against McDonald's and the seven licensees. We affirm. . .

In 1966, AMF began to market individual components of a completely automated restaurant system, including its model 72C computerized cash register involved here. The 72C cash register then consisted of a central computer, one to four input stations, each with a keyboard and cathode ray tube display, plus the necessary cables and controls.

In 1967, McDonald's representatives visited AMF's plant in Springdale, Connecticut, to view a working "breadboard" model 72C to decide whether to use it in McDonald's restaurant system. Later that year, it was agreed that a 72C should be placed in a McDonald's restaurant for evaluation purposes.

In April 1968, a 72C unit accommodating six input stations was installed in McDonald's restaurant in Elk Grove, Illinois. This restaurant was a wholly-owned subsidiary of McDonald's and was its busiest restaurant. Besides functioning as a cash register, the 72C was intended to enable counter personnel to work faster and to assist in providing data for accounting reports and bookkeeping. McDonald's of Elk Grove, Inc. paid some $20,000 for this prototype register on January 3, 1969. AMF never gave McDonald's warranties governing reliability or performance standards for the prototype.

At a meeting in Chicago on August 29, 1968, McDonald's concluded to order sixteen 72C's for its company-owned restaurants and to cooperate with AMF to obtain additional orders from its licensees. In December 1968, AMF accepted McDonald's purchase orders for those sixteen 72C's. In late January 1969, AMF accepted seven additional orders for 72C's from McDonald's licensees for their restaurants. Under the contract for the sale of all the units, there was a warranty for parts and service. AMF proposed to deliver the first unit in February 1969, with installation of the remaining twenty-two units in the first half of 1969.

However, AMF established a new delivery schedule in February 1969, providing for deliveries to commence at the end of July 1969 and to be completed in January 1970, assuming that the first test unit being built at AMF's Vandalia, Ohio, plant was built and satisfactorily tested by the end of July 1969. This was never accomplished. . .

During the operation of the prototype 72C at McDonald's Elk Grove restaurant, many problems resulted, requiring frequent service calls by AMF and others. Because of its poor performance, McDonald's had AMF remove the prototype unit from its Elk Grove restaurant in late April 1969.

At a March 18, 1969, meeting, McDonald's and AMF personnel met to discuss the performance of the Elk Grove prototype. AMF agreed to formulate a set of performance and reliability standards for the future 72C's, including "the number of failures permitted at various degrees of seriousness, total permitted downtime, maximum service hours and cost." Pending mutual agreement on such standards, McDonald's personnel asked that production of the twenty-three units be held up and AMF agreed.

On May 1, 1969, AMF met with McDonald's personnel to provide them with performance and reliability standards. However, the parties never agreed upon such standards. At that time, AMF did not have a working machine and could not produce one within a reasonable time because its Vandalia, Ohio, personnel were too inexperienced. After the May 1st meeting, AMF concluded that McDonald's had canceled all 72C orders. The reasons for the cancellation were the poor performance of the prototype, the lack of assurances that a workable machine was available and the unsatisfactory conditions at AMF's Vandalia, Ohio, plant where the twenty-three 72C's were to be built.

On July 29, 1969, McDonald's and AMF representatives met in New York. At this meeting it was mutually understood that the 72C orders were canceled and that none would be delivered.

In its conclusions of law, the district court held that McDonald's and its licensees had entered into contracts for twenty-three 72C cash registers but that AMF was not able to perform its obligations under the contracts . . . Citing Section 2-610 of the Uniform Commercial Code . . . the court concluded that on July 29, McDonald's justifiably repudiated the contracts to purchase all twenty-three 72C's.

[Section 2-610 provides:

"Anticipatory Repudiation. When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

"(a) for a commercially reasonable time await performance by the repudiating party; or

"(b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

"(c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704)."]

Relying on Section 2-609 and 2-610 of the Uniform Commercial Code . . . the court decided that McDonald's was warranted in repudiating the contracts and therefore had a right to cancel the orders . . . Accordingly, judgment was entered for McDonald's.

[Section 2-609 provides:

"Right to Adequate Assurance of Performance. (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

"(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

"(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

"(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding 30 days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract."

The findings of fact adopted by the district court were a mixture of the court's own findings and findings proposed by the parties, some of them modified by the court. AMF has assailed ten of the 124 findings of fact, but our examination of the record satisfies us that all have adequate support in the record and support the conclusions of law.

Whether in a specific case a buyer has reasonable grounds for insecurity is a question of fact . . . On this record, McDonald's clearly had "reasonable grounds for insecurity" with respect to AMF's performance. At the time of the March 18, 1969, meeting, the prototype unit had performed unsatisfactorily ever since its April 1968 installation. Although AMF had projected delivery of all twenty-three units by the first half of 1969, AMF later scheduled delivery from the end of July 1969 until January 1970. When McDonald's personnel visited AMF's Vandalia, Ohio, plant on March 4, 1969, they saw that none of the 72C systems was being assembled and learned that a pilot unit would not be ready until the end of July that year. They were informed that the engineer assigned to the project was not to commence work until March 17th. AMF's own personnel were also troubled about the design of the 72C, causing them to attempt to reduce McDonald's order to five units. Therefore, under Section 2-609 McDonald's was entitled to demand adequate assurance of performance by AMF.

However, AMF urges that Section 2-609 of the UCC . . . is inapplicable because McDonald's did not make a written demand of adequate assurance of due performance . . . In Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., we noted that the Code should be liberally construed and therefore rejected such "a formalistic approach" to Section 2-609. . .

After the March 18th demand, AMF never repaired the Elk Grove unit satisfactorily nor replaced it. Similarly, it was unable to satisfy McDonald's that the twenty-three machines on order would work. At the May 1st meeting, AMF offered unsatisfactory assurances for only five units instead of twenty-three. The

performance standards AMF tendered to McDonald's were unacceptable because they would have permitted the 72C's not to function properly for 90 hours per year, permitting as much as one failure in every fifteen days in a busy McDonald's restaurant. Also, as the district court found, AMF's Vandalia, Ohio, personnel were too inexperienced to produce a proper machine. Since AMF did not provide adequate assurance of performance after McDonald's March 18th demand, UCC Section 2-609(1) permitted McDonald's to suspend performance. When AMF did not furnish adequate assurance of due performance at the May 1st meeting, it thereby repudiated the contract under Section 2-609(4). At that point, Section 2-610(b) . . . permitted McDonald's to cancel the orders . . . as it finally did on July 29, 1969. . .

JUDGEMENT AFFIRMED.

***AMF Inc. v. McDonald's Corp.*: COMMENTS AND QUESTIONS**

1. It is striking that McD was so patient with AMF throughout this episode. Keep in mind that computerized cash registers would be a huge instrument of cost saving in the highly competitive junkfood industry (among other things, clerks who cannot do arithmetic can be hired to take orders, and such people are sure-fire minimum wage recipients), and McD was probably anxious to get a leg up on the then-existent competitors. Given the delays, and clear evidence that AMF never was able seriously to contemplate delivery in accord with the contract, McD would have been justified in suing for breach. Had they done so, what theory of damages should have been pursued? Reliance losses? Expectation losses? How large might the former have been, and how easily provable the latter?

Case 15: Measurement of Expectation Losses

Vitex Manufacturing Corp. Ltd. v. Caribtex Corp.
UNITED STATES COURT OF APPEALS, THIRD CIRCUIT
377 F.2d 795 (1967)

OPINION BY: STALEY. This is an appeal by Caribtex Corporation from a judgment of the District Court of the Virgin Islands finding Caribtex in breach of a contract entered into with Vitex Manufacturing Company, Ltd., and awarding $21,114 plus interest to Vitex for loss of profits. The only substantial question raised by Caribtex is whether it was error for the district court, sitting without a jury, not to consider overhead as part of Vitex's costs in determining the amount of profits lost. We conclude that under the facts presented, the district court was not compelled to consider Vitex's overhead costs, and we will affirm the judgment.

Before discussing the details of the controversy between the parties, it will be helpful to briefly describe the peculiar legal setting in which this suit arose. At the time of the events in question, there were high tariff barriers [in the U.S.] to the importation of foreign wool products. However, . . . if such goods were imported into the Virgin Islands and were processed in some manner so that their finished value exceeded their importation value by at least 50%, then the high tariffs to importation into the continental United States would be avoided. Even after the processing, the foreign wool enjoyed a price advantage over domestic products so that the business flourished. However, to keep the volume of this business at such levels that Congress would not be stirred to change the law, the Virgin Islands Legislature imposed "quotas" on persons engaging in processing, limiting their output . . .

Vitex was engaged in the business of chemically shower-proofing imported cloth so that it could be imported duty-free into the United States. For this purpose, Vitex maintained a plant in the Virgin Islands and was entitled to process a specific quantity of material under the Virgin Islands quota system. Caribtex was in the business of importing cloth into the islands, securing its processing, and exporting it to the United States.

In the fall of 1963, Vitex found itself with an unused portion of its quota but no customers, and Vitex closed its plant. Caribtex acquired some Italian wool and subsequently negotiations for a processing contract were conducted between the principals of the respective companies in New York City. Though the record below is clouded with differing versions of the negotiations and the alleged final terms, the trial court found upon substantial evidence in the record that the parties did enter into a contract in which Vitex agreed to process 125,000 yards of Caribtex's woolen material at a price of 26 cents per yard.

Vitex proceeded to re-open its Virgin Islands plant, ordered the necessary chemicals, recalled its work force and made all the necessary preparations to perform its end of the bargain. However, no goods were forthcoming from Caribtex, despite repeated demands by Vitex, apparently because Caribtex was unsure that the processed wool would be entitled to duty-free treatment by the customs officials. Vitex subsequently brought this suit to recover the profits lost through Caribtex's breach.

Vitex alleged, and the trial court found, that its gross profits for processing said material under the contract would have been $31,250 and that its costs would have been $10,136, leaving Vitex's damages for

loss of profits at $21,114. On appeal, Caribtex asserted numerous objections to the detailed computation of lost profits. While the record below is sometimes confusing, we conclude that the trial court had substantial evidence to support its findings on damages. It must be remembered that the difficulty in exactly ascertaining Vitex's costs is due to Caribtex's wrongful conduct in repudiating the contract before performance by Vitex. Caribtex will not be permitted to benefit by the uncertainty it has caused. Thus, since there was a sufficient basis in the record to support the trial court's determination of substantial damages, we will not set aside its judgment . . .

Caribtex first raised the issue at the oral argument of this appeal that the trial court erred by disregarding Vitex's overhead expenses in determining lost profits. In general, overhead ". . . may be said to include broadly the continuous expenses of the business, irrespective of the outlay on a particular contract." . . . Such expenses would include executive and clerical salaries, property taxes, general administration expenses, etc. Although Vitex did not expressly seek recovery for overhead, if a portion of these fixed expenses should be allocated as costs to the Caribtex contract, then under the judgment of the district court Vitex tacitly recovered these expenses as part of its damages for lost profits, and the damages should be reduced accordingly. Presumably, the portion to be allocated to costs would be a pro rata share of Vitex's annual overhead according to the volume of business Vitex would have done over the year if Caribtex had not breached the contract.

Although there is authority to the contrary, we feel that the better view is that normally, in a claim for lost profits, overhead should be treated as a part of gross profits and recoverable as damages, and should not be considered as part of the seller's costs. A number of cases hold that since overhead expenses are not affected by the performance of the particular contract, there should be no need to deduct them in computing lost profits . . . The theory of these cases is that the seller is entitled to recover losses incurred and gains prevented in excess of savings made possible, . . . since overhead is fixed and non-performance of the contract produced no overhead cost savings, no deduction from profits should result.

The soundness of the rule is exemplified by this case. Before negotiations began between Vitex and Caribtex, Vitex had reached a lull in business activity and had closed its plant. If Vitex had entered into no other contracts for the rest of the year, the profitability of its operations would have been determined by deducting its production costs and overhead from gross receipts yielded in previous transactions. When this opportunity arose to process Caribtex's wool, the only additional expenses Vitex would incur would be those of re-opening its plant and the direct costs of processing, such as labor, chemicals and fuel oil. Overhead would have remained the same whether or not Vitex and Caribtex entered their contract and whether or not Vitex actually processed Caribtex's goods. Since this overhead remained constant, in no way attributable-to or affected-by the Caribtex contract, it would be improper to consider it as a cost of Vitex's performance to be deducted from the gross proceeds of the Caribtex contract.

However, Caribtex may argue that this view ignores modern accounting principles, and that overhead is as much a cost of production as other expenses. It is true that successful businessmen must set their prices at sufficient levels to recoup all their expenses, including overhead, and to gain profits. Thus, the price the businessman should charge on each transaction could be thought of as that price necessary to yield a pro rata portion of the company's fixed overhead, the direct costs associated with production, and a "clear" profit. Doubtless this type of calculation is used by businessmen and their accountants . . . However, because it is useful for planning purposes to allocate a portion of overhead to each transaction, it does not follow that this allocated share of fixed overhead should be considered a cost factor in the computation of lost profits on individual transactions.

First, it must be recognized that the pro rata allocation of overhead costs is only an analytical construct. In a similar manner one could allocate a pro rata share of the company's advertising cost, taxes and/or charitable gifts. The point is that while these items all are paid from the proceeds of the business, they do not normally bear such a direct relationship to any individual transaction to be considered a cost in ascertaining lost profits.

Secondly, even were we to recognize the allocation of overhead as proper in this case, we should uphold the tacit award of overhead expense to Vitex as a "loss incurred." . . . By the very nature of this allocation process, as the number of transactions over which overhead can be spread becomes smaller, each transaction must bear a greater portion or allocate share of the fixed overhead cost. Suppose a company has fixed overhead of $10,000 and engages in five similar transactions; then the receipts of each transaction would bear $2000 of overhead expense. If the company is now forced to spread this $10,000 over only four transactions, then the overhead expense per transaction will rise to $2500, significantly reducing the profitability of the four remaining transactions. Thus, where the contract is between businessmen familiar with commercial practices, as here, the breaching party should reasonably foresee that his breach will not only cause a loss of "clear" profit, but also a loss in that the profitability of other transactions will be reduced . . . Therefore, this loss is within the contemplation of "losses caused and gains prevented," and overhead should be considered to be a compensable item of damage.

Significantly, the Uniform Commercial Code, adopted in the Virgin Islands, . . . and in virtually every state today, provides for the recovery of overhead in circumstances similar to those presented here. Under [the U.C.C.] the seller's measure of damage for non-acceptance or repudiation is the difference between the contract price and the market price, but if this relief is inadequate to put the seller in as good position as if the contract had been fully performed, " . . . then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer . . . " While this contract is not controlled by the Code, the Code is persuasive here because it embodies the foremost modern legal thought concerning commercial transactions. Indeed, it may overrule some of the cases denying recovery for overhead . . .

The judgment of the district court will be affirmed.

Vitex Manufacturing Corp. Ltd. v. Caribtex Corp.: NOTES AND QUESTIONS

1. The issue here is how overhead expenses affect the lost profit measure required by expectation loss recovery. There is also an overhead issue to be resolved if the theory of damages is reliance loss recovery. The crucial question in either case is: did entry into the contract require any additional investment on the part of the promisee? If it were necessary to add new capital equipment to undertake a contract, then the cost of that equipment would be recoverable under either expectation or reliance damages. The defendants in this case wanted the plaintiffs to take overhead charges against the profit that would have been made on the goods under contract, but no new equipment was required by the contract, so overhead would be "spread" over a larger output, resulting in lower profit on the additional output. If the loss measure is (net worth of the plaintiff firm as it would have been had the contract not been broken) minus (net worth given that the contract was broken), that loss would be understated if overhead on equipment already in place is charged against lost profit. A similar issue arises in Lake River v. Carborundum (below).

2. Notice how the U.S. tariff laws make possible the existence of firms like Vitex and Caribtex.

Case 16: Economic Measurement of Damages

Olds v. Mapes Reeve Construction Co.
SUPREME JUDICIAL COURT OF MASSACHUSETTS
58 N.E. 478 (1900)

Action by Alfred A. Olds and other against the Mapes-Reeves Construction Company. There was a finding for plaintiffs, and for less than claimed, and they except. Exceptions sustained.

KNOWLTON, J. The only question argued in this case relates to the subject of damages. The defendant, as a contractor, had agreed to erect on land of another a large building in Northampton. The plaintiffs, as subcontractors, had agreed with the defendant to furnish and set up all the marble work in the building for $3,000. A controversy afterwards arose between the defendant and the owner of the building, on account of which the defendant ordered the plaintiffs to discontinue the work, and do nothing further under the contract. The defendant, having broken the contract, immediately became liable to the plaintiffs for damages, the measure of which was the difference between the sum which it would cost to complete the work in accordance with the contract, and the sum which the plaintiffs were to receive . . . This breach which fixed the liability occurred on November 9, 1896, and two days afterwards (on November 11th) this suit was brought. On the same day (whether before or after the commencement of the suit does not appear, and is not material) the plaintiffs made a new contract with the owner of the building, to complete the work called for by their contract with the defendant, and also to do certain other work, for a round sum agreed upon between them. The profits on this last contract, as found by the auditor, were $335.23, and the only question before us is whether the plaintiffs are to allow the amount of these profits in diminution of the damages to which they would otherwise be entitled.

The rule which is applicable to one who is under a contract to render personal services, and who, being discharged without cause before the end of his term, sues for damages, requires him, in estimating the damages, to allow for his services during the unexpired term whatever he is able to obtain for them, or, if damages are assessed before the end of the term, whatever he reasonably can be expected to obtain for them during the time covered by the contract. That is, on the breach of the contract he is left with his personal services as his property, in his own control, and he must allow for them, in the computation, their fair value for such use as he is able reasonably to make of them. In estimating the damages in the present case the auditor found that the actual cost of completing the work after the breach of the contract was $717.27, although, with such allowances as he made for work included in the plaintiffs' contract with the landowner which was not included in their contract with the defendant, he found that the plaintiffs received $1,052.50 for completing the work called for by the original contract. In making this estimate of the cost of completing the work, the auditor charged the plaintiffs with all labor and services which would have entered into it, whether personal to themselves or rendered by agents or employees, just as one under a contract to render personal services, when recovering damages for a broken contract, would be charged with the value of the personal services which remained unused after the breach of the contract. But there is this difference between the case of one who is discharged while under a contract to render personal services and a case like the present: In the former case the person discharged, whose personal services come back to him, is bound to dispose of them in a reasonable way, so as to make the damages to the other party not unreasonably large, while, in a case like the present, one deprived of his contract is under no obligation to enter into new contracts with a view to make profits for the other party. In a contract of the kind before the court, personal services are not necessarily included. The labor or supervision may be personally performed by the

contractor, or may be furnished through agents or employees. In either case the value of it is all included, for the benefit of the other party, when the contractor is charged with the whole cost of completing the work, as an amount to be deducted from the contract price in estimating his damages. Since the damages properly are assessable in this way immediately after the breach of the contract, can it make any difference that the contractor afterwards makes a new contract with the owner, which includes the unfinished work? In making this contract the plaintiffs did not include anything which originally belonged to the defendant, in specie, under the original contract. Their agreement was not to render personal services, but only to accomplish a specific result. The plaintiffs were at liberty to leave this work entirely to the care of the hired servants, and to take as many other contracts as they chose elsewhere, and to give their personal time and attention to any occupation that they might choose. The question is whether the profits from the new contract with the landowner were a direct result of the defendant's breach of contract, or whether they came from an independent, intervening cause. It does not appear, and it is not to be assumed, that the plaintiffs were not competent to carry on several contracts at one time, and the making of profits on a new contract does not appear to be because of relief from the obligations of the old one. There is usually plenty of work to be contracted for, and the addition of one more possible job for which contractors may bid does not make the subsequent contract to do the work a direct result of the increase of opportunities for work. The addition of a new piece of work is merely a condition of the subsequent contract to do the work, and not a direct or proximate cause of it. Moreover, the making of such a contract involves many considerations besides the existence of the work to be done. There must be calculations and estimates. In making a contract of this kind there is always a risk of loss, as well as a possibility of gain. To say nothing of the fact that the plaintiff's new contract included work which was not included in the old one, the cost of which could be fixed only as a matter of estimate, this contract with the landowner was a new undertaking, in which the plaintiffs were under no obligation to engage, and which involved risks that they could assume for themselves alone. If the contract had resulted in a loss to them, they could not have charged the defendant with the loss, to the increase of their damages. As the contract resulted in a gain to them, there is no reason why the defendant should receive this gain in diminution of the damages for which it was liable. There is no privity between the defendant and the plaintiffs, or between the defendant and the landowner, in reference to the new contract. There was an independent arrangement made between the plaintiffs and the landowner, and the only relation which the defendant's breach of the former contract had to it was that it furnished one of the conditions, namely, the work to be done, without which the new contract could not have been made. But the existence of this condition was not the cause of the contract, and the creator of this condition has no title to the fruits of the contract. If another person had taken this contract and made profits on it, as the plaintiffs did, it would hardly have been contended that the plaintiffs' damages were to be diminished on that account; or if the plaintiffs, instead of taking this contract after the breach of the former one, had gone elsewhere, and taken another contract, which afforded them similar profits, there would be no ground for a claim of the defendant to be allowed these profits in diminution of the damages. We are of opinion that the ruling at the trial was erroneous, and that the plaintiffs' damages should have been assessed without reference to their profits obtained under the new contract with the landowner. Exceptions sustained.

Olds v. Mapes Reeve Construction Co.: COMMENTS AND QUESTIONS

There are two economically sensible and contradictory theories as to how this case should be viewed.

Case 17: Expectation v. Reliance Loss in Tortious Breach of Contract

Hawkins v. McGee
SUPREME COURT OF NEW HAMPSHIRE
84 N.H. 114 (1929)

OPINION BY BRANCH, J.

1. The operation in question consisted in the removal of a considerable quantity of scar tissue from the palm of the plaintiff's right hand and the grafting of skin taken from the plaintiff's chest in place thereof. The scar tissue was the result of a severe burn caused by contact with an electric wire, which the plaintiff received about nine years before the time of the transactions here involved. There was evidence to the effect that before the operation was performed the plaintiff and his father went to the defendant, in answer to the question, "How long will the boy be in the hospital?" replied, "Three or four days, not over four; then the boy can go home and it will be just a few days when he will go back to work with a good hand." Clearly this and other testimony to the same effect would not justify a finding that the doctor contracted to complete the hospital treatment in three or four days or that the plaintiff would be able to go back to work within a few days thereafter. The above statements could only be considered as expressions of opinion or predictions as to the probable duration of the treatment and plaintiff's resulting disability, and the fact that these estimates were exceeded would impose no contractual liability upon the defendant. The only substantial basis for the plaintiff's claim is the testimony that the defendant also said before the operation was decided upon, "I will guarantee to make the hand a hundred per cent perfect hand or a hundred per cent good hand." The plaintiff was present when these words were alleged to have been spoken, and, if they are to be taken at their face value, it seems obvious that proof of their utterance would establish the giving of a warranty in accordance with his contention.

The defendant argues, however, that, even if those words were uttered by him, no reasonable man would understand that they were used with the intention of entering "into any contractual relation whatever," and that they could reasonably be understood only "as his expression in strong language that he believed and expected that as a result of the operation he would give the plaintiff a very good hand." It may be conceded, as the defendant contends, that, before the question of the making of a contract should be submitted to a jury, there is a preliminary question of law for the trial court to pass upon, i.e., "whether the words could possibly have the meaning imputed to them by the party who founds his case upon a certain interpretation," but it cannot be held that the trial court decided this question erroneously in the present case. It is unnecessary to determine at this time whether the argument of the defendant, based upon "common knowledge of the uncertainty which attends all surgical operations," and the improbability that a surgeon would ever contract to make a damaged part of the human body "one hundred per cent perfect," would, in the absence of countervailing considerations, be regarded as conclusive, for there were other factors in the present case which tended to support the contention of the plaintiff. There was evidence that the defendant repeatedly solicited from the plaintiff's father the opportunity to perform this operation, and the theory was advanced by plaintiff's counsel in cross-examination of defendant that he sought an opportunity to "experiment on skin grafting," in which he had little previous experience. If the jury accepted this part of plaintiff's contention, there would be a reasonable basis for the further conclusion that, if defendant spoke the words attributed to him, he did so with the intention that they should be accepted at their face value, as an inducement for the

granting of consent to the operation by the plaintiff and his father, and there was ample evidence that they were so accepted by them. The question of the making of the alleged contract was properly submitted to the jury.

The substance of the charge to the jury on the question of damages appears in the following quotation: "If you find the plaintiff entitled to anything, he is entitled to recover for what pain and suffering he has been made to endure and for what injury he has sustained over and above what injury he had before." To this instruction the defendant seasonably excepted. By it, the jury was permitted to consider two elements of damage: (1) Pain and suffering due to the operation; and (2) positive ill effects of the operation upon the plaintiff's hand. Authority for any specific rule of damages in cases of this kind seems to be lacking, but, when tested by general principle and by analogy, it appears that the foregoing instruction was erroneous.

"By `damages,' as that term is used in the law of contracts, is intended compensation for a breach, measured in the terms of the contract.". . . The purpose of the law is "to put the plaintiff in as good a position as he would have been in had the defendant kept his contract.". . . The measure of recovery "is based upon what the defendant should have given the plaintiff, not what the plaintiff has given the defendant or otherwise expended.". . . "The only losses that can be said fairly to come within the terms of a contract are such as the parties must have had in mind when the contract was made, or such as they either knew or ought to have known would probably result from a failure to comply with its terms.". . .

The present case is closely analogous to one in which a machine is built for a certain purpose and warranted to do certain work. In such cases, the usual rule of damages for breach of warranty in the sale of chattels is applied, and it is held that the measure of damages is the difference between the value of the machine, if it had corresponded with the warranty and its actual value, together with such incidental losses as the parties knew, or ought to have known, would probably result from a failure to comply with its terms . . .

The rule thus applied is well settled in this state. "As a general rule, the measure of the vendee's damages is the difference between the value of the goods as they would have been if the warranty as to quality had been true, and the actual value at the time of the sale, including gains prevented and losses sustained, and such other damages as could be reasonably anticipated by the parties as likely to be caused by the vendor's failure to keep his agreement, and could not by reasonable care on the part of the vendee have been avoided." . . . We therefore conclude that the true measure of the plaintiff's damage in the present case is the difference between the value to him of a perfect hand or a good hand, such as the jury found the defendant promised him, and the value of his hand in its present condition, including any incidental consequences fairly within the contemplation of the parties when they made their contract . . . Damages not thus limited, although normally resulting, are not to be given.

The extent of the plaintiff's suffering does not measure this difference in value. The pain necessarily incident to a serious surgical operation was a part of the contribution which the plaintiff was willing to make to his joint undertaking with the defendant to produce a good hand. It was a legal detriment suffered by him which constituted a part of the consideration given by him for the contract. It represented a part of the price which he was willing to pay for a good hand, but it furnished no test of the value of a good hand or the difference between the value of the hand which the defendant promised and the one which resulted from the operation.

It was also erroneous and misleading to submit to the jury as a separate element of damage any change for the worse in the condition of the plaintiff's hand resulting from the operation, although this error

was probably more prejudicial to the plaintiff than to the defendant. Any such ill effect of the operation would be included under the true rule of damages set forth above, but damages might properly be assessed for the defendant's failure to improve the condition of the hand, even if there were no evidence that its condition was made worse as a result of the operation.

It must be assumed that the trial court, in setting aside the verdict, undertook to apply the same rule of damages which he had previously given to the jury, and, since this rule was erroneous, it is unnecessary for us to consider whether there was any evidence to justify his finding that all damages awarded by the jury above $500 were excessive.

Defendant's requests for instructions were loosely drawn, and were properly denied. A considerable number of issues of fact were raised by the evidence, and it would have been extremely misleading to instruct the jury in accordance with defendant's request No. 2, that "the only issue on which you have to pass is whether or not there was a special contract between the plaintiff and the defendant to produce a perfect hand." Equally inaccurate was defendant's request No. 5, which reads as follows: "You would have to find, in order to hold the defendant liable in this case, that Dr. McGee and the plaintiff both understood that the doctor was guaranteeing a perfect result from this operation." If the defendant said that he would guarantee a perfect result, and the plaintiff relied upon that promise, any mental reservations which he may have had are immaterial. The standard by which his conduct is to be judged is not internal, but external . . .

Defendant's request No. 7 was a follows: "If you should get so far as to find that there was a special contract guaranteeing a perfect result, you would still have to find for the defendant unless you also found that a further operation would not correct the disability claimed by the plaintiff." In view of the testimony that the defendant had refused to perform a further operation, it would clearly have been erroneous to give this instruction. The evidence would have justified a verdict for an amount sufficient to cover the cost of such an operation, even if the theory underlying this request were correct. . .
New trial.

Hawkins v. McGee: COMMENTS AND QUESTIONS

1. Unlike most surgeries gone wrong, this case was heard at contract, not tort. It serves as a caution to physicians and surgeons not to advertise the results of their work in advance, so as to avoid being faced with a prospect of contract damages. It raises the difference between reliance and expectation damages in contract, and (as we will see) shows the parallel between the former and what is normally recovered at tort. It also, and I think erroneously, provides a theory of the role of pain and suffering as a part of the contract price paid by the recipient of medical treatment.

2. These background facts of the case are provided by a student newspaper account in the *Harvard Law School Record*, March 17, 1978. George Hawkins had been burned on the hand at age eleven in 1920, in an accident resulting from faulty wiring in the electric lighting of his family's kitchen in Berlin, New Hampshire. After healing, the use of his hand was not noticeably impaired. He had, according to the memory of surviving members of his family in interview nearly sixty years later, a "pencil sized" scar on his right thumb and forefinger, and across the tissue separating them. The scar was noticed by the family physician, Dr. McGee, on a house call in 1924. For three years, Dr. McGee urged Hawkins and his parents to have a skin graft, stressing the socially uncomfortable character of a such a scar. The doctor provided significant assurance as to the outcome of the surgery (I will give the boy a whole hand, a new hand) and as to the consequences of the surgical procedure (three or four days in the hospital, followed by three or four

days of outpatient recovery to full normal health with a hand good as new). The first set of assurances was upheld as contractual by the court of appeal, while the latter was not. Part of the Doctor's motive, it was suggested by the plaintiff attorney, was to experiment on skin graft techniques that he had witnessed but not previously performed. That was held to be the element of consideration in the ensuing trial proceeding. Hawkins finally consented (against advice obtained years earlier, from specialists in Montreal, that nothing useful further could be done for the hand), and surgery was undertaken in 1928.

The result was most horrid. When his mother beheld George in post-operative recovery, she fainted. Her son was lying, bleeding profusely, with his hand grafted to his chest. Bleeding continued intermittently throughout the remainder of his life. The wound became infected, and post-operative hospitalization was prolonged through three months. After the graft was released, the skin removed from his chest began to sprout hair on George's hand. Full use of the hand was never recovered, and George, a shy person in any event, dropped out of high school in mortification at its appearance. Further consultation with Montreal specialists resulted in the same advice: cut your losses, and do nothing further. A local Berlin attorney masterminded (or by blind luck mistakenly stipulated) the charge of breach of contract, instead of the more ordinary charge of tort through malpractice or negligence. Negligence might have been very difficult to prove in this case.

The trial court instructed the jury on measurement of damages that we recognize as based on expectation loss; the appropriate sum of money should suffice to make the plaintiff as well off as if the operation had been performed as guaranteed. The appellate court concurred. The trial court instructed on evaluation of reduced functioning of the hand which resulted directly from the surgery, as an additional element of damages. The appellate court, perhaps correctly, perhaps incorrectly, designated that damage as properly comprehended in the expectation loss theory: we cannot tell from the record whether the appellate court reasoning on this point is correct. The trial court instructed on the measurement of pain and suffering as a component of damages. On this point, the appellate court, acting in clear error, ordered a new trial, holding that pain and suffering are components of the price paid by the patient in anticipation of restoration, and should not have been stipulated by the trial court as items against which recovery could be claimed. The trial court jury had awarded plaintiff $3,000 damages. The appeal court offered to let $500 stand, or otherwise a new trial would be set. After the new trial was ordered, the case settled for $1,400 and legal fees.

3. Cooter and Ulen, in their development of the theories of expectation and reliance damages, model Hawkins v. McGee as an exchange of money for a more ordinary looking and/or more dexterous hand. Their analysis is substantially correct, but incomplete in its silence on the issue of pain and suffering. We can lay the groundwork for a more complete treatment with a hypothetical set of numbers.

Suppose that pre-surgery, the economic profile of George Hawkins is reduced to two elements: a personal net worth (including the present value of his prospective future earnings) of $100,000, and a right hand that is scarred but otherwise serviceable. His physician, Dr. Hawkins, offers the following contract: a fully serviceable right hand, without trace of scar, in exchange for a surgeon's fee ($100) plus four days in the hospital ($5 per day, or $20), plus seven or eight days of pain, valued by a sturdy lad at no more than hospital charges: call it $35. Here what quite simply is meant is that George would with equal distaste face the prospect of a loss of $35, or seven days of recuperative pain from the surgery. Those commitments of money and endurance in total actual or implied amount $155 are held, because of the doctor's enthusiastic blandishments, to be contractual prices, and the plaintiff by his action reveals the deal to be a good one by his calculation.

What materialized from the surgery was quite different from what was contracted. Instead of four hospital days, there were about ninety. Instead of the pain and suffering of normal recuperation, there was the pain and suffering of infection and lifelong bleeding. Instead of the abolition of a cosmetic blemish, there was the creation of a matt of hair (the social implications of which at that time must have been all but intolerable). Moreover, there was diminished motor function in the hand itself, limiting the range of tasks that the plaintiff could perform successfully, and limiting his lifetime earning prospects, apart from any impact of his anguish upon his employability.

A diagram can be drawn which shows these outcomes: the promise of a perfect hand, accompanied by a $155 loss in wealth; that is revealed to be preferred to the initial situation, a scarred hand with no loss in wealth; and both certainly are vastly preferred to a crippled, hairy and interminably bleeding paw with a loss in actual wealth due to earning impairment and pain-equivalent wealth that runs to thousands or even tens of thousands of dollars.

4. According to the *Harvard Law School Record* article, George Hawkins went on to lead a miserable reclusive life, and Dr. McGee went on to be elected mayor of Brattleboro, Vt. for several terms.

5. Look at the next-to last paragraph of comment 3 above. If the numbers are approximately correct, what is the difference in recovery between reliance loss and expectation loss?

6. A 1972 movie called "The Paper Chase" prominently featured Hawkins v. McGee in an early law school scene.

Case 18: Restitution Damages

Olwell v. Nye & Nissen Co.
SUPREME COURT OF WASHINGTON
26 Wash. 2d 282 (1946)

OPINION BY: MALLERY

On May 6, 1940, plaintiff, E. L. Olwell, sold and transferred to the defendant corporation his one-half interest in Puget Sound Egg Packers, a Washington corporation having its principal place of business in Tacoma. By the terms of the agreement, the plaintiff was to retain full ownership in an "Eggsact" egg-washing machine, formerly used by Puget Sound Egg Packers. The defendant promised to make it available for delivery to the plaintiff on or before June 15, 1940.

It appears that the plaintiff arranged for and had the machine stored in a space adjacent to the premises occupied by the defendant but not covered by its lease. Due to the scarcity of labor immediately after the outbreak of the war, defendant's treasurer, without the knowledge or consent of the plaintiff, ordered the egg washer taken out of storage. The machine was put into operation by defendant on May 31, 1941, and thereafter, for a period of three years, was used approximately one day a week in the regular course of the defendant's business.

Plaintiff first discovered this use in January or February of 1945, when he happened to be at the plant on business and heard the machine operating. Thereupon, plaintiff offered to sell the machine to defendant for six hundred dollars or half of its original cost in 1929. A counteroffer of fifty dollars was refused, and, approximately one month later, this action was commenced to recover the reasonable value of defendant's use of the machine, and praying for twenty-five dollars per month from the commencement of the unauthorized use until the time of trial. A second cause of action was alleged, but was not pressed and hence is not here involved. The court entered judgment for plaintiff in the amount of ten dollars per week for the period of 156 weeks covered by the statute of limitations, or $ 1,560, and gave the plaintiff his costs.

Defendant has appealed to this court, assigning error upon the judgment, upon the trial of the cause on the theory of unjust enrichment, upon the amount of damages, and upon the court's refusal to make a finding as to the value of the machine, and in refusing to consider such value in measuring damages.

The theory of the respondent was that the tort of conversion could be "waived" and suit brought in quasi contract, upon a contract implied in law, to recover, as restitution, the profits which inured to appellant as a result of its wrongful use of the machine. With this the trial court agreed and, in its findings of facts, found that the use of the machine ". . . resulted in a benefit to the users, in that said use saves the users appromixately $ 1.43 per hour of use as against the expense which would be incurred were eggs to be washed by hand; that said machine was used by Puget Sound Egg Packers and defendant, on an average of one day per week from May of 1941, until February of 1945 at an average saving of $ 10.00 per each day of use."

In substance, the argument presented by the assignments of error is that the principle of unjust enrichment, or quasi contract, is not of universal application but is imposed only in exceptional cases

because of special facts and circumstances and in favor of particular persons; that respondent had an adequate remedy in an action at law for replevin or claim and delivery; that any damages awarded to the plaintiff should be based upon the use or rental value of the machine and should bear some reasonable relation to its market value. Appellant therefore contends that the amount of the judgment is excessive.

[1] It is uniformly held that in cases where the defendant tort feasor has benefited by his wrong, the plaintiff may elect to "waive the tort" and bring an action in assumpsit for restitution. Such an action arises out of a duty imposed by law devolving upon the defendant to repay an unjust and unmerited enrichment. . .

[2] It is clear that the saving in labor cost which appellant derived from its use of respondent's machine constituted a benefit.

According to the *Restatement of Restitution* 12, @ 1 (b),

"A person confers a benefit upon another if he gives to the other possession of or some other interest in money, land, chattels, or choses in action, performs services beneficial to or at the request of the other, satisfies a debt or a duty of the other, or in any way adds to the other's security or advantage. He confers a benefit not only where he adds to the property of another, but also where he saves the other from expense or loss. The word 'benefit,' therefore, denotes any form of advantage." . . .

[3, 4] It is also necessary to show that, while appellant benefited from its use of the egg-washing machine, respondent thereby incurred a loss. It is argued by appellant that, since the machine was put into storage by respondent, who had no present use for it, and for a period of almost three years did not know that appellant was operating it, and since it was not injured by its operation and the appellant never adversely claimed any title to it, nor contested respondent's right of repossession upon the latter's discovery of the wrongful operation, that the respondent was not damaged, because he is as well off as if the machine had not been used by appellant.

The very essence of the nature of property is the right to its exclusive use. Without it, no beneficial right remains. However plausible, the appellant cannot be heard to say that its wrongful invasion of the respondent's property right to exclusive use is not a loss compensable in law. To hold otherwise would be subversive of all property rights, since its use was admittedly wrongful and without claim of right. The theory of unjust enrichment is applicable in such a case.

[5] We agree with appellant that respondent could have elected a "common garden variety of action," as he calls it, for the recovery of damages. It is also true that, except where provided for by statute, punitive damages are not allowed, the basic measure for the recovery of damages in this state being compensation. If, then, respondent had been limited to redress in tort for damages, as appellant contends, the court below would be in error in refusing to make a finding as to the value of the machine. In such case, the award of damages must bear a reasonable relation to the value of the property. . .

[6] But respondent here had an election. He chose rather to waive his right of action in tort and to sue in assumpsit on the implied contract. Having so elected, he is entitled to the measure of restoration which accompanies the remedy.

"Actions for restitution have for their primary purpose taking from the defendant and restoring to the plaintiff something to which the plaintiff is entitled, or if this is not done, causing the defendant to pay the

plaintiff an amount which will restore the plaintiff to the position in which he was before the defendant received the benefit. If the value of what was received and what was lost were always equal, there would be no substantial problem as to the amount of recovery, since actions of restitution are not punitive. In fact, however, the plaintiff frequently has lost more than the defendant has gained, and sometimes the defendant has gained more than the plaintiff has lost.

"In such cases the measure of restitution is determined with reference to the tortiousness of the defendant's conduct or the negligence or other fault of one or both of the parties in creating the situation giving rise to the right to restitution. If the defendant was tortious in his acquisition of the benefit he is required to pay for what the other has lost although that is more than the recipient benefited. If he was consciously tortious in acquiring the benefit, he is also deprived of any profit derived from his subsequent dealing with it. If he was no more at fault than the claimant, he is not required to pay for losses in excess of benefit received by him and he is permitted to retain gains which result from his dealing with the property." Restatement of Restitution 595-6.

Respondent may recover the profit derived by the appellant from the use of the machine.

[7] Respondent has prayed "on his first cause of action for the sum of twenty-five dollars per month from the time defendant first commenced to use said machine subsequent to May 1940 (1941) until present time."

In computing judgment, the court below computed recovery on the basis of ten dollars per week. This makes the judgment excessive, since it cannot exceed the amount prayed for. . ..

We therefore direct the trial court to reduce the judgment, based upon the prayer of the complaint, to twenty-five dollars per month for thirty-six months, or nine hundred dollars.

The judgment as modified is affirmed. Appellant will recover its costs.

Case 19: Fraud and Restitution

Vokes v. Arthur Murray, Inc.
DISTRICT COURT OF APPEAL OF FLORIDA, SECOND DISTRICT.
212 So. 2d 906 (1968)

OPINION: PIERCE, Judge.

This is an appeal by Audrey E. Vokes, plaintiff below, from a final order dismissing with prejudice, for failure to state a cause of action, her fourth amended complaint, hereinafter referred to as plaintiff's complaint.

Defendant Arthur Murray, Inc., a corporation, authorizes the operation throughout the nation of dancing schools under the name of "Arthur Murray School of Dancing" through local franchised operators, one of whom was defendant J. P. Davenport whose dancing establishment was in Clearwater.

Plaintiff Mrs. Audrey E. Vokes, a widow of 51 years and without family, had a yen to be "an accomplished dancer" with the hopes of finding "new interest in life." So, on February 10, 1961, a dubious fate, with the assist of a motivated acquaintance, procured her to attend a "dance party" at Davenport's "School of Dancing" where she whiled away the pleasant hours, sometimes in a private room, absorbing his accomplished sales technique, during which her grace and poise were elaborated upon and her rosy future as "an excellent dancer" was painted for her in vivid and glowing colors. As an incident to this interlude, he sold her eight 1/2-hour dance lessons to be utilized within one calendar month therefrom, for the sum of $14.50 cash in hand paid, obviously a baited "come-on."

Thus she embarked upon an almost endless pursuit of the terpsichorean art during which, over a period of less than sixteen months, she was sold fourteen "dance courses" totalling in the aggregate 2302 hours of dancing lessons for a total cash outlay of $31,090.45, all at Davenport's dance emporium. All of these fourteen courses were evidenced by execution of a written "Enrollment Agreement - Arthur Murray's School of Dancing" with the addendum in heavy black print, "No one will be informed that you are taking dancing lessons. Your relations with us are held in strict confidence," setting forth the number of "dancing lessons" and the "lessons in rhythm sessions" currently sold to her from time to time, and always of course accompanied by payment of cash of the realm.

These dance lesson contracts and the monetary consideration therefor of over $31,000 were procured from her by means and methods of Davenport and his associates which went beyond the unsavory, yet legally permissible, perimeter of "sales puffing" and intruded well into the forbidden area of undue influence, the suggestion of falsehood, the suppression of truth, and the free exercise of rational judgment, if what plaintiff alleged in her complaint was true. From the time of her first contact with the dancing school in February, 1961, she was influenced unwittingly by a constant and continuous barrage of flattery, false praise, excessive compliments, and panegyric encomiums, to such extent that it would be not only inequitable, but unconscionable, for a Court exercising inherent chancery power to allow such contracts to stand.

She was incessantly subjected to over-reaching blandishment and cajolery. She was assured she had "grace and poise;" that she was "rapidly improving and developing in her dancing skill;" that the additional lessons would "make her a beautiful dancer, capable of dancing with the most accomplished dancers;" that

she was "rapidly progressing in the development of her dancing skill and gracefulness," etc., etc. She was given "dance aptitude tests" for the ostensible purpose of "determining" the number of remaining hours instructions needed by her from time to time.

At one point she was sold 545 additional hours of dancing lessons to be entitled to award of the "Bronze Medal" signifying that she had reached "the Bronze Standard," a supposed designation of dance achievement by students of Arthur Murray, Inc.

Later she was sold an additional 926 hours in order to gain the "Silver Medal", indicating she had reached "the Silver Standard," at a cost of $12,501.35.

At one point, while she still had to her credit about 900 unused hours of instructions, she was induced to purchase an additional 24 hours of lessons to participate in a trip to Miami at her own expense, where she would be "given the opportunity to dance with members of the Miami Studio."

She was induced at another point to purchase an additional 126 hours of lessons in order to be not only eligible for the Miami trip but also to become "a life member of the Arthur Murray Studio," carrying with it certain dubious emoluments, at a further cost of $1,752.30.

At another point, while she still had over 1,000 unused hours of instruction she was induced to buy 151 additional hours at a cost of $2,049.00 to be eligible for a "Student Trip to Trinidad," at her own expense as she later learned.

Also, when she still had 1100 unused hours to her credit, she was prevailed upon to purchase an additional 347 hours at a cost of $4,235.74, to qualify her to receive a "Gold Medal" for achievement, indicating she had advanced to "the Gold Standard."

On another occasion, while she still had over 1200 unused hours, she was induced to buy an additional 175 hours of instruction at a cost of $2,472.75 to be eligible "to take a trip to Mexico."

Finally, sandwiched in between other lesser sales promotions, she was influenced to buy an additional 481 hours of instruction at a cost of $6,523.81 in order to "be classified as a Gold Bar Member, the ultimate achievement of the dancing studio."

All the foregoing sales promotions, illustrative of the entire fourteen separate contracts, were procured by defendant Davenport and Arthur Murray, Inc., by false representations to her that she was improving in her dancing ability, that she had excellent potential, that she was responding to instructions in dancing grace, and that they were developing her into a beautiful dancer, whereas in truth and in fact she did not develop in her dancing ability, she had no "dance aptitude," and in fact had difficulty in "hearing the musical beat." The complaint alleged that such representations to her "were in fact false and known by the defendant to be false and contrary to the plaintiff's true ability, the truth of plaintiff's ability being fully known to the defendants, but withheld from the plaintiff for the sole and specific intent to deceive and defraud the plaintiff and to induce her in the purchasing of additional hours of dance lessons." It was averred that the lessons were sold to her "in total disregard to the true physical, rhythm, and mental ability of the plaintiff." In other words, while she first exulted that she was entering the "spring of her life", she finally was awakened to the fact there was "spring" neither in her life nor in her feet.

The complaint prayed that the Court decree the dance contracts to be null and void and to be canceled, that an accounting be had, and judgment entered against the defendants "for that portion of the $31,090.45 not charged against specific hours of instruction given to the plaintiff." The Court held the complaint not to state a cause of action and dismissed it with prejudice. We disagree and reverse.

The material allegations of the complaint must, of course, be accepted as true for the purpose of testing its legal sufficiency. Defendants contend that contracts can only be rescinded for fraud or misrepresentation when the alleged misrepresentation is as to a material fact, rather than an opinion, prediction or expectation, and that the statements and representations set forth at length in the complaint were in the category of "trade puffing." within its legal orbit.

It is true that "generally a misrepresentation, to be actionable, must be one of fact rather than of opinion." . . . But this rule has significant qualifications, applicable here. It does not apply where there is a fiduciary relationship between the parties, or where there has been some artifice or trick employed by the representor, or where the parties do not in general deal at "arm's length" as we understand the phrase, or where the representee does not have equal opportunity to become apprised of the truth or falsity of the fact represented. . . As stated by Judge Allen of this Court in Ramel v. Chasebrook Construction Company:

". . . A statement of a party having . . . superior knowledge may be regarded as a statement of fact although it would be considered as opinion if the parties were dealing on equal terms."

It could be reasonably supposed here that defendants had "superior knowledge" as to whether plaintiff had "dance potential" and as to whether she was noticeably improving in the art of terpsichore. And it would be a reasonable inference from the undenied averments of the complaint that the flowery eulogiums heaped upon her by defendants as a prelude to her contracting for 1944 additional hours of instruction in order to attain the rank of the Bronze Standard, thence to the bracket of the Silver Standard, thence to the class of the Gold Bar Standard, and finally to the crowning plateau of a Life Member of the Studio, proceeded as much or more from the urge to "ring the cash register" as from any honest or realistic appraisal of her dancing prowess or a factual representation of her progress.

Even in contractual situations where a party to a transaction owes no duty to disclose facts within his knowledge or to answer inquiries respecting such facts, the law is if he undertakes to do so he must disclose the whole truth. . . From the face of the complaint, it should have been reasonably apparent to defendants that her vast outlay of cash for the many hundreds of additional hours of instruction was not justified by her slow and awkward progress, which she would have been made well aware of if they had spoken the "whole truth".

In Hirschman v. Hodges, etc., it was said that ". . . what is plainly injurious to good faith ought to be considered as a fraud sufficient to impeach a contract," and that an improvident agreement may be avoided ". . . because of surprise, or mistake, want of freedom, undue influence, the suggestion of falsehood, or the suppression of truth".

We repeat that where parties are dealing on a contractual basis at arm's length with no inequities or inherently unfair practices employed, the Courts will in general "leave the parties where they find themselves." But in the case sub judice, from the allegations of the unanswered complaint, we cannot say that enough of the accompanying ingredients, as mentioned in the foregoing authorities, were not present

which otherwise would have barred the equitable arm of the Court to her. In our view, from the showing made in her complaint, plaintiff is entitled to her day in Court.

It accordingly follows that the order dismissing plaintiff's last amended complaint with prejudice should be and is reversed.

Reversed.

COMMENTS AND QUESTIONS

1. Does the behavior of Davenport's dance studio franchise constitute, in your mind, a strong argument that dance studios should be licensed by the state? If dance studios in Florida had been licensed by the state, do you think the abuse of Audrey Vokes could have occurred?

2. Contrast this case to *Williams v. Walker Thomas*. Both plaintiffs who were treated unconscionably are made to appear pretty dumb in the appeal findings. But Audrey Vokes was getting her vanity catered to, whereas Ms. Williams was only getting swindled. Do you think the two cases are equally unconscionable, or do you think one (if so, which one) is more evil than the other?

3. In addition to being amusingly written, this opinion contains a nice statement of when a contract shall not be undone by a court, in the next to last paragraph.

Case 20: Effective Specific Performance Remedy

Groves v. John Wunder Co.
SUPREME COURT OF MINNESOTA
205 Minn. 163 (1939)

OPINION: STONE, JUSTICE.

In August, 1927, S. J. Groves & Sons Company, a corporation (hereinafter mentioned simply as Groves), owned a tract of 24 acres of Minneapolis suburban real estate. It was served or easily could be reached by railroad trackage. It is zoned as heavy industrial property. But for lack of development of the neighborhood its principal value thus far may have been in the deposit of sand and gravel which it carried. The Groves company had a plant on the premises for excavating and screening the gravel. Near by defendant owned and was operating a similar plant.

In August, 1927, Groves and defendant made the involved contract. For the most part it was a lease from Groves, as lessor, to defendant, as lessee; its term seven years. Defendant agreed to remove the sand and gravel and to leave the property "at a uniform grade, substantially the same as the grade now existing at the roadway . . . on said premises, and that in stripping the overburden . . . it will use said overburden for the purpose of maintaining and establishing said grade."

Under the contract defendant got the Groves screening plant. The transfer thereof and the right to remove the sand and gravel made the consideration moving from Groves to defendant, except that defendant incidentally got rid of Groves as a competitor. On defendant's part it paid Groves $105,000. So that from the outset, on Groves' part the contract was executed except for defendant's right to continue using the property for the stated term. (Defendant had a right to renewal which it did not exercise.)

Defendant breached the contract deliberately. It removed from the premises only "the richest and best of the gravel" and wholly failed, according to the findings, "to perform and comply with the terms, conditions, and provisions of said lease . . . with respect to the condition in which the surface of the demised premises was required to be left." Defendant surrendered the premises, not substantially at the grade required by the contract "nor at any uniform grade." Instead, the ground was "broken, rugged, and uneven." Plaintiff sues as assignee and successor in right of Groves.

As the contract was construed below, the finding is that to complete its performance 288,495 cubic yards of overburden would need to be excavated, taken from the premises, and deposited elsewhere. The reasonable cost of doing that was found to be upwards of $60,000. But, if defendant had left the premises at the uniform grade required by the lease, the reasonable value of the property on the determinative date would have been only $12,160. The judgment was for that sum, including interest, thereby nullifying plaintiff's claim that cost of completing the contract rather than difference in value of the land was the measure of damages. The gauge of damage adopted by the decision was the difference between the market value of plaintiff's land in the condition it was when the contract was made and what it would have been if defendant had performed. The one question for us arises upon plaintiff's assertion that he was entitled, not to that difference in value, but to the reasonable cost to him of doing the work called for by the contract which defendant left undone.

1. Defendant's breach of contract was wilful. There was nothing of good faith about it. Hence, that the decision below handsomely rewards bad faith and deliberate breach of contract is obvious. That is not allowable. Here the rule is well settled, and has been since Elliott v. Caldwell, 43 Minn. 357, . . . that where the contractor wilfully and fraudulently varies from the terms of a construction contract he cannot sue thereon and have the benefit of the equitable doctrine of substantial performance. . . .

Jacob & Youngs, Inc. v. Kent, . . . is typical. It was a case of substantial performance of a building contract. (This case is distinctly the opposite.) Mr. Justice Cardozo, in the course of his opinion, stressed the distinguishing features. "Nowhere," he said, "will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract." Again, "the willful transgressor must accept the penalty of his transgression."

2. In reckoning damages for breach of a building or construction contract, the law aims to give the disappointed promisee, so far as money will do it, what he was promised. . . It is so ruled by a long line of decisions in this state, beginning with Carli v. Seymour, Sabin & Co. 26 Minn. 276, . . . where the contract was for building a road. There was a breach. Plaintiff was held entitled to recover what it would cost to complete the grading as contemplated by the contract. . .

Never before, so far as our decisions show, has it even been suggested that lack of value in the land furnished to the contractor who had bound himself to improve it any escape from the ordinary consequences of a breach of the contract.

A case presently as interesting as any of our own is Sassen v. Haegle, 125 Minn. 441. . . The defendant, lessee of a farm, had agreed to haul and spread manure. He removed it, but spread it elsewhere than on the leased farm. Plaintiff had a verdict, but a new trial was ordered for error in the charge as to the measure of damages. The point was thus discussed by Mr. Justice Holt [125 Minn. 443]:

"But it is also true that the landlord had a perfect right to stipulate as to the disposal of the manure or as to the way in which the farm should be worked, and the tenant cannot evade compliance by showing that the farm became more valuable or fertile by omitting the agreed work or doing other work. Plaintiff's pleading and proof was directed to the reasonable value of performing what defendant agreed but failed to perform. Such reasonable cost or value was the natural and proximate damages. The question is not whether plaintiff made a wise or foolish agreement. He had a right to have it performed as made, and the resulting damage, in case of failure, is the reasonable cost of performance. Whether such performance affects the value of the farm was no concern of defendant."

Even in case of substantial performance in good faith, the resulting defects being remediable, it is error to instruct that the measure of damage is "the difference in value between the house as it was and as it would have been if constructed according to contract." The "correct doctrine" is that the cost of remedying the defect is the "proper" measure of damages. Snider v. Peters Home Bldg. Co. 139 Minn. 413,. . .

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

The owner's right to improve his property is not trammeled by its small value. It is his right to erect thereon structures which will reduce its value. If that be the result, it can be of no aid to any contractor who declines performance. As said long ago in Chamberlain v. Parker, 45 N.Y. 569, 572:

"A man may do what he will with his own, . . . and if he chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it, it does not lie with a defendant who has been so employed and paid for building it, to say that his own performance would not be beneficial to the plaintiff."

. . .

Suppose a contractor were suing the owner for breach of a grading contract such as this. Would any element of value, or lack of it, in the land have any relevance in reckoning damages? Of course not. The contractor would be compensated for what he had lost, i.e., his profit. Conversely, in such a case as this, the owner is entitled to compensation for what he has lost, that is, the work or structure which he has been promised, for which he has paid, and of which he has been deprived by the contractor's breach.

To diminish damages recoverable against him in proportion as there is presently small value in the land would favor the faithless contractor. It would also ignore and so defeat plaintiff's right to contract and build for the future. To justify such a course would require more of the prophetic vision than judges possess. This factor is important when the subject matter is trackage property in the margin of such an area of population and industry as that of the Twin Cities. . .

[In] Morgan v. Gamble, 230 Pa. 165, 79 A. 410, . . .the doctrine of substantial performance is . . . correctly stated, but plaintiff was denied its benefit because he had deliberately breached his building contract. It was held that:

"Where a building contractor agrees to lay an extra strong lead water pipe, and he substitutes therefor an iron pipe, he will be required to allow to the owners in a suit upon the contract, not the difference [in value] between the iron and lead pipes, but the cost of laying a lead pipe as provided in the agreement."

To show how remote any factors of value were considered, it was also held that:

"Where a contractor of a building agrees to construct two gas lines, one for natural gas, and one for artificial gas, he will not be relieved from constructing both lines, because artificial gas was not in use in the town in which the building was being constructed."

. . .

It is suggested that because of little or no value in his land the owner may be unconscionably enriched by such a reckoning. The answer is that there can be no unconscionable enrichment, no advantage upon which the law will frown, when the result is but to give one party to a contract only what the other has promised; particularly where, as here, the delinquent has had full payment for the promised performance.

It is said by the *Restatement of Contracts*, @ 346, Comment b:

"Sometimes defects in a completed structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste. If no such waste is involved, the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance."

The "economic waste" declaimed against by the decisions applying that rule has nothing to do with the value in money of the real estate, or even with the product of the contract. The waste avoided is only that which would come from wrecking a physical structure completed, or nearly so, under the contract. The cases applying that rule go no further. . . . Absent such waste, as it is in this case, the rule of the *Restatement*

of Contracts, @ 346, is that "the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance." That means that defendants here are liable to plaintiff for the reasonable cost of doing what defendants promised to do and have wilfully declined to do. . ..
The judgment must be reversed with a new trial to follow.

So ordered.

DISSENT: JULIUS J. OLSON, JUSTICE (dissenting). . .

The involved lease provides that the granted premises were to be used by defendant "for the purpose of removing the sand and gravel therefrom." The cash consideration was $105,000, plus defendant's covenant to level and grade the premises to a specified base. There was no segregation or allocation of the cash consideration made applicable to any of the various items going into the deal, and the instrument does not suggest any sum as being representative of the cost of performance by defendant of the leveling and grading process. Nor is there any finding that the contractor "wilfully and fraudulently" violated the terms of its contract. All that can be said is that defendant did nothing except to mine the sand and gravel purchased by it and deemed best suited to its own interest and advantage. No question of partial or substantial performance of its covenant is involved since it did nothing in that behalf. The sole question here is whether the rule adopted by the court respecting recoverable damages is wrong. The essential facts, not questioned, are that "The fair and reasonable value as of the end of the term of said lease, May 1, 1934, of performing the said work necessary to put the premises in the condition in which they were required by the terms of said lease to be left, is the sum of $60,893.28," and that if defendant "had left said premises at a uniform grade as required by said lease, the fair and reasonable value of said premises on May 1, 1934, would have been the sum of $12,160." In that sum, plus interest from May 1, 1934, plaintiff was awarded judgment, $15,053.58. His sole contention before the trial court and here is that upon these findings the court, as a matter of law, should have allowed him the cost of performance, $60,893.28, plus interest since date of the breach, May 1, 1934, amounting to more than $76,000.

Since there is no issue of fact, we should limit our inquiry to the single legal problem presented: What amount in money will adequately compensate plaintiff for his loss caused by defendant's failure to render performance?

When the parties entered into this contract each had a right to rely upon the promise of full and complete performance on the part of the other. And by "performance" is meant "such a thorough fulfillment of a duty as puts an end to obligations by leaving nothing more to be done." . . .

But the "obligation of the contract does not inhere or subsist in the agreement itself proprio vigore, but in the law applicable to the agreement, that is, in the act of the law in binding the promisor to perform his promise. When it is said that one who enters upon an undertaking assumes the legal duties relating to it, what is really meant is that the law imposes the duties on him. A contract is not a law, nor does it make law. It is the agreement plus the law that makes the ordinary contract an enforceable obligation." . . .

There is here no room for dispute as to contract obligation; therefore it is the duty of the court to enforce its terms "without a leaning in either direction," the parties being "on an equal footing" and as such "were free to do what they chose." . . .

Another principle, of universal application, is that a party is entitled to have that for which he contracted, or its equivalent. What that equivalent is depends upon the circumstances of each case. If the

effect of performance is such that the defective part "may be remedied without the destruction of any substantial part of the benefit which the owner's property has received by reason of the contractor's work, the equivalent to which the owner is entitled is the cost of making the work conform to the contract." . . . As such plaintiff "is entitled to be placed, in so far as this can be done by money, in the same position he would have occupied if the contract had been performed." But "his recovery is limited to the loss he has actually suffered by reason of the breach; he is not entitled to be placed in a better position than he would have been in if the contract had not been broken." . . . The measure of damages "is not affected by the financial condition of the one entitled to the damages"; nor may there be included in the assessment of damages "the motive of the defendant in breaking" his contract, compensatory damages alone being involved. In such a case the measure is "the same whatever the cause of the breach, regardless of whether it was due to mistake, accident, or inability to perform or was wilful and malicious." . . . Liability in damages has for its basis the value of the promised performance to the promisee, not what it would cost the promisor in completing performance. . . .

That the subject matter here involved was one within the proper scope of contractual obligation, and its purpose entirely lawful, is obvious. Plaintiff, as owner of the tract upon which the work was to be done, had the undoubted right to insist upon that kind of contract and to its performance. We are not concerned with whether he exercised economic wisdom or displayed lack thereof. Defendant agreed to do the work for what is conceded to have been a legally sufficient consideration. It must either perform or pay plaintiff for all damages by him suffered. . .

As the rule of damages to be applied in any given case has for its purpose compensation, not punishment, we must be ever mindful that, "if the application of a particular rule for measuring damages to given facts results in more than compensation, it is at once apparent that the wrong rule has been adopted." Crowley v. Burns Boiler & Mfg. Co. 100 Minn. 178. . . .

We have here then a situation where, concededly, if the contract had been performed, plaintiff would have had property worth, in round numbers, no more than $12,000. If he is to be awarded damages in an amount exceeding $60,000 he will be receiving at least 500 per cent more than his property, properly leveled to grade by actual performance, was intrinsically worth when the breach occurred. To so conclude is to give him something far beyond what the parties had in mind or contracted for. There is no showing made, nor any finding suggested, that this property was unique, specially desirable for a particular or personal use, or of special value as to location or future use different from that of other property surrounding it. . .

The theory upon which plaintiff relies for application of the cost of performance rule must have for its basis cases where the property or the improvement to be made is unique or personal instead of being of the kind ordinarily governed by market values. His action is one at law for damages, not for specific performance. As there was no affirmative showing of any peculiar fitness of this property to a unique or personal use, the rule to be applied is, I think, the one applied by the court. . .

The opinion also suggests that this property lies in an area where the owner might rightly look for future development, being in a so-called industrial zone, and that as such he should be privileged to so hold it. This he may of course do. But let us assume that on May 1, 1934, condemnation to acquire this area had so far progressed as to leave only the question of price (market value) undetermined; that the area had been graded in strict conformity with the contract but that the actual market value of the premises was only $12,160, as found by the court and acquiesced in by plaintiff, what would the measure of his damages be? Obviously, the limit of his recovery could be no more than the then market value of his property. In that sum

he has been paid with interest and costs; and he still has the fee title to the premises, something he would not possess if there had been condemnation. In what manner has plaintiff been hurt beyond the damages awarded? As to him "economic waste" is not apparent. Assume that defendant abandoned the entire project without taking a single yard of gravel therefrom but left the premises as they were when the lease was made, could plaintiff recover damages upon the basis here established? The trouble with the prevailing opinion is that here plaintiff's loss is not made the basis for the amount of his recovery but rather what it would cost the defendant. No case has been decided upon that basis until now. . .

Groves v. John Wunder Inc.: COMMENTS AND QUESTIONS

1. Elliott v. Caldwell, referred to on p. 2 of the case, asserts that a plaintiff, having wilfully breached a contract himself, cannot sue for performance on that contract. What (if anything) does that doctrine have to do with the case here? Are the economic values at stake the same in the two cases? Are the incentive consequences identical?

2. Does Jacob and Youngs v. Kent contain anything in its finding, other than the "aside" quoted in the opinion, that supports the finding of the Groves court? What are the parallels between Jacob & Youngs on the one hand and Groves on the other? What would the Jacob & Youngs court have to award for the finding to come out as Groves did? How do the economic values of these two cases differ?

3. Both the majority opinion and the dissent are silent on the exchange of economic values in this contract: the $105,000 paid by the defendant, and the value of the sand and gravel extracted by the defendant from the plaintiff's land. What bearing should those values have on an economically sensible decision?

At the end of the majority decision there is a favorable comment on a quote from *Restatement of Contracts* to this effect: "economic waste should be avoided in contract remedy." In contrasting Groves to the earlier Jacob and Youngs case, does Justice Stone (author of this opinion) understand what economic waste is?

5. Effective specific performance (the measure of legal remedy) differs radically in efficiency consequences from specific performance. Were specific performance awarded, defendant would spend resources (not money) to produce leveled land of no commensurate value. The plaintiff surely would have been unhappy with such a disposition of his complaint.

6. However, specific performance and substantial (or effective) specific performance convey the same incentives to future contractors faced with a choice between performing of saving resources. Explain.

7. The second from last paragraph of Justice Olsen's dissent provides an excellent lead-in to the next case.

Case 21: Effective Specific Performance Denied

Peevyhouse v. Garland Coal and Mining Co.
SUPREME COURT OF OKLAHOMA
382 P 2d 109 (1962)

OPINION: JACKSON, Justice. In the trial court, plaintiffs Willie and Lucille Peevyhouse sued the defendant, Garland Coal and Mining Company, for damages for breach of contract. Judgment was for plaintiffs in an amount considerably less than was sued for. Plaintiffs appeal and defendant cross-appeals.

In the briefs on appeal, the parties present their argument and contentions under several propositions; however, they all stem from the basic question of whether the trial court properly instructed the jury on the measure of damages.

Briefly stated, the facts are as follows: plaintiffs owned a farm containing coal deposits, and in November, 1954, leased the premises to defendant for a period of five years for coal mining purposes. A 'strip-mining' operation was contemplated in which the coal would be taken from pits on the surface of the ground, instead of from underground mine shafts. In addition to the usual covenants found in a coal mining lease, defendant specifically agreed to perform certain restorative and remedial work at the end of the lease period. It is unnecessary to set out the details of the work to be done, other than to say that it would involve the moving of many thousands of cubic yards of dirt, at a cost estimated by expert witnesses at about $29,000.00. However, plaintiffs sued for only $25,000.00.

During the trial, it was stipulated that all covenants and agreements in the lease contract had been fully carried out by both parties, except the remedial work mentioned above; defendant conceded that this work had not been done.

Plaintiffs introduced expert testimony as to the amount and nature of the work to be done, and its estimated cost. Over plaintiffs' objections, defendant thereafter introduced expert testimony as to the 'diminution in value' of plaintiffs' farm resulting from the failure of defendant to render performance as agreed in the contract -- that is, the difference between the present value of the farm, and what its value would have been if defendant had done what it agreed to do.

At the conclusion of the trial, the court instructed the jury that it must return a verdict for plaintiffs, and left the amount of damages for jury determination. On the measure of damages, the court instructed the jury that it might consider the cost of performance of the work defendant agreed to do, 'together with all of the evidence offered on behalf of either party'.

It thus appears that the jury was at liberty to consider the 'diminution in value' of plaintiffs' farm as well as the cost of 'repair work' in determining the amount of damages.

It returned a verdict for plaintiffs for $ 5000.00 -- only a fraction of the 'cost of performance', but more than the total value of the farm even after the remedial work is done.

On appeal, the issue is sharply drawn. Plaintiffs contend that the true measure of damages in this case is what it will cost plaintiffs to obtain performance of the work that was not done because of defendant's

default. Defendant argues that the measure of damages is the cost of performance 'limited, however, to the total difference in the market value before and after the work was performed'.

It appears that this precise question has not heretofore been presented to this court. In Ardizonne v. Archer, . . . this court held that the measure of damages for breach of a contract to drill an oil well was the reasonable cost of drilling the well, but here a slightly different factual situation exists. The drilling of an oil well will yield valuable geological information, even if no oil or gas is found, and of course if the well is a producer, the value of the premises increases. In the case before us, it is argued by defendant with some force that the performance of the remedial work defendant agreed to do will add at the most only a few hundred dollars to the value of plaintiffs' farm, and that the damages should be limited to that amount because that is all plaintiffs have lost.

Plaintiffs rely on Groves v. John Wunder Co., ... In that case, the Minnesota court, in a substantially similar situation, adopted the 'cost of performance' rule as-opposed to the 'value' rule. The result was to authorize a jury to give plaintiff damages in the amount of $ 60,000, where the real estate concerned would have been worth only $ 12,160, even if the work contracted for had been done.

It may be observed that Groves v. John Wunder Co., supra, is the only case which has come to our attention in which the cost of performance rule has been followed under circumstances where the cost of performance greatly exceeded the diminution in value resulting from the breach of contract. Incidentally, it appears that this case was decided by a plurality rather than a majority of the members of the court.

Defendant relies principally upon . . . cases in which, under similar circumstances, the appellate courts followed the 'value' rule instead of the 'cost of performance' rule. Plaintiff points out that in the earliest of these cases . . . the court cites as authority on the measure of damages an earlier Pennsylvania tort case, and that the other two cases follow the first, with no explanation as to why a measure of damages ordinarily followed in cases sounding in tort should be used in contract cases. Nevertheless, it is of some significance that three out of four appellate courts have followed the diminution in value rule under circumstances where, as here, the cost of performance greatly exceeds the diminution in value.

The explanation may be found in the fact that the situations presented are artificial ones. It is highly unlikely that the ordinary property owner would agree to pay $ 29,000 (or its equivalent) for the construction of 'improvements' upon his property that would increase its value only about ($ 300) three hundred dollars. The result is that we are called upon to apply principles of law theoretically based upon reason and reality to a situation which is basically unreasonable and unrealistic.

In Groves v. John Wunder Co., supra, in arriving at its conclusions, the Minnesota court apparently considered the contract involved to be analogous to a building and construction contract, and cited authority for the proposition that the cost of performance or completion of the building as contracted is ordinarily the measure of damages in actions for damages for the breach of such a contract.

In an annotation following the Minnesota case beginning at 123 A.L.R. 515, the annotator places the three cases relied on by defendant (Sandy Valley, Bigham and Sweeney) under the classification of cases involving 'grading and excavation contracts'.

We do not think either analogy is strictly applicable to the case now before us. The primary purpose of the lease contract between plaintiffs and defendant was neither 'building and construction' nor 'grading and

excavation'. It was merely to accomplish the economical recovery and marketing of coal from the premises, to the profit of all parties. The special provisions of the lease contract pertaining to remedial work were incidental to the main object involved.

Even in the case of contracts that are unquestionably building and construction contracts, the authorities are not in agreement as to the factors to be considered in determining whether the cost of performance rule or the value rule should be applied. The American Law Institute's *Restatement of the Law, Contracts*, Volume 1, Sections 346(1)(a)(i) and (ii) submits the proposition that the cost of performance is the proper measure of damages 'if this is possible and does not involve unreasonable economic waste'; and that the diminution in value caused by the breach is the proper measure 'if construction and completion in accordance with the contract would involve unreasonable economic waste'. (Emphasis supplied.) In an explanatory comment immediately following the text, the Restatement makes it clear that the 'economic waste' referred to consists of the destruction of a substantially completed building or other structure. Of course no such destruction is involved in the case now before us.

On the other hand, in McCormick, *Damages*, Section 168, it is said with regard to building and construction contracts that ' . . . in cases where the defect is one that can be repaired or cured without undue expense' the cost of performance is the proper measure of damages, but where ' . . . the defect in material or construction is one that cannot be remedied without an expenditure for reconstruction disproportionate to the end to be attained' (emphasis supplied) the value rule should be followed. The same idea was expressed in Jacob & Youngs, Inc. v. Kent . . . as follows:

'The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value.'

It thus appears that the prime consideration in the Restatement was 'economic waste'; and that the prime consideration in McCormick, *Damages*, and in Jacob & Youngs, Inc. v. Kent, supra, was the relationship between the expense involved and the 'end to be attained' -- in other words, the 'relative economic benefit'.

In view of the unrealistic fact situation in the instant case, and certain Oklahoma statutes to be hereinafter noted, we are of the opinion that the 'relative economic benefit' is a proper consideration here. . . .

23 O.S.1961 @@ 96 and 97 provide as follows:

'@ 96. . . Notwithstanding the provisions of this chapter, no person can recover a greater amount in damages for the breach of an obligation, than he would have gained by the full performance thereof on both sides. . .

'@ 97. . . Damages must, in all cases, be reasonable, and where an obligation of any kind appears to create a right to unconscionable and grossly oppressive damages, contrary to substantial justice no more than reasonable damages can be recovered.'

Although it is true that the above sections of the statute are applied most often in tort cases, they are by their own terms, and the decisions of this court, also applicable in actions for damages for breach of

contract. It would seem that they are peculiarly applicable here where, under the 'cost of performance' rule, plaintiffs might recover an amount about nine times the total value of their farm. Such would seem to be 'unconscionable and grossly oppressive damages, contrary to substantial justice' within the meaning of the statute. Also, it can hardly be denied that if plaintiffs here are permitted to recover under the 'cost of performance' rule, they will receive a greater benefit from the breach than could be gained from full performance, contrary to the provisions of Sec. 96.

An analogy may be drawn between the cited sections, and the provisions of 15 O.S.1961 @@ 214 and 215. These sections tend to render void any provisions of a contract which attempt to fix the amount of stipulated damages to be paid in case of a breach, except where it is impracticable or extremely difficult to determine the actual damages. This results in spite of the agreement of the parties, and the obvious and well known rationale is that insofar as they exceed the actual damages suffered, the stipulated damages amount to a penalty or forfeiture which the law does not favor.

23 O.S.1961 @@ 96 and 97 have the same effect in the case now before us. In spite of the agreement of the parties, these sections limit the damages recoverable to a reasonable amount not 'contrary to substantial justice'; they prevent plaintiffs from recovering a 'greater amount in damages for the breach of an obligation' than they would have 'gained by the full performance thereof'.

We therefore hold that where, in a coal mining lease, lessee agrees to perform certain remedial work on the premises concerned at the end of the lease period, and thereafter the contract is fully performed by both parties except that the remedial work is not done, the measure of damages in an action by lessor against lessee for damages for breach of contract is ordinarily the reasonable cost of performance of the work; however, where the contract provision breached was merely incidental to the main purpose in view, and where the economic benefit which would result to lessor by full performance of the work is grossly disproportionate to the cost of performance, the damages which lessor may recover are limited to the diminution in value resulting to the premises because of the non-performance.

We believe the above holding is in conformity with the intention of the Legislature as expressed in the statutes mentioned, and in harmony with the better-reasoned cases from the other jurisdictions where analogous fact situations have been considered. It should be noted that the rule as stated does not interfere with the property owner's right to 'do what he will with his own' . . ., or his right, if he chooses, to contract for 'improvements' which will actually have the effect of reducing his property's value. Where such result is in fact contemplated by the parties, and is a main or principal purpose of those contracting, it would seem that the measure of damages for breach would ordinarily be the cost of performance.

The above holding disposes of all of the arguments raised by the parties on appeal.

Under the most liberal view of the evidence herein, the diminution in value resulting to the premises because of non-performance of the remedial work was $300.00. After a careful search of the record, we have found no evidence of a higher figure, and plaintiffs do not argue in their briefs that a greater diminution in value was sustained. It thus appears that the judgment was clearly excessive, and that the amount for which judgment should have been rendered is definitely and satisfactorily shown by the record.

We are asked by each party to modify the judgment in accordance with the respective theories advanced. . .

We are of the opinion that the judgment of the trial court for plaintiffs should be, and it is hereby, modified and reduced to the sum of $300.00, and as so modified it is affirmed.

WELCH, DAVISON, HALLEY, and JOHNSON, JJ., concur.

WILLIAMS, C. J., BLACKBIRD, V. C. J., and IRWIN and BERRY, JJ., dissent.

DISSENT: IRWIN, Justice (dissenting). By the specific provisions in the coal mining lease under consideration, the defendant agreed as follows:

'. .. '7b Lessee agrees to make fills in the pits dug on said premises on the property line in such manner that fences can be placed thereon and access had to opposite sides of the pits.

'c Lessee agrees to smooth off the top of the spoil banks on the above premises.

'7d Lessee agrees to leave the creek crossing the above premises in such a condition that it will not interfere with the crossings to be made in pits as set out in 7b.

'7f Lessee further agrees to leave no shale or dirt on the high wall of said pits. . . '

Following the expiration of the lease, plaintiffs made demand upon defendant that it carry out the provisions of the contract and to perform those covenants contained therein.

Defendant admits that it failed to perform its obligations that it agreed and contracted to perform under the lease contract and there is nothing in the record which indicates that defendant could not perform its obligations. Therefore, in my opinion defendant's breach of the contract was wilful and not in good faith.

Although the contract speaks for itself, there were several negotiations between the plaintiffs and defendant before the contract was executed. Defendant admitted in the trial of the action, that plaintiffs insisted that the above provisions be included in the contract and that they would not agree to the coal mining lease unless the above provisions were included.

In consideration for the lease contract, plaintiffs were to receive a certain amount as royalty for the coal produced and marketed and in addition thereto their land was to be restored as provided in the contract.

Defendant received as consideration for the contract, its proportionate share of the coal produced and marketed and in addition thereto, the right to use plaintiffs' land in the furtherance of its mining operations.

The cost for performing the contract in question could have been reasonably approximated when the contract was negotiated and executed and there are no conditions now existing which could not have been reasonably anticipated by the parties. Therefore, defendant had knowledge, when it prevailed upon the plaintiffs to execute the lease, that the cost of performance might be disproportionate to the value or benefits received by plaintiff for the performance.

Defendant has received its benefits under the contract and now urges, in substance, that plaintiffs' measure of damages for its failure to perform should be the economic value of performance to the plaintiffs and not the cost of performance.

If a peculiar set of facts should exist where the above rule should be applied as the proper measure of damages, (and in my judgment those facts do not exist in the instant case) before such rule should be applied, consideration should be given to the benefits received or contracted for by the party who asserts the application of the rule.

Defendant did not have the right to mine plaintiffs' coal or to use plaintiffs' property for its mining operations without the consent of plaintiffs. Defendant had knowledge of the benefits that it would receive under the contract and the approximate cost of performing the contract. With this knowledge, it must be presumed that defendant thought that it would be to its economic advantage to enter into the contract with plaintiffs and that it would reap benefits from the contract, or it would have not entered into the contract.

Therefore, if the value of the performance of a contract should be considered in determining the measure of damages for breach of a contract, the value of the benefits received under the contract by a party who breaches a contract should also be considered. However, in my judgment, to give consideration to either in the instant action, completely rescinds and holds for naught the solemnity of the contract before us and makes an entirely new contract for the parties.

In Goble v. Bell Oil & Gas Co., . . . we held: 'Even though the contract contains harsh and burdensome terms which the court does not in all respects approve, it is the province of the parties in relation to lawful subject matter to fix their rights and obligations, and the court will give the contract effect according to its expressed provisions, unless it be shown by competent evidence proof that the written agreement as executed is the result of fraud, mistake, or accident.'

> In Cities Service Oil Co. v. Geolograph Co. Inc., . . . 'While we do not agree that the contract as presently written is an onerous one, we think the short answer is that the folly or wisdom of a contract is not for the court to pass on.'

In Great Western Oil & Gas Company v. Mitchell, . . . 'The law will not make a better contract for parties than they themselves have seen fit to enter into, or alter it for the benefit of one party and to the detriment of the others; the judicial function of a court of law is to enforce a contract as it is written.'

I am mindful of Title 23 O.S.1961 @ 96, which provides that no person can recover a greater amount in damages for the breach of an obligation than he could have gained by the full performance thereof on both sides, except in cases not applicable herein. However, in my judgment, the above statutory provision is not applicable here.

In my judgment, we should follow the case of Groves v. John Wunder Company, 205 Minn. 163, 286 N.W. 235, 123 A.L.R. 502, which defendant agrees 'that the fact situation is apparently similar to the one in the case at bar', and where the Supreme Court of Minnesota held:

'The owner's or employer's damages for such a breach (i. e. breach hypothesized in 2d syllabus) are to be measured, not in respect to the value of the land to be improved, but by the reasonable cost of doing that which the contractor promised to do and which he left undone.'

The hypothesized breach referred to states that where the contractor's breach of a contract is wilful, that is, in bad faith, he is not entitled to any benefit of the equitable doctrine of substantial performance.

In the instant action defendant has made no attempt to even substantially perform. The contract in question is not immoral, is not tainted with fraud, and was not entered into through mistake or accident and is not contrary to public policy. It is clear and unambiguous and the parties understood the terms thereof, and the approximate cost of fulfilling the obligations could have been approximately ascertained. There are no conditions existing now which could not have been reasonably anticipated when the contract was negotiated and executed. The defendant could have performed the contract if it desired. It has accepted and reaped the benefits of its contract and now urges that plaintiffs' benefits under the contract be denied. If plaintiffs' benefits are denied, such benefits would inure to the direct benefit of the defendant.

Therefore, in my opinion, the plaintiffs were entitled to specific performance of the contract and since defendant has failed to perform, the proper measure of damages should be the cost of performance. Any other measure of damage would be holding for naught the express provisions of the contract; would be taking from the plaintiffs the benefits of the contract and placing those benefits in defendant which has failed to perform its obligations; would be granting benefits to defendant without a resulting obligation; and would be completely rescinding the solemn obligation of the contract for the benefit of the defendant to the detriment of the plaintiffs by making an entirely new contract for the parties.

I therefore respectfully dissent to the opinion promulgated by a majority of my associates.

Peevyhouse v. Garland Coal and Mining Co.: COMMENTS AND QUESTIONS

Peevyhouse bears a striking resemblance to two other cases in the folio, both of which appear as citations in the opinion: Jacob and Youngs v. Kent, and Groves v. Wunder. There is a paradoxical element in these three cases. Groves-Wunder alone involves commercial not residential property, which makes it the only case of the three in which subjective values cannot reasonably come to bear. Jacob and Youngs involves a clear breach of the contract, but it is hard not to laugh about a homeowner who loses sleep over the manufacture of the cast iron sewer pipe used in his home. Wunder has some of the elements of a ripoff: you agreed to level my commercial lot at a time when it would have been cost effective to do so, refused to honor your agreement after it ceased to be cost effective to do so, and now you owe me the amount that it would cost me today to get that job done-- even though there is no reason to do that job. Peevyhouse differs from both cases in this respect: though repair according to contract agreement would not be cost effective, it involves the usability and appearance of a residential property, about which it is not ludicrous for an owner to be concerned (thereby distinguishing it from Jacob and Youngs); it differs from Wunder precisely in the fact that it is residential not commercial property.

Case 22: Liquidated Damages or Penalty Clauses?

Lake River Corp. v. Carborundum Co.
U.S. COURT OF APPEALS, SEVENTH CIRCUIT
769 F.2d 1284 (1985)

OPINION BY: POSNER

. . .

Carborundum manufactures "Ferro Carbo," an abrasive powder used in making steel. To serve its midwestern customers better, Carborundum made a contract with Lake River by which the latter agreed to provide distribution services in its warehouse in Illinois. Lake River would receive Ferro Carbo in bulk from Carborundum, "bag" it, and ship the bagged produce to Carborundum's customers. The Ferro Carbo would remain Carborundum's property until delivered to the customers.

Carborundum insisted that Lake River install a new bagging system to handle the contract. In order to be sure of being able to recover the cost of the new system ($89,000) and make a profit of 20 percent of the contract price, Lake River insisted on the following minimum-quantity guarantee: In consideration of the special equipment [i.e., the new bagging system] to be acquired and furnished by Lake River for handling the product, Carborundum shall, during the initial three-year term of this Agreement, ship to Lake River for bagging a minimum quantity of [22,500 tons]. If, at the end of the three-year term, this minimum quantity shall not have been shipped, Lake River shall invoice Carborundum at the then prevailing rates for the difference between the quantity bagged and the minimum guaranteed. If Carborundum had shipped the full minimum quantity that it guaranteed, it would have owed Lake River roughly $533,000 under the contract.

After the contract was signed in 1979, the demand for domestic steel, and with it the demand for Ferro Carbo, plummeted, and Carborundum failed to ship the guaranteed amount. When the contract expired late in 1982, Carborundum had shipped only 12,000 of the 22,500 tons it had guaranteed. Lake River had bagged the 12,000 tons and had billed Carborundum for this bagging, and Carborundum had paid, but by virtue of the formula in the minimum-guarantee clause Carborundum still owed Lake River $241,000--the contract price of $533,000 if the full amount of Ferro Carbo had been shipped, minus what Carborundum had paid for the bagging of the quantity it had shipped.

When Lake River demanded payment of this amount, Carborundum refused, on the ground that the formula imposed a penalty. At the time, Lake River had in its warehouse 500 tons of bagged Ferro Carbo, having a market value of $269,000, which it refused to release unless Carborundum paid the $241,000 due under the formula. Lake River did offer to sell the bagged product and place the proceeds in escrow until its dispute with Carborundum over the enforceability of the formula was resolved, but Carborundum rejected the offer and trucked in bagged Ferro Carbo from the East to serve its customers in Illinois, at an additional cost of $31,000.

Lake River brought this suit for $241,000, which it claims as liquidated damages. Carborundum counterclaimed for the value of the bagged Ferro Carbo when Lake River impounded it and the additional cost of serving the customers affected by the impounding. The theory of the counterclaim is that the impounding was a conversion, and not as Lake River contends the assertion of a lien. The district judge, after a bench trial, gave judgment for both parties. Carborundum ended up roughly $42,000 to the good:

$269,000 + $31,000 - $241,000 - $17,000, the last figure representing prejudgment interest on Lake River's damages. (We have rounded off all dollar figures to the nearest thousand.) Both parties have appealed.

The only issue that is not one of damages is whether Lake River had a valid lien on the bagged Ferro Carbo that it refused to ship to Carborundum's customers-- that, indeed, it holds in its warehouse to this day. Although Ferro Carbo does no deteriorate with age, the domestic steel industry remains in the doldrums and the product is worth less than it was in 1982 when Lake River first withheld it. If Lake River did not have a valid lien on the product, then it converted it, and must pay Carborundum the $269,000 that the Ferro Carbo was worth back then.

It might seem that if the minimum-guarantee clause was a penalty clause and hence unenforceable, the lien could not be valid, and therefore that we should discuss the penalty issue first. But this is not correct. If the contractual specification of damages is invalid, Lake River still is entitled to any actual damages caused by Carborundum's breach of contract in failing to deliver the minimum amount of Ferro Carbo called for by the contract. The issue is whether an entitlement to damages, large or small, entitles the victim of the breach to assert a lien on goods that are in its possession though they belong to the other party.

Lake River has not been very specific about the type of lien it asserts. We think it best described as a form of artisan's lien, the "lien of the bailee, who does work upon or adds materials to chattels . . ." Lake River was the bailee of the Ferro Carbo that Carborundum delivered to it, and it did work on the Ferro Carbo-bagging it, and also storing it (storage is a service, too). If Carborundum had refused to pay for the services that Lake River performed on the Ferro Carbo delivered to it, then Lake River would have had a lien on the Ferro Carbo in its possession to coerce payment. . . But in fact, when Lake River impounded the bagged Ferro Carbo, Carborundum had paid in full for all bagging and storage services that Lake River had performed on Ferro Carbo shipped to it by Carborundum. The purpose of impounding was to put pressure on Carborundum to pay for services not performed, Carborundum having failed to ship the Ferro Carbo on which those services would have been performed.

Unlike a contractor who, having done the work contracted for without having been paid, may find himself in a box, owing his employees or suppliers money he does not have-- money he was counting on from his customer-- Lake River was the victim of a breach of a portion of the contract that remained entirely unexecuted on either side. Carborundum had not shipped the other 10,500 tons, as promised; but on the other hand Lake River had not had to bag those 10,500 tons, as it had promised. It is not as if Lake River had bagged those tons, incurring heavy costs that it expected to recoup from Carborundum, and then Carborundum had said, "Sorry, we won't pay you; go ahead and sue us."

A lien is strong medicine; it clogs up markets, as the facts of this case show. Its purpose is to provide an effective self-help remedy for one who has done work in expectation of payment and then is not paid. The vulnerable position of such a person gives rise to "the artisan's privilege of holding the balance for work done in the past." . . . A lien is thus a device for preventing unjust enrichment-- not for forcing the other party to accede to your view of a contract dispute. "The right to retain possession of the property to enforce a possessory lien continues until such time as the charges for such materials, labor and services are paid." . . . Since here the charges were paid before the lien was asserted, the lien was no good.

Lake River tries to compare its position to that of a conventional lien creditor by pointing out that it made itself particularly vulnerable to a breach of contract by buying specialized equipment at Carborundum's insistence, to the tune of $89,000, before performance under the contract began. It says it insisted on the

minimum guarantee in order to be sure of being able to amortize this equipment over a large enough output of bagging services to make the investment worthwhile. But the equipment was not completely useless for other contracts-- Lake River having in fact used it for another contract; it was not the major cost of fulfilling the contract; and Lake River received almost $300,000 under the term of the contract, thus enabling it to amortize much of the cost of the special equipment. Although Lake River may have lost money on the contract (but as yet there is no proof it did), it was not in the necessitous position of a contractor who completes his performance without receiving a dime and then is told by his customer to sue for the price. The recognition of a lien in such a case is based on policies akin to those behind the rule that a contract modification procured by duress will not be enforced. . . When as a practical matter the legal remedy may be inadequate because it operates too slowly, self-help is allowed. But we can find no case recognizing a lien on facts like these, no ground for thinking that the Illinois Supreme Court would be the first court to recognize such a lien if this case were presented to it, and no reason to believe that the recognition of such a lien would be a good thing. It would impede the marketability of goods without responding to any urgent need of creditors.

Conrow v. Little, . . . on which Lake River relies heavily because the lien allowed in that case extended to "money expended in the preparation of instrumentalities," is not in point. The plaintiffs, dealers in paper, had made extensive deliveries to the defendants for which they had received no payment. . . If Lake River had bagged several thousand tons of Ferro Carbo without being paid anything, it would have had a lien on the Ferro Carbo; and maybe-- if Conrow is good law in Illinois, a question we need not try to answer-- the lien would have included not only the contract price for the Ferro Carbo that Lake River had bagged but also the unreimbursed, unsalvageable cost of the special bagging system that Lake River had installed. But that is not this case. Carborundum was fully paid up and Lake River has made no effort to show how much if any money it stood to lose because the bagging system was not fully amortized. The only purpose of the lien was to collect damages which would have been unrelated to-- and certainly exceeded-- the investment in the bagging system.

It is no answer that the bagging system should be presumed to have been amortized equally over the life of the contract, and therefore to have been only half amortized when Carborundum broke the contract. Amortization is an accounting device; it need not reflect cash flows. There is no evidence that when the contract was broken, Lake River was out of pocket a cent in respect of the bagging system, especially when we consider that the bagging system was still usable, and was used to fulfill another contract.

The hardest issue in the case is whether the formula in the minimum-guarantee clause imposes a penalty for breach of contract or is merely an effort to liquidate damages. Deep as the hostility to penalty clauses runs in the common law, . . . we still might be inclined to question, if we thought ourselves free to do so, whether a modern court should refuse to enforce a penalty clause where the signator is a substantial corporation, well able to avoid improvident commitments. Penalty clauses provide an earnest of performance. The clause here enhanced Carborundum's credibility in promising to ship the minimum amount guaranteed by showing that it was willing to pay the full contract price even if it failed to ship anything. On the other side it can be pointed out that by raising the cost of a breach of contract to the contract breaker, a penalty clause increases the risk to his other creditors; increases (what is the same thing and more, because bankruptcy imposes "deadweight" social costs) the risk of bankruptcy; and could amplify the business cycle by increasing the number of bankruptcies in bad times, which is when contracts are most likely to be broken. But since little effort is made to prevent businessmen from assuming risks, these reasons are no better than makeweights.

A better argument is that a penalty clause may discourage efficient as well as inefficient breaches of contract. Suppose a breach would cost the promisee $12,000 in actual damages but would yield the promisor $20,000 in additional profits. Then there would be a net social gain from breach. After being fully compensated for his loss the promisee would be no worse off than if the contract had been performed, while the promisor would be better off by $8,000. But now suppose the contract contains a penalty clause under which the promisor if he breaks his promise must pay the promisee $25,000. The promisor will be discouraged from breaking the contract, since $25,000, the penalty, is greater than $20,000, the profits of the breach; and a transaction that would have increased value will be foregone.

On this view, since compensatory damages should be sufficient to deter inefficient breaches (that is, breaches that cost the victim more than the gain to the contract breaker), penal damages could have no effect other than to deter some efficient breaches. But this overlooks the earlier point that the willingness to agree to a penalty clause is a way of making the promisor and his promise credible and may therefore be essential to inducing some value-maximizing contracts to be made. It also overlooks the more important point that the parties (always assuming they are fully competent) will, in deciding whether to include a penalty clause in their contract, weigh the gains against the costs-- costs that include the possibility of discouraging an efficient breach somewhere down the road-- and will include the clause only if the benefits exceed those costs as well as all other costs.

On this view the refusal to enforce penalty clauses is (at best) paternalistic-- and it seems odd that courts should display parental solicitude for large corporations. But however this may be, we must be on guard to avoid importing our own ideas of sound public policy into an area where our proper judicial role is more than usually deferential. The responsibility for making innovations in the common law of Illinois rests with the courts of Illinois, and not with the federal courts in Illinois. And like every other state, Illinois, untroubled by academic skepticism of the wisdom of refusing to enforce penalty clauses against sophisticated promisors, . . . continues steadfastly to insist on the distinction between penalties and liquidated damages. . . To be valid under Illinois law a liquidation of damages must be a reasonable estimate at the time of contracting of the likely damages from breach, and the need for estimation at that time must be shown by reference to the likely difficulty of measuring the actual damages from a breach of contract after the breach occurs. If damages would be easy to determine then, of if the estimate greatly exceeds a reasonable upper estimate of what the damages are likely to be, it is a penalty. . .

The distinction between a penalty and liquidated damages is not an easy one to draw in practice but we are required to draw it and can give only limited weight to the district court's determination. Whether a provision for damages is a penalty clause or a liquidated-damages clause is a question of law rather than fact, . . . and unlike some courts of appeals we do not treat a determination by a federal district judge on an issue of state law as if it were a finding of fact, and reverse only if persuaded that clear error has occurred, though we give his determination respectful consideration. . .

Mindful that Illinois courts resolve doubtful cases in favor of classification as a penalty, . . . we conclude that the damage formula in this case is a penalty and not a liquidation of damages, because it is designed always to assure Lake River more than its actual damages. The formula-- full contract price minus the amount already invoiced to Carborundum-- is invariant to the gravity of the breach. When a contract specifies a single sum in damages for any and all breaches even though it is apparent that all are not of the same gravity, the specification is not a reasonable effort to estimate damages; and when in addition the fixed sum greatly exceeds the actual damages likely to be inflicted by a minor breach, its character as a penalty

becomes unmistakable. . . This case is within the gravitational field of these principles even though the minimum-guarantee clause does not fix a single sum as damages.

Suppose to begin with that the breach occurs the day after Lake River buys its new bagging system for $89,000 and before Carborundum ships any Ferro Carbo. Carborundum would owe Lake River $533,000. Since Lake River would have incurred at that point a total cost of only $89,000, its net gain from the breach would be $444,000. This is more than four times the profit of $107,000 (20 percent of the contract price of $533,000) that Lake River expected to make from the contract if it had been performed: a huge windfall.

Next suppose (as actually happened here) that breach occurs when 55 percent of the Ferro Carbo has been shipped. Lake River would already have received $293,000 from Carborundum. To see what its costs then would have been (as estimated at the time of contracting), first subtract Lake River's anticipated profit on the contract of $107,000 from the total contract price of $533,000. The difference-Lake River's total cost of performance-is $426,000. Of this, $89,000 is the cost of the new bagging system, a fixed cost. The rest ($426,000-$89,000 = $337,000) presumably consists of variable costs that are roughly proportional to the amount of Ferro Carbo bagged; there is no indication of any other fixed costs. Assume, therefore, that if Lake River bagged 55 percent of the contractually agreed quantity, it incurred in doing so 55 percent of its variable costs, or $185,000. When this is added to the cost of the new bagging system, assumed for the moment to be worthless except in connection with the contract, the total cost of performance to Lake River is $274,000. Hence a breach that occurred after 55 percent of contractual performance was complete would be expected to yield Lake River a modest profit of $19,000 ($293,000 - $274,000). But now add the "liquidated damages" of $241,000 that Lake River claims, and the result is a total gain from the breach of $260,000, which is almost two and a half times the profit that Lake River expected to gain if there was no breach. And this ignores any use value or salvage value of the new bagging system, which is the property of Lake River-- though admittedly it also ignores the time value of money; Lake River paid $89,000 for that system before receiving any revenue from the contract.

To complete the picture, assume that the breach had not occurred till performance was 90 percent complete. Then the "liquidated damages" clause would not be so one-sided, but it would be one-sided. Carborundum would have paid $480,000 for bagging. Against this, Lake River would have incurred its fixed cost of $89,000 plus 90 percent of its variable costs of $337,000 or $303,000. Its total costs would thus be $392,000, and its net profit $88,000. But on top of this it would be entitled to "liquidated damages" of $53,000, for a total profit of $141,000-more than 30 percent more that its expected profit of $107,000 if there was no breach.

The reason for these results is that most of the costs to Lake River of performing the contract are saved if the contract is broken, and this saving is not reflected in the damage formula. As a result, at whatever point in the life of the contract a breach occurs, the damage formula gives Lake River more than its lost profits form the breach-- dramatically more if the breach occurs at the beginning of the contract; tapering off at the end, it is true. Still, over the interval between the beginning of Lake River's performance and nearly the end, the clause could be expected to generate profits ranging from 400 percent of the expected contract profits to 130 percent of those profits. And this is on the assumption that the bagging system has no value apart from the contract. If it were worth only $20,000 to Lake River, the range would be 434 percent to 150 percent.

Lake River argues that it would never get as much as the formula suggests, because it would be required to mitigate its damages. This is a dubious argument on several grounds. First, mitigation of damages is a doctrine of the law of court-assessed damages, while the point of a liquidated-damages clause is to substitute party assessment; and that point is blunted, and the certainty that liquidated-damages clauses are designed to give the process of assessing damages impaired, if a defendant can force the plaintiff to take less than the damages specified in the clause, on the ground that the plaintiff could have avoided some of them. It would seem therefore that the clause in this case should be read to eliminate any duty of mitigation, that what Lake River is doing is attempting to rewrite the clause to make it more reasonable, and that since actually the clause is designed to give Lake River the full damages it would incur from breach (and more) even if it made no effort to find a substitute use for the equipment that it brought to perform the contract, this is just one more piece of evidence that it is a penalty clause rather than a liquidated-damages clause. . .

But in any event mitigation would not mitigate the penal character of this clause. If Carborundum did not ship the guaranteed minimum quantity, the reason was likely to be . . . that the steel industry had fallen on hard times and the demand for Ferro Carbo was therefore down. In these circumstances Lake River would have little prospect of finding a substitute contract that would yield it significant profits to set off against the full contract price, which is the method by which it proposes to take account of mitigation. At argument Lake River suggested that it might at least have been able to sell the new bagging equipment to someone for something, and the figure $40,000 was proposed. If the breach occurred on the first day when performance under the contract was due and Lake River promptly sold the bagging equipment for $40,000, its liquidated damages would fall to $493,000. But by the same token its costs would fall to $49,000. Its profit would still be $444,000, which as we said was more than 400 percent of its expected profit on the contract. The penal component would be unaffected. . .

The fact that the damage formula is invalid does not deprive Lake River of a remedy. The parties did not contract explicitly with reference to the measure of damages if the agreed-on damage formula was invalidated, but all this means is that the victim of the breach is entitled to his common law damages. . . In this case that would be the unpaid contract price of $241,000 minus the costs that Lake River saved by not having to complete the contract (the variable costs on the other 45 percent of the Ferro Carbo that it never had to bag). The case must be remanded to the district judge to fix these damages.

Two damages issues remain. The first concerns Carborundum's expenses of delivering bagged Ferro Carbo to its customers to replace that impounded by Lake River. The district judge gave Carborundum the full market value of the bagged Ferro Carbo. Lake River argues that it should not have to pay for Carborundum's expense of selling additional Ferro Carbo-additional in the sense that Carborundum is being given credit for the full retail value of the product that Lake River withheld. To explain, suppose that Carborundum had an order for $1,000 worth of bagged Ferro Carbo, which Lake River was supposed to deliver; and because it refused, Carborundum incurred a transportation cost of $100 to make a substitute shipment of bagged Ferro Carbo to the customer. Carborundum would still get $1,000 from the customer, and if that price covered the transportation cost it would still make a profit. In what sense, therefore, is that cost a separate item of damage, of loss? On all Ferro Carbo (related to this case) sold by Carborundum in the Midwest, Carborundum received the full market price, either from its customers in the case of Ferro Carbo actually delivered to them, or from Lake River in the case of the Ferro Carbo that Lake River refused to deliver. Having received a price designed to cover all expenses of sale, a seller cannot also get an additional damage award for any of those expenses.

If, however, the additional Ferro Carbo that Carborundum delivered to its midwestern customers in substitution for Ferro Carbo previously delivered to, and impounded by, Lake River would have been sold in the East at the same price but lower cost, Carborundum would have had an additional loss, in the form of reduced profits, for which it could recover additional damages. But it made no effort to prove such a loss. Maybe it had no unsatisfied eastern customers, and expanded rather than shifted output to fulfill its midwestern customers' demand. The damages on the counterclaim must be refigured also.

Finally, Lake River argues that Carborundum failed to mitigate its damages by accepting Lake River's offer to deliver the bagged product and place the proceeds in escrow. But a converter is not entitled to retain the proceeds of the conversion even temporarily. Lake River had an opportunity to limit its exposure by selling the bagged product on Carborundum's account and deducting what it claimed was due it on its "lien." Its failure to follow this course reinforces our conclusion that the assertion of the lien was a naked attempt to hold Carborundum hostage to Lake River's view-- an erroneous view, as it has turned out--of the enforceability of the damage formula in the contract.

The judgment of the district court is affirmed in part and reversed in part, and the case is returned to that court to redetermine both parties' damages in accordance with the principles in this opinion. The parties may present additional evidence on remand, and shall bear their own costs in this court. . .

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

Lake River Corp. V. Carborundum Co.: COMMENTS AND QUESTIONS

1. The main feature of this brilliant opinion is its clarification of why the damages sought by Lake River should be regarded as penalty for breach rather than liquidated damages.

2. The idea of self help is introduced in the opinion. Review from the opinion when and under what circumstances (not those of this case) self help in the form of a lien is warranted, and think of how recourse to such self help might serve to diminish economic loss.

Case 23: The "Clark v. Marsiglia" Rule of Damages Mitigation

Rockingham County v. Luten Bridge Co.
U.S. CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT
35 F.2d 301 (1929)

OPINION BY: PARKER.

This was an action at law instituted in the court below by the Luten Bridge Company, as plaintiff, to recover of Rockingham county, North Carolina, an amount alleged to be due under a contract for the construction of a bridge. The county admits the execution and breach of the contract, but contends that notice of cancellation was given the bridge company before the erection of the bridge was commenced, and that it is liable only for the damages which the company would have sustained, if it had abandoned construction at that time. The judge below refused to strike out an answer filed by certain members of the board of commissioners of the county, admitting liability in accordance with the prayer of the complaint, allowed this pleading to be introduced in evidence as the answer of the county, excluded evidence offered by the county in support of its contentions as to notice of cancellation and damages, and instructed a verdict for plaintiff for the full amount of its claim. From the judgment on this verdict the county has appealed.

The facts out of which the case arises, as shown by the affidavits and offers of proof appearing in the record, are as follows: On January 7, 1924, the board of commissioners of Rockingham county voted to award to plaintiff a contract for the construction of the bridge in controversy. Three of the five commissioners favored the awarding of the contract and two opposed it. Much feeling was engendered over the matter, with the result that on February 11, 1924, W. K. Pruitt, one of the commissioners who had voted in the affirmative, sent his resignation to the clerk of the superior court of the county. The clerk received this resignation on the same day, and immediately accepted same and noted his acceptance thereon. Later in the day, Pruitt called him over the telephone and stated that he wished to withdraw the resignation, and later sent him written notice to the same effect. The clerk, however, paid no attention to the attempted withdrawal, and proceeded on the next day to appoint one W. W. Hampton as a member of the board to succeed him.

After his resignation, Pruitt attended no further meetings of the board, and did nothing further as a commissioner of the county. Likewise Pratt and McCollum, the other two members of the board who had voted with him in favor of the contract, attended no further meetings. Hampton, on the other hand, took the oath of office immediately upon his appointment and entered upon the discharge of the duties of a commissioner. He met regularly with the two remaining members of the board, Martin and Barber, in the courthouse at the county seat, and with them attended to all of the business of the county. Between the 12th of February and the first Monday in December following, these three attended, in all, 25 meetings of the board.

At one of these meetings, a regularly advertised called meeting held on February 21st, a resolution was unanimously adopted declaring that the contract for the building of the bridge was not legal and valid, and directing the clerk of the board to notify plaintiff that it refused to recognize same as a valid contract, and that plaintiff should proceed no further thereunder. This resolution also rescinded action of the board theretofore taken looking to the construction of a hard-surfaced road, in which the bridge was to be a mere connecting link. The clerk duly sent a certified copy of this resolution to plaintiff.

At the regular monthly meeting of the board on March 3d, a resolution was passed directing that plaintiff be notified that any work done on the bridge would be done by it at its own risk and hazard, that the board was of the opinion that the contract for the construction of the bridge was not valid and legal, and that, even if the board were mistaken as to this, it did not desire to construct the bridge, and would contest payment for same if constructed. A copy of this resolution was also sent to plaintiff. At the regular monthly meeting on April 7th, a resolution was passed, reciting that the board had been informed that one of its members was privately insisting that the bridge be constructed. It repudiated this action on the part of the member and gave notice that it would not be recognized. At the September meeting, a resolution was passed to the effect that the board would pay no bills presented by plaintiff or any one connected with the bridge. At the time of the passage of the first resolution, very little work toward the construction of the bridge had been done, it being estimated that the total cost of labor done and material on the ground was around $1,900; but, notwithstanding the repudiation of the contract by the county, the bridge company continued with the work of construction.

On November 24, 1924, plaintiff instituted this action against Rockingham county, and against Pruitt, Pratt, McCollum, Martin, and Barber, as constituting its board of commissioners. Complaint was filed, setting forth the execution of the contract and the doing of work by plaintiff thereunder, and alleging that for work done up until November 3, 1924, the county was indebted in the sum of $ 18,301.07. On November 27th, three days after the filing of the complaint, and only three days before the expiration of the term of office of the members of the old board of commissioners, Pruitt, Pratt, and McCollum met with an attorney at the county seat, and, without notice to or consultation with the other members of the board, so far as appears, had the attorney prepare for them an answer admitting the allegations of the complaint. This answer, which was filed in the cause on the following day, did not purport to be an answer of the county, or of its board of commissioners, but of the three commissioners named.

On December 1, 1924, the newly elected board of commissioners held its first meeting and employed attorneys to defend the action which had been instituted by plaintiff against the county. These attorneys immediately moved to strike out the answer which had been filed by Pruitt, Pratt, and McCollum, and entered into an agreement with opposing counsel that the county should have 30 days from the action of the court on the motion within which to file answer. The court denied the motion on June 2, 1927, and held the answer filed by Pruitt, Pratt, and McCollum to be the answer of the county. An order was then entered allowing the county until August 1st to file answer, pursuant to stipulation, within which time the answer of the county was filed. This answer denied that the contract sued on was legal or binding, and for a further defense set forth the resolutions of the commissioners with regard to the building of the bridge, to which we have referred, and their communication to plaintiff. A reply was filed to this, and the case finally came to trial.

At the trial, plaintiff, over the objection of the county, was allowed to introduce in evidence the answer filed by Pruitt, Pratt, and McCollum, the contract was introduced, and proof was made of the value under the terms of the contract of the work done up to November 3, 1924. The county elicited on cross-examination proof as to the state of the work at the time of the passage of the resolutions to which we have referred. It then offered these resolutions in evidence, together with evidence as to the resignation of Pruitt, the acceptance of his resignation, and the appointment of Hampton; but all of this evidence was excluded, and the jury was instructed to return a verdict for plaintiff for the full amount of its claim. The county preserved exceptions to the rulings which were adverse to it, and contends that there was error on the part of the judge below in denying the motion to strike out the answer filed by Pruitt, Pratt, and McCollum; in allowing same to be introduced in evidence; in excluding the evidence offered of the resignation of Pruitt, the acceptance of his resignation, and the appointment of Hampton, and of the resolutions attempting to cancel

the contract and the notices sent plaintiff pursuant thereto; and in directing a verdict for plaintiff in accordance with its claim.

As the county now admits the execution and validity of the contract, and the breach on its part, the ultimate question in the case is one as to the measure of plaintiff's recovery, and the exceptions must be considered with this in mind. Upon these exceptions, three principal questions arise for our consideration, viz.: (1) Whether the answer filed by Pruitt, Pratt, and McCollum was the answer of the county. If it was, the lower court properly refused to strike it out, and properly admitted it in evidence. (2) Whether, in the light of the evidence offered and excluded, the resolutions to which we have referred, and the notices sent pursuant thereto, are to be deemed action on the part of the county. If they are not, the county has nothing upon which to base its position as to minimizing damages, and the evidence offered was properly excluded. And (3) whether plaintiff, if the notices are to be deemed action by the county, can recover under the contract for work done after they were received, or is limited to the recovery of damages for breach of contract as of that date.

With regard to the first question the learned District Judge held that the answer of Pruitt, Pratt, and McCollum was the answer of the county, but we think that this holding was based upon an erroneous view of the law. It appears, without contradiction, not only that their answer purports to have been filed by them individually, and not in behalf of the county or of the board of commissioners, but also that it was not authorized by the board of commissioners, acting as a board at a meeting regularly held. ,,,

Coming to the second inquiry -- i. e., whether the resolutions to which we have referred and the notices sent pursuant thereto are to be deemed the action of the county, and hence admissible in evidence on the question of damages -- it is to be observed that, along with the evidence of the resolutions and notices, the county offered evidence to the effect that Pruitt's resignation had been accepted before he attempted to withdraw same, and that thereafter Hampton was appointed, took the oath of office, entered upon the discharge of the duties of the office, and with Martin and Barber transacted the business of the board of commissioners until the coming into office of the new board. We think that this evidence, if true, shows (1) that Hampton, upon his appointment and qualification, became a member of the board in place of Pruitt, and that he, Martin, and Barber constituted a quorum for the transaction of its business; and (2) that, even if this were not true, Hampton was a de facto commissioner, and that his presence at meetings of the board with that of the other two commissioners was sufficient to constitute a quorum, so as to give validity to its proceedings. . .

Coming, then, to the third question -- i. e., as to the measure of plaintiff's recovery -- we do not think that, after the county had given notice, while the contract was still executory, that it did not desire the bridge built and would not pay for it, plaintiff could proceed to build it and recover the contract price. It is true that the county had no right to rescind the contract, and the notice given plaintiff amounted to a breach on its part; but, after plaintiff had received notice of the breach, it was its duty to do nothing to increase the damages flowing therefrom. If A enters into a binding contract to build a house for B, B, of course, has no right to rescind the contract without A's consent. But if, before the house is built, he decides that he does not want it, and notifies A to that effect, A has no right to proceed with the building and thus pile up damages. His remedy is to treat the contract as broken when he receives the notice, and sue for the recovery of such damages, as he may have sustained from the breach, including any profit which he would have realized upon performance, as well as any other losses which may have [befallen] him. In the case at bar, the county decided not to build the road of which the bridge was to be a part, and did not build it. The bridge, built in the midst of the forest, is of no value to the county because of this change of circumstances. When, therefore, the county gave notice to the plaintiff that it would not proceed with the project, plaintiff should

have desisted from further work. It had no right thus to pile up damages by proceeding with the erection of a useless bridge. . .

The leading case on the subject in this country is the New York case of Clark v. Marsiglia, 1 Denio (N. Y.) 317, 43 Am. Dec. 670. In that case defendant had employed plaintiff to paint certain pictures for him, but countermanded the order before the work was finished. Plaintiff, however, went on and completed the work and sued for the contract price. In reversing a judgment for plaintiff, the court said:

"The plaintiff was allowed to recover as though there had been no countermand of the order; and in this the court erred. The defendant, by requiring the plaintiff to stop work upon the paintings, violated his contract, and thereby incurred a liability to pay such damages as the plaintiff should sustain. Such damages would include a recompense for the labor done and materials used, and such further sum in damages as might, upon legal principles, be assessed for the breach of the contract; but the plaintiff had no right, by obstinately persisting in the work, to make the penalty upon the defendant greater than it would otherwise have been." . . .

Our conclusion, on the whole case, is that there was error in failing to strike out the answer of Pruitt, Pratt, and McCollum, and in admitting same as evidence against the county, in excluding the testimony offered by the county to which we have referred, and in directing a verdict for plaintiff. The judgment below will accordingly be reversed, and the case remanded for a new trial. Reversed.

Rockingham County v. Luten Bridge Co.: COMMENTS AND QUESTIONS

The complications that ensue in this case from the confusion caused by uncertainty as to who is and is not a member of the Board of County Commissioners should not obscure the central (Clark-Marsiglia) issue. The prudent course for Luten Bridge was to resolve the issue of who speaks on behalf of the county before proceeding with construction of the bridge.

Case 23: Discovering Intent of Contracting Parties: Risk Allocation

Trident Center v. Connecticut General Life Insurance Company
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT
847 F.2d 564 (1988)

KOZINSKI, Circuit Judge. The parties to this transaction are, by any standard, highly sophisticated business people: Plaintiff is a partnership consisting of an insurance company and two of Los Angeles' largest and most prestigious law firms; defendant is another insurance company. Dealing at arm's length and from positions of roughly equal bargaining strength, they negotiated a commercial loan amounting to more than $ 56 million. The contract documents are lengthy and detailed; they squarely address the precise issue that is the subject of this dispute; to all who read English, they appear to resolve the issue fully and conclusively.

Plaintiff nevertheless argues here, as it did below, that it is entitled to introduce extrinsic evidence that the contract means something other than what it says. This case therefore presents the question whether parties in California can ever draft a contract that is proof to parol evidence. Somewhat surprisingly, the answer is no.

The facts are rather simple. Sometime in 1983 Security First Life Insurance Company and the law firms of Mitchell, Silberberg & Knupp and Manatt, Phelps, Rothenberg & Tunney formed a limited partnership for the purpose of constructing an office building complex on Olympic Boulevard in West Los Angeles. The partnership, Trident Center, the plaintiff herein, sought and obtained financing for the project from defendant, Connecticut General Life Insurance Company. The loan documents provide for a loan of $ 56,500,000 at 12 1/4 percent interest for a term of 15 years, secured by a deed of trust on the project. The promissory note provides that "maker shall not have the right to prepay the principal amount hereof in whole or in part" for the first 12 years. In years 13-15, the loan may be prepaid, subject to a sliding prepayment fee. The note also provides that in case of a default during years 1-12, Connecticut General has the option of accelerating the note and adding a 10 percent prepayment fee.

Everything was copacetic for a few years until interest rates began to drop. The 12 1/4 percent rate that had seemed reasonable in 1983 compared unfavorably with 1987 market rates and Trident started looking for ways of refinancing the loan to take advantage of the lower rates. Connecticut General was unwilling to oblige, insisting that the loan could not be prepaid for the first 12 years of its life, that is, until January 1996.

Trident then brought suit in state court seeking a declaration that it was entitled to prepay the loan now, subject only to a 10 percent prepayment fee. Connecticut General promptly removed to federal court and brought a motion to dismiss, claiming that the loan documents clearly and unambiguously precluded prepayment during the first 12 years. The district court agreed and dismissed Trident's complaint. The court also "sua sponte, sanction[ed] the plaintiff for the filing of a frivolous lawsuit." . . . Trident appeals both aspects of the district court's ruling.

Trident makes two arguments as to why the district court's ruling is wrong. First, it contends that the language of the contract is ambiguous and proffers a construction that it believes supports its position.

Second, Trident argues that, under California law, even seemingly unambiguous contracts are subject to modification by parol or extrinsic evidence. Trident faults the district court for denying it the opportunity to present evidence that the contract language did not accurately reflect the parties' intentions.

A. The Contract

As noted earlier, the promissory note provides that Trident "shall not have the right to prepay the principal amount hereof in whole or in part before January 1996." It is difficult to imagine language that more clearly or unambiguously expresses the idea that Trident may not unilaterally prepay the loan during its first 12 years. Trident, however, argues that there is an ambiguity because another clause of the note provides that "in the event of a prepayment resulting from a default hereunder or the Deed of Trust prior to January 10, 1996 the prepayment fee will be ten percent (10%)." Trident interprets this clause as giving it the option of prepaying the loan if only it is willing to incur the prepayment fee.

We reject Trident's argument out of hand. In the first place, its proffered interpretation would result in a contradiction between two clauses of the contract; the default clause would swallow up the clause prohibiting Trident from prepaying during the first 12 years of the contract. The normal rule of construction, of course, is that courts must interpret contracts, if possible, so as to avoid internal conflict. . .

In any event, the clause on which Trident relies is not on its face reasonably susceptible to Trident's proffered interpretation. Whether to accelerate repayment of the loan in the event of default is entirely Connecticut General's decision. The contract makes this clear at several points. ("[I]n each such event [of default], the entire principal indebtedness, or so much thereof as may remain unpaid at the time, shall, *at the option of Holder,* become due and payable immediately" (emphasis added)); ("in the event *Holder exercises its option to accelerate the maturity hereof . . .*" (emphasis added)); ("in each such event [of default], *Beneficiary may declare all sums secured hereby immediately due and payable . . .*" (emphasis added)). Even if Connecticut General decides to declare a default and accelerate, it "may rescind any notice of breach or default." Finally, Connecticut General has the option of doing nothing at all: "Beneficiary reserves the right at its sole option to waive noncompliance by Trustor with any of the conditions or covenants to be performed by Trustor hereunder."

Once again, it is difficult to imagine language that could more clearly assign to Connecticut General the exclusive right to decide whether to declare a default, whether and when to accelerate, and whether, having chosen to take advantage of any of its remedies, to rescind the process before its completion.

Trident nevertheless argues that it is entitled to precipitate a default and insist on acceleration by tendering the balance due on the note plus the 10 percent prepayment fee. The contract language, cited above, leaves no room for this construction. It is true, of course, that Trident is free to stop making payments, which may then cause Connecticut General to declare a default and accelerate. But that is not to say that Connecticut General would be required to so respond. The contract quite clearly gives Connecticut General other options: It may choose to waive the default, or to take advantage of some other remedy such as the right to collect "all the income, rents, royalties, revenue, issues, profits, and proceeds of the Property." By interpreting the contract as Trident suggests, we would ignore those provisions giving Connecticut General, not Trident, the exclusive right to decide how, when and whether the contract will be terminated upon default during the first 12 years.

California law is unsettled on this point and it may be that Connecticut General could not enforce the 10 percent fee in the event of certain defaults by Trident. . . But the contract assigns to Connecticut General alone the right to decide whether and under what circumstances to seek the prepayment fee. Connecticut General may well attempt to enforce the fee only in circumstances where it is valid. What the contract clearly does not provide is what Trident suggests. If the parties had wanted to give Trident the option of prepaying with a 10 percent fee, they certainly could have done so expressly.

In any event, Trident's premise is wrong. Section 726 does not prevent Connecticut General from exercising certain of its non-foreclosure remedies under the deed of trust. "By its own terms section 726 applies only where the creditor-beneficiary has brought an action against the debtor-trustor to recover a debt or to enforce some right secured by a deed of trust. It does not apply in other situations." . . . Thus, for example, "a private sale under the power contained in the trust deed is not a judicial foreclosure within section 726.". . . Similarly, Connecticut General could enforce the assignment of rents provision in the deed of trust by demanding that all of Trident's tenants make rental payments to Connecticut General. . . This would not implicate section 726 because it would not be an action to enforce any right under the deed of trust. Since the deed of trust contains an absolute assignment of rents -- "Trustor hereby absolutely and unconditionally assigns and transfers to Beneficiary all the income, rents . . . and proceeds of the Property . . .," Deed of Trust at 22, para. 1.18 -Connecticut General has a perfected right to require that tenants pay it directly once it has given them notice of a default by Trident. -

In effect, Trident is attempting to obtain judicial sterilization of its intended default. But defaults are messy things; they are supposed to be. Once the maker of a note secured by a deed of trust defaults, its credit rating may deteriorate; attempts at favorable refinancing may be thwarted by the need to meet the trustee's sale schedule; its cash flow may be impaired if the beneficiary takes advantage of the assignment of rents remedy; default provisions in its loan agreements with other lenders may be triggered. Fear of these repercussions is strong medicine that keeps debtors from shirking their obligations when interest rates go down and they become disenchanted with their loans. That Trident is willing to suffer the cost and delay of a lawsuit, rather than simply defaulting, shows far better than anything we might say that these provisions are having their intended effect. We decline Trident's invitation to truncate the lender's remedies and deprive Connecticut General of its bargained-for protection.

B. Extrinsic Evidence

Trident argues in the alternative that, even if the language of the contract appears to be unambiguous, the deal the parties actually struck is in fact quite different. It wishes to offer extrinsic evidence that the parties had agreed Trident could prepay at any time within the first 12 years by tendering the full amount plus a 10 percent prepayment fee. cAs discussed above, this is an interpretation to which the contract, as written, is not reasonably susceptible. Under traditional contract principles, extrinsic evidence is inadmissible to interpret, vary or add to the terms of an unambiguous integrated written instrument.

Trident points out, however, that California does not follow the traditional rule. Two decades ago the California Supreme Court in Pacific Gas & Electric Co. v. G. W. Thomas Drayage & Rigging Co., 69 Cal. 2d 33. . ., turned its back on the notion that a contract can ever have a plain meaning discernible by a court without resort to extrinsic evidence. The court reasoned that contractual obligations flow not from the words of the contract, but from the intention of the parties. "Accordingly," the court stated, "the exclusion of relevant, extrinsic, evidence to explain the meaning of a written instrument could be justified only if it were

feasible to determine the meaning the parties gave to the words from the instrument alone.". . . This, the California Supreme Court concluded, is impossible: "If words had absolute and constant referents, it might be possible to discover contractual intention in the words themselves and in the manner in which they were arranged. Words, however, do not have absolute and constant referents." . . .

Under Pacific Gas, it matters not how clearly a contract is written, nor how completely it is integrated, nor how carefully it is negotiated, nor how squarely it addresses the issue before the court: the contract cannot be rendered impervious to attack by parol evidence. If one side is willing to claim that the parties intended one thing but the agreement provides for another, the court must consider extrinsic evidence of possible ambiguity. If that evidence raises the specter of ambiguity where there was none before, the contract language is displaced and the intention of the parties must be divined from self-serving testimony offered by partisan witnesses whose recollection is hazy from passage of time and colored by their conflicting interests. . . We question whether this approach is more likely to divulge the original intention of the parties than reliance on the seemingly clear words they agreed upon at the time. . . Pacific Gas casts a long shadow of uncertainty over all transactions negotiated and executed under the law of California. As this case illustrates, even when the transaction is very sizeable, even if it involves only sophisticated parties, even if it was negotiated with the aid of counsel, even if it results in contract language that is devoid of ambiguity, costly and protracted litigation cannot be avoided if one party has a strong enough motive for challenging the contract. While this rule creates much business for lawyers and an occasional windfall to some clients, it leads only to frustration and delay for most litigants and clogs already overburdened courts.

It also chips away at the foundation of our legal system. By giving credence to the idea that words are inadequate to express concepts, Pacific Gas undermines the basic principle that language provides a meaningful constraint on public and private conduct. If we are unwilling to say that parties, dealing face to face, can come up with language that binds them, how can we send anyone to jail for violating statutes consisting of mere words lacking "absolute and constant referents"? How can courts ever enforce decrees, not written in language understandable to all, but encoded in a dialect reflecting only the "linguistic background of the judge"? Can lower courts ever be faulted for failing to carry out the mandate of higher courts when "perfect verbal expression" is impossible? Are all attempts to develop the law in a reasoned and principled fashion doomed to failure as "remnant[s] of a primitive faith in the inherent potency and inherent meaning of words"?

Be that as it may. While we have our doubts about the wisdom of Pacific Gas, we have no difficulty understanding its meaning, even without extrinsic evidence to guide us. As we read the rule in California, we must reverse and remand to the district court in order to give plaintiff an opportunity to present extrinsic evidence as to the intention of the parties in drafting the contract. It may not be a wise rule we are applying, but it is a rule that binds us. . .

Nothing we say should be construed as foreclosing Connecticut General from moving for summary judgment after completion of discovery; given the unambiguous language of the contract itself, such a motion would succeed unless Trident were to come forward with extrinsic evidence sufficient to render the contract reasonably susceptible to Trident's alternate interpretation, thereby creating a genuine issue of fact resolvable only at trial.

In imposing sanctions on plaintiff, the district court stated:

Pursuant to Fed. R. Civ. P. 11, the Court, sua sponte, sanctions the plaintiff for the filing of a frivolous lawsuit. The Court concludes that the language in the note and deed of trust is plain and clear. No reasonable person, much less firms of able attorneys, could possibly misunderstand this crystal-clear language. Therefore, this action was brought in bad faith.

` Order of Dismissal at 3. Having reversed the district court on its substantive ruling, we must, of course, also reverse it as to the award of sanctions. While we share the district judge's impatience with this litigation, we would suggest that his irritation may have been misdirected. It is difficult to blame plaintiff and its lawyers for bringing this lawsuit. With this much money at stake, they would have been foolish not to pursue all remedies available to them under the applicable law. At fault, it seems to us, are not the parties and their lawyers but the legal system that encourages this kind of lawsuit. By holding that language has no objective meaning, and that contracts mean only what courts ultimately say they do, Pacific Gas invites precisely this type of lawsuit. With the benefit of 20 years of hindsight, the California Supreme Court may wish to revisit the issue. If it does so, we commend to it the facts of this case as a paradigmatic example of why the traditional rule, based on centuries of experience, reflects the far wiser approach.

The judgment of the district court is REVERSED. The case is REMANDED for reinstatement of the complaint and further proceedings in accordance with this opinion. The parties shall bear their own costs on appeal.

Trident Center v. Connecticut General Life Insurance Co.: **COMMENTS AND QUESTIONS**

1. The opinion in Pacific Gas, which Judge Kozinski obviously deplores, was written by Justice Traynor, a jurist held in high esteem during his time on the California Supreme court. The issue at controversy is: can a party introduce parol (extrinsic) evidence as to the meaning of a contract, or must that meaning be inferred when it is possible to do so from contract language? The lower court in Pacific Gas refused to hear testimony interpreting the contract, and instead relied on the language of the contract itself. In overturning that stand, Justice Traynor wrote

"Although this offer of proof might ordinarily be regarded as too general to provide a ground for appeal, . . . since the court repeatedly ruled that it would not admit extrinsic evidence to interpret the contract and sustained objections to all questions seeking to elicit such evidence, no formal offer of proof was required. . ."

When the court interprets a contract on this basis, it determines the meaning of the instrument in accordance with the ". . . extrinsic evidence of the judge's own linguistic education and experience." . . . The exclusion of testimony that might contradict the linguistic background of the judge reflects a judicial belief in the possibility of perfect verbal expression. . . This belief is a remnant of a primitive faith in the inherent potency and inherent meaning of words.

[As examples of faith in words' potency]: "The elaborate system of taboo and verbal prohibitions in primitive groups; the ancient Egyptian myth of Khern, the apotheosis of the words, and of Thoth, the Scribe of Truth, the Giver of Words and Script, the Master of Incantations; the avoidance of the name of God in Brahmanism, Judaism and Islam; totemistic and protective names in mediaeval Turkish and Finno-Ugrian languages; the misplaced verbal scruples of the 'Precieuses'; the Swedish peasant custom of curing sick cattle

smitten by witchcraft, by making them swallow a page torn out of the psalter and put in dough. . . .' from Ullman, *The Principles of Semantics* (1963 ed.) 43.

2. This case raises an issue of efficiency. If the contract must always and under all circumstances speak for itself, a heavy burden is put on those who draft it to anticipate all contingencies and provide for them. On the other hand, if the words of the contract are subject to renegotiation in court, then we are in the morass that Judge Kozinski foresees in the last paragraph of his discussion. How does the issue of the foreseeability of a contingency affect the efficient disposition of this problem?

3. This case also highlights the issue of risk allocation in a contract. The purpose in denying Trident the option of early prepayment of the loan was so that Connecticut General could lock in a high rate of interest. But the rate of interest was high for a reason: the country was just beginning to come out of a period of severe inflation, and when inflation is high, an interest rate must also be high to assure the lender of a positive real return. There was a twofold risk at work: interest rates could rise further, whether due to uncontrolled inflation or for some other reason. Had that happened, Connecticut General would not have had the option of calling the payment in early so as to make a new loan at a higher rate of interest. Or, alternatively (as actually did happen) interest rates could fall, a contingency against which Connecticut General sought to protect itself by prohibition of loan prepayment. Trident's effort to prepay was an effort to deprive C.G. of the reward it earned when it extended the loan in face of the risk of possible rate increases.