THE LAW OF CONTRACTS

SUPPLEMENTAL READINGS

Class 06

Professor Robert T. Farley, JD/LLM

EXAMPLES & EXPLANATIONS

Contracts

Seventh Edition

Brian A. Blum

Wolters Kluwer

CHAPTER 7

Consideration

§7.1 CONSIDERATION AS THE BASIS OF CONTRACT OBLIGATION

Consideration can be fun.[1] It has a network of interlocking rules that can be applied to all kinds of silly cases featuring beneficent aunts, sanctimonious uncles, hypothetical tramps, mysteriously illusory promises, and detriments that are actually beneficial. Yet at the same time, consideration doctrine can be a huge pain in the neck. How often have poor students (and poor professors) cursed the quirk of history[2] that left us with so sad a legacy. It is not that the basic rules of consideration are difficult, arcane, or unfathomable. The real problem lies in rationalizing these rules, understanding how courts are likely to use them, and justifying them in light of the policies of contract law.

Consideration doctrine is not static but has gradually changed over many years. It has evolved away from the more rigid and certain classical form. Courts have long recognized that an inflexible insistence on doctrinaire rules can undermine freedom of contract by precluding the enforcement of serious promises, fairly and voluntarily made. As a result, they have manipulated the

rules, created exceptions and legal fictions, and have recognized alternative theories for enforcing promises that lack consideration. It is therefore not enough simply to learn the rules of consideration and to attempt to apply them mechanically to a set of facts. Consideration must be studied with an awareness of the purpose of these rules, a focus on their impact in each transaction, and an understanding of the way in which consideration doctrine fits in with the broader principles and policies of contract law. You will not be fully able to appreciate this complex interaction between consideration and other elements of contract law just yet, but it will become more apparent as your study of contract law proceeds. At this stage it may be helpful to alert you to some themes that you will begin to see.

Often you will find that although consideration doctrine is the basis of a decision, the court is really concerned with the legitimacy of the transaction in issue and is in fact using the doctrine to achieve an appropriate result in the case. Therefore, a court may stretch to find consideration when the promise appears to be seriously intended and fairly obtained but may more readily apply the doctrine to invalidate a promise that appears to have resulted from advantage-taking or unfair dealing. In this respect, consideration often serves a purpose parallel to other doctrines such as fraud, duress, or unconscionability (discussed in Chapter 13) in the policing of bargaining behavior.

Consideration is an essential element of contract, and a promise is not recognized or enforced as contractual unless consideration has been given for it. However, an obligation assumed without consideration may be enforceable under an alternative theory such as promissory estoppel, restitution, or moral obligation, discussed in Chapters 8 and 9. Therefore, although we may decide in this chapter that a promise or assumption of duty is not a contract because of lack of consideration, this may not mean that the person to whom it is owed is without remedy. Under appropriate circumstances there may be grounds for full or partial relief under one of those other theories, developed to avoid the injustice of turning away an obligee[3] empty-handed where the lack of consideration precludes contractual liability.

---

§7.2 THE ESSENCE AND SCOPE OF CONSIDERATION

When “consideration” entered the legal lexicon many centuries ago, its usage by lawyers was apparently close to its lay meaning of “reflection,” “contemplation,” or “thinking.” It was a vague concept that probably did no more than assert the general principle that a promise must be seriously contemplated and deliberately intended to be legally binding. As courts expounded on this principle over the years, they gradually embellished it so that it came to require something more than a serious and deliberate intent to be bound. It demanded, in addition, that some quid pro quo be given for the promise by the promisee (that is, the person to whom it was made).[4] In other words, a purely gratuitous promise—one that is not “paid for” in some way—cannot be enforced as a contract. This is the essence of consideration doctrine. From this, we can draw some initial inferences about the scope of our subject.

We are concerned with the validity of promises. Consideration is only an issue when there is an outstanding promise to be enforced, and it does not affect the validity of an executed performance—that is, one that has already been completed. Therefore, even if a donor gives property or services to another as a gift, once the transfer is completed, it is an executed gift and it is too late to claim that no consideration was received.

Although consideration issues may potentially arise in connection with any unexecuted promise, there are two types of cases in which it presents no problems, simply because its absence or presence is so obvious. At the one end of the scale, we have the unquestionable donative promise, in which the promisor, motivated by kinship, friendship, generosity, or charity, unconditionally undertakes to make a future gift and asks for and receives nothing in return. There is no point in agonizing over consideration here because it is obviously absent, and the promise is not legally binding. For example, following his 300th nosedive into the snow, Al Pine has become terminally frustrated with the sport of skiing. He decides to give his skis to his friend Buster Legg and promises to drop them off at Buster’s home as soon as he gets out of traction. Until the skis are handed over to Buster, this is simply an unexecuted promise. There is no suggestion that Buster gave Al any quid pro quo for the promise, which is purely gratuitous. On these facts, consideration is not in issue because it is so obviously absent. If Al changes his mind and fails to deliver the skis, Buster can sulk or pout or even have a massive tantrum, but he has no legal recourse.

At the other end of the scale, we have the straightforward commercial

exchange in which the promise is clearly purchased for an economically equivalent price, so that there is no plausible argument that consideration was lacking. For example, instead of promising to donate the skis to Buster, Al agrees to sell them to him for $100, their market value. Buster pays Al $100 in cash immediately, and Al promises to deliver the skis as soon as he leaves the hospital. On these facts, there is no issue that Al's promise was not paid for.

Between these two obvious cases is the happy hunting ground of consideration doctrine, in which apparently commercial promises are made for an unclear or questionable exchange, and apparently gratuitous promises have strings attached to them. Unless you are using very boring class materials, most of the consideration cases that you study will fall within this range.

§7.3 THE ELEMENTS OF CONSIDERATION: DETRIMENT, BENEFIT, AND BARGAINED-FOR EXCHANGE

The broad statement was made above that a promise must be paid for to be contractually binding. As you will soon see, "payment" for the promise is much more complicated than you might first have suspected. Especially in older cases (but one still finds this language in modern cases) consideration is commonly described in the alternative as either a detriment to the promisee or a benefit to the promisor. The idea here is that if the promisee suffers a detriment by giving up property, money, or some legal right, the receipt of that detriment translates into a benefit to the promisor. We should therefore be able to identify consideration either by looking for a detriment to the promisee or a benefit to the promisor. However, although this definition is quite commonly found, it not the best formulation, and can be misleading if taken literally. Its shortcoming is that it does not clearly articulate the relationship between the promisee's detriment and the promisor's benefit. Some courts began to recognize, beginning in the late nineteenth century, that it is not accurate simply to look for detriment or benefit. It also had to be apparent that the promisee's detriment was suffered in exchange for the promise: The parties must have bargained for (that is, agreed to) an exchange

of the promise for the detriment, so that each induces the other. This became known as the "bargain theory" of consideration.[5] Because benefit to the promisor is simply a natural consequence of having the promisee suffer whatever detriment was sought in the exchange (that is, the benefit is simply getting what was bargained for), the bargain theory obviates any need to focus on benefit to the promisor as a distinct element of consideration. (As explained in section 7.3.2, the fact that some tangible benefit was received may have evidentiary value in showing that an exchange was intended.)

So far, the words "detriment," "benefit," and "bargained-for exchange" have been used in an abstract way. These terms of art can easily be misinterpreted. We now explore their scope and meaning.

§7.3.1 What Is a "Detriment"?

A legal detriment is any relinquishment of a legal right. In the context of consideration doctrine, "detriment" does not mean that the person has suffered some horrible harm, loss, or injury. In fact, a detriment could even be something that benefits or advances the interests of the sufferer. The important element is not harm but the yielding of a legal right. It could take the form of an immediate act (that is, doing or giving something), a forbearance (refraining from something), or the partial or complete abandonment of an intangible right.

Consideration may be found either in the action of incurring the detriment or in the promise to perform (to act or forbear) in the future. That is, provided that an immediate performance is a detriment, a promise of that performance creates a future liability to perform, which is also a detriment. (Stated differently, a promise to do something in the future is an abandonment of the legal right not to do it, and is therefore consideration.) To be a promise, and hence a detriment, the undertaking must be a genuine commitment. If it is too vague, too discretionary, or too qualified, it may not qualify as a promise. This is discussed in section 7.9.

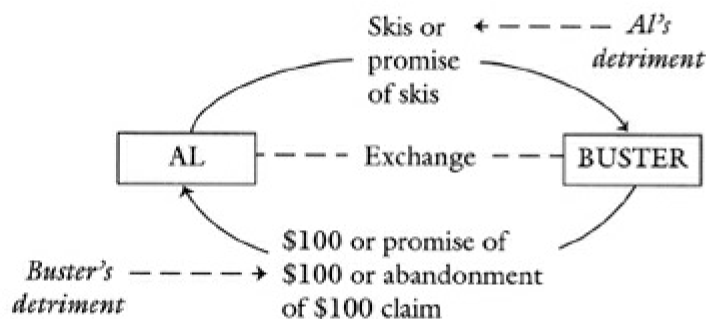
In the example of the sale of skis by Al to Buster for $100, Buster's payment of $100 was an act constituting his detriment. It would equally have been a detriment if, instead of paying the money, Buster had promised to pay $100 to Al on delivery of the skis. As the act of payment is consideration, the promise to perform that act is also consideration. (Al's detriment is, of course, the promise to deliver the skis. Buster's promise to pay $100 makes

this a standard bilateral contract, in which the promise by each party is exchanged for and induces the promise by the other.)

If instead of paying or promising to pay $100, Buster had accepted the promise of the skis in settlement of a prior overdue claim of $100 that he had against Al, Buster's detriment would be the abandonment of his right to sue on the claim, or stated differently, his forbearance from exercising that right.

Diagram 7A illustrates the exchange of Buster's detriment for Al's promise in these examples.

Diagram 7A



Because both the skis and the money (or the claim for money) have economic value, it is not hard to see that each party suffers a detriment by giving them up. If instead of asking for $100 for the skis, Al had agreed to give them to Buster in exchange for Buster's promise to quit smoking, the detriment to Buster is less obvious. Unanimous medical opinion is that giving up smoking is decidedly not detrimental but is beneficial. Notwithstanding, because Buster has the legal right to smoke, his promise to refrain from doing so (forbearance) is a legal detriment and can qualify as consideration for Al's promise of the skis. Restatement, Second, §79(a) reflects this principle by stating that if the requirement of consideration is met, there is no additional requirement of loss or disadvantage to the promisee.

One of the best-loved cases illustrating the meaning of detriment is *Hamer v. Sidway*, 124 N.Y. 538 (1891), in which sanctimonious Uncle William Story promised $5,000 to his nephew, William II, if the nephew refrained from drinking, using tobacco, swearing, and playing cards or billiards for money until he reached the age of 21. Young Willie complied but had not been paid by the time that his uncle died. The court enforced Willie's claim against the uncle's estate. It rejected the estate's argument that

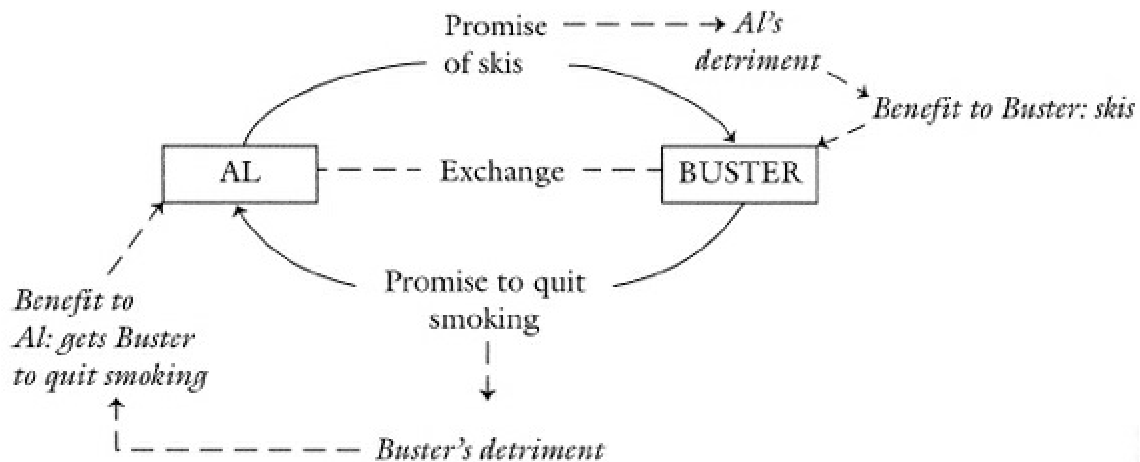
Willie had not given consideration for his uncle's promise. Defining consideration as either a benefit to the promisor or a detriment to the promisee, the court found that Willie's abstention from the stated activities pursuant to the promise was sufficient detriment, because it was the abandonment of his legal right to engage in them. The legal benefit to the uncle did not need to be economic. His benefit lay in having his expressed desire fulfilled. Although the court in *Hamer* used the older definition of consideration, the result is consistent with the bargain theory in that the parties manifested the intent to exchange Willie's conduct for Uncle William's promise.

This concludes our first look at the concept of detriment. Specific applications of this subject are discussed below.

§7.3.2 How Does Benefit to the Promisor Fit In?

Benefit to the promisor is even more prone to misunderstanding than detriment to the promisee. As stated earlier, it is sometimes expressed as one of the alternative tests for consideration, but under the bargain theory, it plays only an evidentiary role. In many cases, the promisee's detriment translates easily into a benefit to the promisor. In the exchange of the promise of skis for money, the detriment to Buster (a loss of $100) is obviously a benefit to Al (a gain of $100). By contrast, when Al's promise of skis is exchanged for Buster's promise to quit smoking, it is not as clear that Buster's detriment of giving up the legal right to smoke translates into any benefit to Al. However, in the same way as "detriment" has a very broad meaning, "benefit" is seen as meaning simply that Al got what he bargained for. As *Hamer v. Sidway* shows, it need not be established that Al received any tangible or economically valuable gain. Restatement, Second, §79(a) states that a gain or advantage to the promisor is not a requirement for consideration. This is illustrated by Diagram 7B.

Diagram 7B



Thus, we need not ask why Al wished for Buster to quit smoking or speculate what is in it for him. His motive in making the exchange is not of central concern, as long as it is apparent that he intended to exchange his promise of skis for the promise to quit. This does not mean that Al's motive is entirely irrelevant, because it could be evidence of his intent to make the exchange. If a gain or advantage to Al can be identified, this bolsters the argument that he did in fact bargain for the detriment suffered by Buster. This issue is discussed further in the next section.

§7.3.3 The Bargained-for Exchange

As stated earlier, the bargain theory was formulated around the end of the nineteenth century and it is now thoroughly well established in our law. It is reflected in Restatement, Second, §71, which requires that a performance or return promise must be bargained for to constitute consideration. That is, the performances or promises of the parties must induce each other: The promisee's performance or promise must be sought by the promisor and given by the promisee in exchange for the promise. Section 33 reinforces this by defining a bargain as an agreement (in turn defined as a manifestation of mutual assent) to exchange promises, performances, or promise for performance. The bargain theory recognizes that contracts are voluntary exchange relationships involving reciprocal promises or performances. It means nothing if a party suffers a legal detriment unless the parties agree that it is the price for the promise.

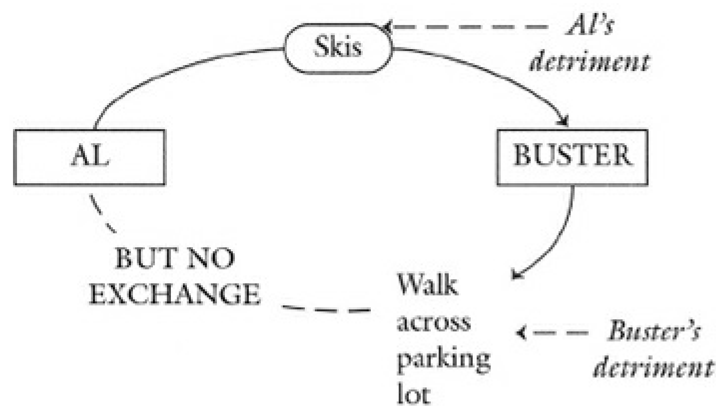
Be careful not to get too carried away by all this talk of bargain and

inducement. "Bargain" simply means "agreement" and does not suggest that the parties have to dicker back and forth or to negotiate at length. If each agrees to a performance desired by the other, the bargain can be struck instantly without any fuss. Also, the objective test (discussed in section 4.1) applies to the determination of contractual intent, so "inducement" is gleaned from the manifestation of intent rather than from a probing of the party's actual state of mind. The motive for the transaction is therefore the apparent motive, as evidenced by the nature of the exchange in context.

§7.3.4 The Distinction Between Bargained-for and Incidental Detriment

In the example of the sale of the skis for $100, the fact that Al and Buster had agreed to an exchange seems obvious. In most commercial transactions the existence of a bargained-for exchange is not in question. Exchange also seems to be quite clear in the case of the promise of skis for the promise to quit smoking. Even though the motivation is apparently not commercial, we can still understand an incentive for the exchange based on friendship. However, what if Al had said to Buster, "If you walk over to my car, I will give you the skis that I have on my rack." Under the broad concept of legal detriment, Buster's act of walking to the car is a detriment: He gave up his legal right to remain where he was and undertook the perambulation across the parking lot. However, this detriment seems incidental to Al's promise. Common experience suggests that the parties did not see it as the price for the skis but simply as the act needed to take delivery of the gift. This conclusion is based, not on a probing of Al's innermost thoughts but on the apparent purpose of his request, based on our understanding of human motivation. There is no evidence from which one could reasonably understand that Al was so desirous of having Buster walk across the lot that he felt it was worth promising him skis to induce him to do it. This is shown in Diagram 7C.

Diagram 7C



The same conclusion would follow if Al had said to Buster, "Put out your hand, and I will place a $10 bill in it." It would be hard to argue with a straight face that the act of extending the hand was bargained for as the exchange for the money. Al's apparent purpose is to give a gift to Buster, and the request to position the hand is merely intended as a means of its efficient delivery—better than cramming it in his ear or casting it on the ground.

However, there may be some additional evidence that makes this conclusion less obvious, so that under all the circumstances, Buster may reasonably understand from Al's words and conduct that the extension of his hand was a bargained-for detriment. (Note the objective test used here: It is not what Buster in fact understood, but what he has reasonably understood. We measure Buster's interpretation of Al's words and conduct from the perspective of a reasonable person in Buster's position.) Say, for example, that Buster was one of those sidewalk performers who strikes a pose and tries to stand dead-still like a statue. Al's offer of money may well be in exchange for the hand movement, because Buster could reasonably infer that Al is bargaining for the pleasure of seeing Buster abandon his art for filthy lucre. (Is that pleasure worth $10? We do not usually need to inquire. As discussed in section 7.7, once exchange is determined, it is not necessary to evaluate the adequacy of consideration.)

This example again confronts the awkward fit between benefit to the promisor, motive, and the objective test of intent. When no benefit to Al was evident, we concluded that the detriment was not bargained for. When additional facts were supplied that suggested a motive, albeit not an economic one, the conclusion was that the detriment was bargained for. Yet we tried to seek not Al's actual motive for the exchange but rather his

apparent motive. The benefit to the promisor, measured objectively, is purely the satisfaction of having his apparent desire fulfilled. This is sufficient to support a finding of exchange. (As we see later in this chapter, the exchange requirement has many facets.)

§7.3.5 The Distinction Between a Detriment and a Condition of Gift

One of the most elusive distinctions in consideration doctrine is that between an act or promise that is a legal detriment, and one that merely relates to the manner in which a gift is to be used. For example, Al Umnus promises to donate $10,000 to his alma mater and specifies that the gift is to be allocated to the college's scholarship program. The college accepts the promise and agrees to use the funds as specified by Al. The college has made a promise to Al in return for his promise of $10,000, but is that promise consideration? As a doctrinal matter, there is a good argument that it is not, because the college's promise is not a legal detriment. At the time of the promise, Al has not handed over the money to the college, and the college has no right to spend Al's money. Therefore when it makes the promise to use Al's prospective payment in a specified way, it does not forbear from any legal right that it has at the time that it makes the promise. On this reasoning, there is no contract. Al has simply made a gift to the college with a condition attached. Some courts will follow this approach, but others will not, especially if the court believes that as a matter of policy, the public interest is best served by the enforcement of charitable promises whenever there is a plausible rationale for doing so.

The case would be a bit easier, and a finding of detriment in exchange for Al's promise would be more justifiable on doctrinal grounds, if the college's undertaking included any promise that went beyond the simple promise to use the gift for its intended purpose. Say, for example, Al and the college had agreed not only that the promised funds would be used for the scholarship program, but also that the college would include Al's name on a donor's list published in its alumni magazine. The college's promise to publicize the gift goes beyond the use of the money, so it can constitute a legal detriment. To be sure, it is a small detriment, and the idea that it was exchanged for (that is, induced) the promise is quite artificial, but it is likely enough to qualify as consideration. As discussed in section 7.7, the court does not enquire into the adequacy of consideration.

A few cases illustrate the subtlety of the distinction between a detriment and a promise to use a gift as required by the donor. In *King v. Trustees of Boston University*, 420 Mass. 52 (1995), the estate of Dr. Martin Luther King Jr. sued the university to recover papers that Dr. King had deposited with the university library. The estate claimed that Dr. King gave the university only temporary custody of his papers, but the university asserted that he had transferred ownership of them. At the time of handing over the papers, Dr. King had written a letter to the university reserving ownership of the papers until his death, but stating that they would become the property of the university when he died. The question was whether this promise to transfer ownership of the papers was merely an unenforceable gift, or a contract for which the university had given consideration.[6] The court upheld the jury's finding that the university gave consideration to Dr. King. When accepting the papers, the university had undertaken to index them, to take care of them, and to make them available to researchers. The court found that these duties went beyond a mere promise to use the gift as instructed by the donor. Recognize that the court could easily have reached the opposite conclusion. There is a good argument that these duties were nothing more than conditions imposed by Dr. King on the use of the gift.

In *Massachusetts Eye and Ear Infirmary v. Eugene B. Casey Foundation*, 417 F. Supp. 2d 192 (D. Mass. 2006), the foundation pledged to give $2 million to the infirmary to be used for a voice restoration research program. When the foundation terminated its pledge, the infirmary sued it for breach of contract. The foundation moved to dismiss the case on several grounds, one of which was that the infirmary gave no consideration to the foundation for its promise. The court refused to dismiss the case because it considered that there was a colorable argument that the infirmary gave consideration for the pledge by committing to use the funds only for the express purpose of supporting the voice restoration program, and by undertaking to submit biannual reports to the foundation. Again, the decision could have been opposite—the infirmary's undertakings can be seen as no more than conditions of the gift. The court, citing the *King* case, revealed the policy rationale for its decision. It observed, quite obliquely, that the public interest in protecting and supporting charitable subscriptions calls for a different standard to decide on the existence of consideration in relation to charitable pledges.[7]

Sometimes this distinction comes up in cases that do not involve

charitable gifts. For example, in *Bono v. McCutcheon*, 824 N.E.2d 1013 (Ohio App. 2005), the parties entered into an agreement under which McCutcheon gave Bono possession of a whippet puppy named Doozie. Bono paid no money for Doozie, but the agreement required her to keep the dog in good condition, to show her, to breed her, to give McCutcheon a puppy from her first litter, and to allow McCutcheon to take and breed her for one litter. At some time later, McCutcheon regained possession of Doozie and refused to return her. Bono sued for conversion and breach of contract. McCutcheon moved to dismiss the suit, claiming that there was no contract because Bono had not paid anything for the dog.[8] The issue was whether Bono's undertakings were consideration for the dog or just conditions of gift. The trial court found no consideration and granted the motion to dismiss, but the court of appeals took the opposite view and reversed. Again, it is hard to be sure that the court of appeals was right and the trial court was wrong.

§7.4 THE PURPOSE AND FUNCTION OF CONSIDERATION DOCTRINE

§7.4.1 Consideration Doctrine in Common Law and Its Absence in Civil Law

Having identified the basic principles of consideration doctrine, it is helpful to consider the policy justifications for the doctrine. There has been much written over the years in an effort to explain why the doctrine arose in the common law, and why it has survived. A plausible argument can be made that there really is no coherent and persuasive policy basis for the continued existence of the doctrine, which is nothing more than an historical relic that has survived in our law because of inertia and tradition. Indeed, the various policy justifications that have been advanced by courts and scholars over the years seem to be quite dubious and not very convincing. Whatever the rationale for the continued vitality of the doctrine, it unquestionably remains part of our law, and courts routinely assert that the presence of consideration is one of the crucial elements of a valid contract. Of course, that does not mean that courts apply the doctrine with an unflinching rigor. As courts have worked with it over time, they have developed a variety of principles,

distinctions, and qualifications that allow some flexibility in applying it, and have recognized alternative bases of enforcing promises under some circumstances where consideration is absent.

Civilian jurisdictions have never had a similar doctrine, and simply operate under the general principle that a contract must be founded on just cause, which is constituted by a serious and deliberate intent to be bound. The UNIDROIT Principles expressly adopt the civilian position by stating, in Article 3.2, that a contract is concluded by the mere agreement of the parties, without any further requirement. (The CISG does not directly address consideration doctrine and largely defers, in Article 4, to domestic law on issues relating to the validity of a contract.) We therefore know that it is possible for a legal system to operate without the doctrine and that many of the functions that it serves could be accomplished by the use of other doctrines of contract law.

§7.4.2 The Formal and Substantive Basis for the Doctrine in Relation to Gratuitous Promises

Probably the most influential and enduring justification of consideration doctrine is Professor Lon Fuller's 1941 article, *Consideration and Form* (41 Colum. L. Rev. 799). Fuller identified both formal and substantive bases for consideration. He identified three formal functions of consideration, which he called "evidentiary," "cautionary," and "channeling." In essence, he argued that by requiring consideration, the law gives courts some evidentiary indication that a contract was intended, allows them to distinguish between contractual commitments and mere informal or tentative expressions of intent, and makes the promisor aware that she has made a serious legal commitment. Since Fuller wrote his article there has been much scholarly discussion of his identification and characterization of the formal functions of consideration. Some of the discussion reinforces his views, and some of it refutes them. Nevertheless, Fuller's analysis is still widely cited, and the comment to Restatement, Second, §72 adopts it.

Fuller recognized that the formal functions of consideration do not fully justify the doctrine's continued vitality in our law. If its role was purely formal, it could easily be dispensed with because these formal functions could be accomplished simply by having a rule that upholds written, signed promises. Our law does not have such a rule.[9] In fact, as section 7.7.3

explains, the parties cannot usually circumvent the requirement of consideration by using sham or nominal consideration purely for the purpose of validating the promise. Fuller therefore also identified a substantive (policy-based) justification for the doctrine. The doctrine's substantive function may better explain its durability.

The substantive basis of consideration lies in the policy that the law should not hold a person to a promise that was made gratuitously. The point here is that the law should be concerned only with the enforcement of exchanges, and should not hold a promisee to a promise motivated by affection, generosity, or altruism, and lacking in any return benefit. Because the promisor has received nothing in exchange for the promise, and the promisee loses nothing by nonenforcement except the prospect of a gift, the promisor should be able to recant without legal liability. This policy protects the donor from improvidence. It also indirectly protects her heirs and creditors by ensuring that their claims against her assets will not be defeated by her promise to donate them. Of course, there is a contrary policy argument, especially where charitable promises are made: Charitable organizations serve a crucial role in our society, and important public interests are served by the sustenance and support of these organizations. Nevertheless, in the absence of consideration, the prevailing principle is that these promises are not to be enforced. (We see later in this chapter that in some cases courts are able to uphold these promises by a manipulation of bargained-for detriment. In addition, we see in Chapter 9 that there is an alternative basis for enforcing charitable promises if the promisee has acted in reliance on the promise and can establish the elements of promissory estoppel.)

§7.4.3 Consideration Doctrine in the Commercial Context

So far, this discussion of the function of the doctrine has focused on gratuitous promises, and if consideration doctrine were strictly confined to promises of gifts, its operation would be relatively straightforward. However, as you will find as you proceed through this chapter, the doctrine often arises in transactions that are not motivated by generosity, charity, or altruism, but have a commercial purpose. A commercial promise without consideration may sound like a contradiction in terms because the purpose of a commercial transaction is usually exchange. Nevertheless, you will see many situations in

this chapter in which consideration issues do arise in commercial transactions because there is some problem with the apparent consideration that is claimed to support the promise. For example, apparent consideration in the form of a promise may be illusory or unenforceable, or it may not qualify as an exchanged detriment because of its timing. In a commercial transaction, in which there is no charitable or donative intent, the rationale relating to the nonenforcement of gifts is inapplicable. The usual justification for not enforcing the promise is that the lack of consideration shows that the parties did not have the legal intent to create a binding contractual relationship.

§7.4.4 The Flexibility of Consideration Concepts and the Use of the Doctrine for Policing Purposes

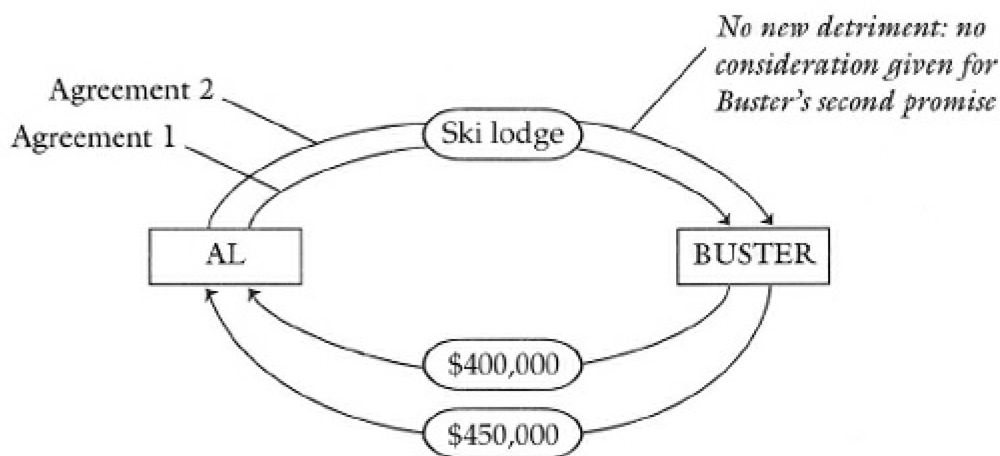
It has already been intimated, and will become even more apparent as you read this chapter, that concepts such as detriment and exchange are quite open-ended. In all but the most clear-cut cases, this allows courts considerable flexibility in deciding whether to find that purported consideration actually qualifies as such. Courts seldom apply consideration doctrine mechanically in cases that are not clear cut and use flexibility in the doctrine to achieve a result that seems best to serve the policies of contract law. That is, a court will likely try to find the existence of consideration if it believes that the promise should be enforced and will likely refuse to find consideration it if believes that the promisor should not be bound. One of the reasons why a court may decline to bind the promisor is because it concludes that there is something unfair or improper in the way in which the promise was exacted (for example, that the promisor was taken advantage of or was coerced or tricked into making the promise). There are several doctrines, discussed in Chapter 13, that are available to prevent the enforcement of a promise induced by fraud, duress, or other unfair means. However, consideration doctrine can also sometimes be used by a court as a tool to protect a promisor from an ill-advised or improperly obtained promise.

§7.5 DETRIMENT AND PREEXISTING DUTY

§7.5.1 The Basic Rule

If a detriment is the relinquishment of a right, it follows that one does not suffer a detriment by doing or promising to do something that one is already obliged to do or by forbearing to do something that is already forbidden. Therefore, the rule is often stated that the performance of, or promise to perform, a preexisting duty is not consideration. For example, say that Al Pine owns a ski lodge. He entered into a contract with Buster Legg under which he sold the lodge to Buster for $400,000. Before the sale closed, Al realized that he had underpriced the lodge, which is worth at least $450,000. He approached Buster and asked him to agree to change the price to $450,000. Buster believed that he did underpay and felt that the lodge was still a good buy at $450,000. Not wishing to take advantage of Al's mistake, he agreed to pay the extra amount, and the parties amended their written contract. An agreement to modify an existing contract is itself a contract, and needs new consideration, separate from the consideration given under the original contract. Therefore, the agreement to modify the contract by increasing the price is not a valid contract because Al gave Buster no consideration for his promise to pay $50,000 more. Al already had a duty to transfer the lodge under the original contract, and he neither gave nor promised anything new. It cannot be a legal detriment to promise what he is already obliged to do. Because Buster's second promise is not binding, he can refuse to perform it and can insist on transfer of the lodge for the original price of $400,000. This is shown in Diagram 7D.

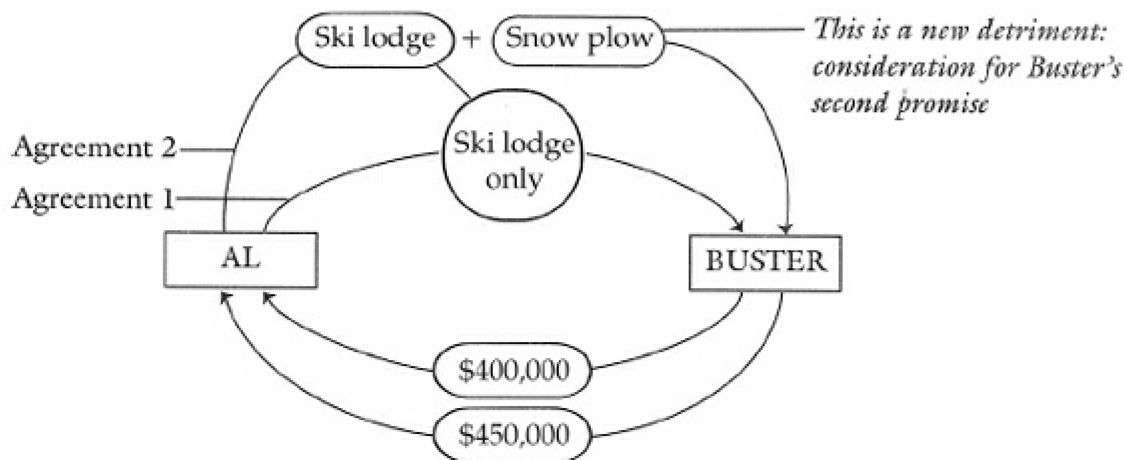
Diagram 7D



The preexisting duty rule only applies if the performance of the promisee is completely encompassed by the preexisting duty. Therefore, if Al

had in any way added to his performance or obligation as an apparent incentive to Buster's agreement to pay more (for example, Al offered to include a snowplow in the sale), this new increase in his detriment would be sufficient to constitute consideration for Buster's promise of more money. It would not matter if the snow plow was worth much less than $50,000 because, as explained in section 7.7, economic equivalence is not normally required in the exchange. *See* Diagram 7E.

Diagram 7E



§7.5.2 The Justification for the Rule Where the Duty Is Owed to the Promisor: Coerced Modifications

It is quite easy to express the preexisting duty rule in its basic form, but application of the rule is seldom this simple. In some cases, the problem may be factual. For example, it may be unclear if a preexisting duty exists or if the detriment in the later agreement really is coextensive with this duty. However, the bigger problem is a conceptual one. Why have the rule at all? True, it is consistent with and simply a specific application of the concept of detriment, so the rule is doctrinally justifiable. But what policy does it serve?

The rule makes most sense when, after a contract has been made, one of the parties takes advantage of the other's dependence on his performance, by threatening to breach the contract unless the other promises to increase her payment or other return performance. When a modification of an existing contract has been coerced in this way, the court can employ the preexisting

duty rule to void the unfair modification. Although we return to the subject of contract modification in section 13.9 in connection with a broader study of the doctrines governing unfair bargaining, we must deal with it here as well, because it has a significant connection to consideration doctrine. To illustrate, say that a traveler, on arriving at the airport of a large city, contracts with a cab driver to pay him $85 to take her to a hotel on the other side of town. Halfway through the journey, as they are driving through a dark and frightening part of town, the cab driver jams on the brakes, turns to the passenger, and says, "Sorry, but unless you agree to pay me $150 for my fare, I am going to dump you off here." Of course the passenger agrees to this modification of the contract. However, the cab driver had a preexisting duty to complete the trip. He has therefore given the passenger nothing more than what he originally promised—transport to the hotel. Because he has suffered no further detriment in exchange for the passenger's promise to pay another $65, this promise of additional payment lacks consideration and the passenger can refuse to pay any more than $85 when they reach the hotel.[10]

Although the justification of the rule is the prevention of this kind of coerced modification, the rule has two serious shortcomings. First, a promisee who knows of the rule can evade it simply by agreeing to add some minor new detriment to his side of the exchange. Because the courts do not generally inquire into adequacy of consideration, the new detriment does not have to be economically equivalent to the additional performance exacted from the promisor. For example, the cab driver would have made it harder for his passenger to challenge the modification on grounds of lack of consideration if he had promised in exchange for the increase in fare, to hum soothing melodies during the remainder of the journey. Second, the rule covers all modifications, even those such as the genuinely consensual increase in the price of the ski lodge in the contract between Al and Buster. In these circumstances (unless the parties know the rule and provide for some new detriment by the promisee), application of the rule precludes parties from making a binding agreement to modify the obligations of one of them, even when circumstances justify a modification and the promisor genuinely agreed to it without unfair pressure. Such an unquestioning use of the rule undermines freedom of contract and has led many commentators and courts to believe that the rule is unnecessary and undesirable.

In response to this concern, some courts do take into account whether the modification was fairly agreed to and justifiable. If a court is persuaded

that the modification was legitimate, it will probably do what it can to find some new detriment incurred by the promise to support it. However, this works only if there is some colorable basis for finding a detriment. Conversely, if a party seeks to validate a coerced modification by providing some purely technical form of detriment, a court will likely try to find that the purported exchange did not really constitute consideration. Notwithstanding, there is a better way to distinguish legitimate and improper modifications. Doctrines such as duress, fraud, and unconscionability and the general obligation of good faith provide a more direct way of policing for unfair modification, and unless the modification has been unfairly obtained, there is no good policy reason for refusing to enforce it. The drafters of Article 2 have recognized this, as explained in section 7.5.3, but the complications of using consideration doctrine to police modifications still encumber the common law.

§7.5.3 The Abolition of the Preexisting Duty Rule in Relation to Modifications Under Article 2

Although the preexisting duty rule precluded the enforcement of Al's promise to pay more for real property (the ski lodge), the result would have been different if the contract involved a sale of goods. Say, for example, that Al and Buster contracted for the sale of Al's skis to Buster for $100, and the parties later agreed to increase the price to $150. UCC §2.209(1) states that an agreement modifying a sale of goods needs no consideration to be binding. Instead, the Official Comment to §2.209 explains that all that is required to validate the modification is that it meets Article 2's test of good faith. In essence, an extorted modification would not satisfy that test, but a modification that is fairly agreed to and justified by a legitimate business reason is valid even in the absence of consideration. This is discussed more fully in section 13.9.

§7.5.4 Modifications in Light of Supervening Difficulty

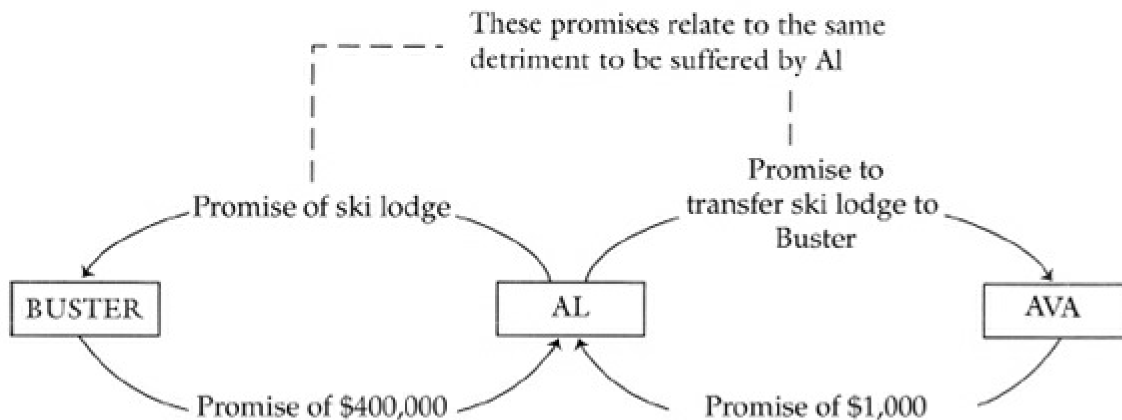
The requirement that contract modification requires consideration is not applied where the modification was motivated by supervening difficulties that materially affect the basic assumption under which the contract was made. The underlying rationale for this exception is that a modification to

take account of an unexpected burden on the promisee is less likely to be coercive. Of course, the exception can only be used where the facts support it. The promisee must be able to show that such an unforeseen difficulty did arise in the course of performance and did motivate the modification.

§7.5.5 Preexisting Duty to a Third Party

So far, we have talked only about a preexisting duty owed by the promisee to the promisor. What if the duty is owed to someone else? For example, Al contracted to sell his ski lodge to Buster for $400,000. Buster has promised Ava Lanche that when he takes over the ski lodge, he will grant her a concession to run the snack bar in the lodge. Ava is most anxious for the sale to go through, so to give Al an additional incentive to complete his contract with Buster, Ava promises Al that if he completes the sale to Buster, she will pay him $1,000. Because Al has already contracted with Buster to transfer the lodge, he has a preexisting legal duty to perform that promise. It would therefore seem that he has not incurred any new legal detriment by making the same promise to Ava. This is illustrated by Diagram 7F.

Diagram 7F



However, the concern about extorted contract modification is not present in a case like this, so this justification for the preexisting duty rule is not applicable. Some courts (and Restatement, Second, §73) simply confine the preexisting duty rule to cases in which the duty is owed to the promisor. An alternate way of looking at the situation is to say that Al does incur a

detriment in that he forbears from the right to negotiate with Buster for the cancellation of the contract to sell the lodge to him.[11] A preexisting duty may be owed, not to the promisor or a third party, but to the state or the public. This type of duty presents slightly different policy concerns because the public interest may demand that external incentives to obey that duty must be discouraged. This is particularly so when the promisee is a public official, and an additional reward for performing the public duty may create the danger of corruption or favoritism. For example, a police officer has a preexisting duty to apprehend criminals. Therefore, if the owner of a store promises a police officer a reward for catching the robber who robbed the store, the court is likely to invalidate this promise on the basis of the preexisting duty rule. However, the true basis for refusing to recognize a contract is not some technical approach to consideration doctrine, but the public policy that a member of the public should not be able to influence the police officer's priorities in performing his duties.

§7.6 CONSIDERATION IN AN AGREEMENT TO SETTLE A DISPUTED CLAIM OR DEFENSE

As we have seen, under the preexisting duty rule, a party suffers no legal detriment by performing or promising to perform something that she already is legally obliged to do. Under this principle, a creditor who agrees to accept partial payment of a debt, or to extend the payment period of an undisputed debt, is not bound by that promise. This is because the debtor already owes the undisputed debt, and a new promise by the debtor to pay in part or after due date is nothing more than a promise to pay what is already owed. For example, say a borrower owes $20,000 to a lender, payable on August 1. He fails to pay and the lender sues him to recover the debt. Upon receiving the summons, the borrower contacts the lender and explains that he has severe financial difficulty and cannot pay the $20,000 in full. He offers to settle the lawsuit by paying the lender $10,000 in cash within one week in full settlement of the claim. The lender accepts because she decides that it is better to receive $10,000 within a week than to struggle, possibly unsuccessfully, to recover the full $20,000. Clearly, the lender has suffered a detriment by forgiving half of her claim and agreeing not to continue her suit.

However, unless the borrower undertook some new detriment in addition to the promise to pay a portion of the debt, he is doing no more than what he was obliged to do under the original contract, so that his promise to pay is a preexisting duty, rather than a legal detriment. The lender is therefore not bound by her promise to settle the claim for half its value. *McGowan v. Homeward Residential, Inc.*, 2012 WL 6115984 (11th Cir. 2012), provides another illustration of the application of the preexisting duty rule to a lender's agreement to make concessions to a borrower relating to the payment of the debt. The McGowans had mortgaged several properties to secure loans by Homeward. They subsequently entered into an agreement with Homeward under which Homeward allowed them to make lower monthly payments on their mortgages and agreed not to commence foreclosure proceedings against them provided that those payments were made. Although the McGowans made the payments, Homeward did commence foreclosure proceedings. The court held that it was entitled to do so because the McGowans had incurred no new detriment and had therefore given Homeward no consideration in exchange for the payment extension and promise to forbear from disclosure.

The preexisting duty rule applies only where the debt is undisputed. If there is a dispute over the debt, an agreement between the parties is supported by consideration because, by compromising the dispute, each of them gives up a right: The creditor party forbears from asserting her full claim, and the debtor party forbears from asserting his defense to the claim. For example, Sue Permodel attended a gala reception at a hotel. She wore a breathtakingly tight-fitting evening gown and inconceivably high heels, which badly restricted her agility. As a result, when she stepped onto the highly polished marble floor of the hotel lobby, she slipped and injured herself. She sued the hotel for $500,000 damages for medical expenses, pain and suffering, and public humiliation, on the grounds that the hotel was negligent in having such a slippery floor in its lobby. The hotel defended the suit, denying liability on the basis that the floor was not unduly slippery, and that Sue's restrictive attire caused her to slip. Just before the trial, the hotel offered to settle the suit by paying Sue $10,000. Sue was relieved at being spared the further mortification of a trial and accepted the offer. Although the injury occurred before the settlement, and the hotel may have already incurred the duty to compensate Sue for her injury, the fact and extent of liability are uncertain. Therefore, this agreement to compromise the disputed and uncertain claim is very different from the settlement of the loan debt in the previous example.

There is no consideration problem here. Because Sue's claim is disputed and the outcome of the litigation is uncertain, each party gives up something: Sue's detriment is her agreement to accept less than she claimed and to forbear from pursuing her suit against the hotel. The hotel's detriment, exchanged for Sue's, is its promise to pay Sue $10,000 and its forbearance from asserting its defense to liability. Because a jury could have found that the hotel had no liability, or lesser liability to Sue, the hotel's uncertain debt is not treated as a preexisting duty to pay Sue $10,000 or any other amount. Not only is this result in accordance with consideration principles, but it is also good public policy. There is a strong public interest in the settlement of disputes by agreement, and the law should therefore encourage and uphold honest and legitimate compromise agreements.

The words "honest and legitimate" indicate an important qualification: While genuine compromises should be encouraged, the law should not be used as a means of extorting payment or evading obligations through spurious or vexatious claims or defenses. Say, for example, that Sue did not slip on the hotel floor. However, she dishonestly claims that she did, and the hotel cannot prove otherwise. She sues the hotel, which agrees to settle the claim for $10,000, just to avoid the cost and publicity of a trial. Before paying, the hotel discovers that Sue's claim is false. Sue cannot claim that she gave consideration by settling her claim because she had no right to assert a false claim.[12] The same principle applies to a vexatious defense: A party who defends a claim without having a genuine basis for disputing it cannot claim that he gave consideration by giving up the defense.

Sue's trumped-up claim is clearly spurious, but in some cases it is harder to decide whether the claim or defense is genuine. In any claim that is litigated, the jury will ultimately find in favor of one of the parties. Therefore, to establish that the claim or defense was legitimate, the party does not need to show that he would ultimately have prevailed in the litigation.

Rather, the test for legitimacy is based on the existence of enough doubt about the claim or defense to make the dispute genuine. Restatement, Second, §74 adopts a test that measures legitimacy on, alternatively, an objective or subjective standard. Either the claim or defense must be objectively reasonable (that it is subject to reasonable doubt because of uncertainty in fact or law), or the party asserting the claim or defense must have an honest belief in its merits (that is, he is subjectively in good faith). Some courts are stricter and require the claim and defense to satisfy both the objective and

subjective standards—that it has a colorable legal basis, and also that it is asserted in good faith. Some courts do not enquire into the objective plausibility of the claim or defense, but require only an examination of the good faith of the party asserting it. In many cases, the outcome of these tests may amount to the same thing because it may be hard to convince a jury that a party had a genuine belief in the validity of a claim or defense that has no objective basis of support. However, the subjective test does allow the court to take account of honest ignorance. Whatever test is used, the legitimacy of the claim must be determined as at the date of the agreement, not in light of later events.

For an example of a case in which the court required only a good faith belief in the merits of the claim, see *Denburg v. Parker, Chapin, Flattau, & Klimpl*, 604 N.Y.S.2d 900 (1993). A law firm's partnership agreement contained a clause that created financial disincentives for a partner to leave the firm and practice in competition with it. This provision was void as against public policy because, by discouraging a partner from setting up a competing practice upon leaving the firm, it inhibited his clients' right to maintain access to the attorney of their choice. The firm sought to enforce the provision against a partner who left the firm and the partner challenged its right to do so. The parties then settled the dispute by agreement. Thereafter, the ex-partner claimed that the settlement agreement lacked consideration because it compromised an invalid claim. The court upheld the settlement. Although the partnership's claim was not legally tenable, the firm believed in good faith that it was viable. This was enough to validate the firm's forbearance as consideration.

---

§7.7 THE MEASUREMENT OF DETRIMENT: ADEQUACY OF CONSIDERATION

§7.7.1 The General Rule: Courts Are Not Concerned with Adequacy of Consideration

Recall the illustrations in section 7.3.1 involving Al's promise to sell his skis to Buster. In one of the illustrations, Buster's consideration was the payment of, or promise to pay, $100 to Al in exchange for the skis. In another

example, Buster's consideration was his promise to quit smoking. When skis are exchanged for money, items of ascertainable economic worth are involved, so it is usually not difficult to determine if there has been equivalence in the exchange. It is a lot harder to value the right given up by Buster in promising to quit smoking. However, this generally does not matter, because consideration doctrine does not require that the performances or promises exchanged be of equal value. As long as a legal detriment has been suffered in exchange for the promise, consideration is present, and the court will not invalidate the contract (or make an adjustment to the contract terms) on the ground that the consideration given for a promise is inadequate in relation to the value of the promise. (Restatement, Second, §79(b).) A related principle is that there does not have to be an equivalence in the number of promises or performances provided by each party. One party can exchange a single promise or performance for multiple promises and performances by the other. For example, Al could have given Buster the skis in exchange for Buster's payment of $100 plus his promise to stop smoking and his forbearance from asserting a claim that he has against Al. For the purposes of finding consideration, we need not worry that Buster has given up three rights to one of Al's or fret about whether the promise of the skis is worth more or less than Buster's detriment.

The rule that the court will not inquire into adequacy of consideration is based on the policy of enforcing the voluntary exchange on the terms agreed by the parties. As long as consideration has been found to exist, the court should not second-guess the value placed on the exchange by the parties at the time of contracting, even if one of the parties subsequently seeks to overturn the transaction because the other received a great bargain at his expense. The disparity in value may be the result of many and varied factors such as poor judgment, inaccurate cost calculations, bad luck in market predictions, or even deliberate underpricing. Whatever the reason, the party who fairly agreed to take less than the value of his performance has no basis to complain after entering the contract. Therefore, if Al's skis are actually worth $500, and he agreed to sell them to Buster for $100, the court should not allow him to escape the contract and disappoint Buster's expectations. This argument has even more force when the economic value of one of the performances is hard to determine (or was so at the time of contracting). For example, one really cannot place an economic value on Buster's promise to stop smoking, so one cannot even be sure that this promise was an inadequate

exchange for the skis. (Some may think that $100 is overpayment for taking the sensible action of overcoming a dangerous addiction, while others may think it is a measly reward for the agony of withdrawal.)

§7.7.2 Inadequacy of Consideration as the Result of Unfair Bargaining

The general rule that the court will not inquire into the adequacy of consideration cannot be applied blindly, and courts do examine the adequacy of consideration where the disparity in the exchange results from oppressive or underhanded bargaining or justifiable mistake. In such cases, a court may find that the promisee's performance is so lacking in value that it cannot count as consideration at all. If so, the court may invalidate the transaction on the grounds of lack of consideration. More commonly, however, courts employ other doctrines, such as fraud, duress, or unconscionability (dealt with in Chapter 13) or mistake (dealt with in Chapter 15) to give relief to the party who is the victim of the unfair bargaining or the error. In some cases, the appropriate relief under these doctrines is the avoidance of the contract, but in other situations, the more fitting remedy may be an adjustment of the terms of the exchange to make it fairer.

§7.7.3 Sham or Nominal Consideration

The rule that a court will not inquire into adequacy of consideration may not apply where it is clear that the purported consideration is so inadequate that it cannot be said that it really amounts to consideration at all. Where the parties intend a promise to be gratuitous, they may seek to make the promise binding by creating an apparent consideration. They may do this by falsely reciting that the promisee did give consideration (that is, create a sham consideration) or may provide for the promisee to suffer some nominal detriment in apparent exchange for the promise. For example, a donor agrees to pledge $100,000 to a charitable organization. The pledge is recorded in writing, is signed by the donor, and states that it is given for consideration received, even though no consideration was actually given to the donor. Here, the recital of consideration for the $100,000 pledge is a sham. Alternatively, the pledge may state that the promise is given in consideration for a coffee mug bearing the organization's logo. If the coffee mug is in fact given to the promisor, the purported consideration for the pledge is not a sham, but it is

nominal. In both these cases, the pretense of consideration is not really given in exchange for the promise, but simply serves the purpose of establishing an apparent exchange to validate the promise.

There is a convincing policy argument that the parties should be able to use the device of recited or nominal consideration to validate a gratuitous promise, provided that the pretense at consideration is not designed to defraud a third party and the promisor has not been tricked or coerced into making the promise. However, Restatement, Second, does not take this approach. While it asserts the general rule that courts should not inquire into adequacy of consideration, it states several times that the pretense of a bargain does not satisfy the exchange element. It does not treat as sufficient consideration a false detriment that cannot reasonably be conceived as inducing the return promise. (*See* §71, Comment *b*; §72, Comment *c*; §79, Comment *d*; and §81, Comment *b*.)

Sham or nominal consideration satisfies the formal functions of consideration doctrine: The parties' effort to go through the formality of constructing apparent consideration provides evidence of their serious intent to be bound, cautions the promisor that she has made a binding commitment, and allows the court to distinguish this as such. Therefore, any justification for the Restatement, Second's position must lie in the substantive function of the doctrine: It is contrary to the public interest for courts to become involved in the enforcement of gratuitous promises. Sometimes the circumstances may suggest that the goal of protecting against generosity outweighs the policy of upholding private autonomy, but in other situations, despite what the Restatement, Second, says, the better approach may be to treat the apparent consideration as sufficient where the formal functions of consideration are fully satisfied by a clear document, there is no suggestion of advantage taking or underhanded conduct by the promisee, and no indication that the promisor acted impulsively and with immediate regret.

In some cases, courts adopt the position of the Restatement, Second, and refuse to recognize consideration when it is clearly nominal or false. In others, courts have been willing to give effect to the parties' effort to validate the promise and have upheld promises that were really gratuitous, but were supported by recited or nominal consideration. They have recognized nominal consideration on the basis of the general principle that a court will not inquire into adequacy of consideration, and they have upheld a false recital of consideration either by interpreting the recital as an implied promise

to provide the stated act or forbearance at some future time, or by estopping[13] the promisor from denying receipt of recited consideration. For many courts, the decision to validate recited or nominal consideration depends on the court being satisfied that the equities do not favor protecting the promisor for ill-considered generosity or unfair imposition.

§7.7.4 Nominal Consideration in Options

Recall, from section 4.13 that, at common law, an option (a promise not to revoke an offer for a stated period) does not bind the offeror unless the offeree has given consideration to the offeror in exchange for that promise. (In a sale of goods, this rule is generally not applicable because UCC §2.205 dispenses with consideration for a firm offer that satisfies its requirements.[14]) The consideration required from the offeree to support the option is distinct from the consideration that the offeree would provide under the underlying contract if he accepts the offer.

However, in relation to options, Restatement, Second, adopts a more lenient attitude to purely formal consideration. The justification for this is that an offeror who grants an option does not typically have gratuitous motives. Rather, she has decided to grant the option in the hope of inducing the grantee to enter the underlying contract. Therefore, there is less concern about protecting a grantor from generosity and not intervening to impose legal liability for the promise of a gift. Many courts that follow the stricter attitude toward nominal consideration in other situations are willing to follow the Restatement, Second, and adopt a more flexible approach to options. Similarly, if the consideration recited in an offer is a sham, the court will more readily interpret the recital as a promise to furnish the consideration or will more easily estop the grantor from asserting that the recital was a sham.

---

§7.8 PAST PERFORMANCE

Because exchange is the basis of consideration, each party's detriment must induce and be induced by the other's. Therefore, if the promisee suffered the detriment before the promise was made, it cannot be said that the detriment was exchanged for the promise. Although the detriment may have induced

the promise, it was not itself induced by the promise, which had not yet been made. This means that if a person makes a promise to compensate another for some prior performance, that prior detriment cannot be consideration for the promise. The promise is seen as gratuitous and nonbinding, even if it was seriously and freely made, and even if the prior detriment conferred a valuable benefit on the promisor. For example, in January, Buster lent Al his car for a week so that Al could use it to go on a skiing vacation. At the time, Buster did not ask Al for anything in return for lending him the car. In March, Al decided to give up skiing. Remembering Buster's kindness to him in January, Al promised to give the skis to Buster, stating that he was doing so in consideration for Buster's loan of the car in January. Buster did suffer a legal detriment in lending his car to Al. However, even though Al has described this detriment as consideration, it cannot be. It was suffered prior to the promise and not in exchange for it. This kind of prior detriment is sometimes referred to as "past consideration," but this is a misnomer because it is not consideration at all.

§7.9 THE QUALITY OF A PROMISE AS CONSIDERATION: "MUTUALITY OF OBLIGATION," ILLUSORY, CONDITIONAL, AND ALTERNATIVE PROMISES

§7.9.1 Mutuality and Illusory Promises

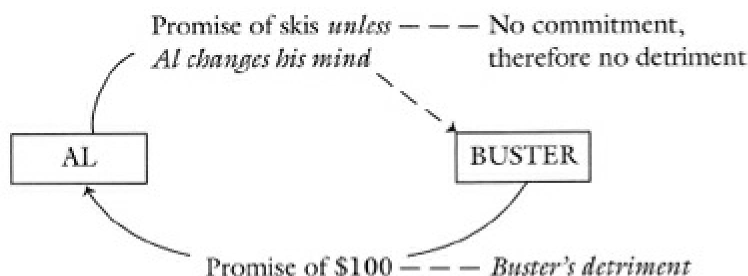
The requirement of mutuality of obligation is expressed in the old maxim "both parties must be bound, or neither is bound." Taken too literally, the concept of mutuality can be confusing and misleading because it seems to suggest that one could never have a unilateral contract, or a contract in which one of the parties has the legal right to escape liability. Yet both types of contract are well recognized in law. As explained in section 4.12, a promise can be exchanged for an immediate performance, resulting in a unilateral contract in which only the promisor has an outstanding obligation at the instant of contract formation. Elsewhere in this book many other situations are described in which only one of the parties is bound because the other has the right to end the contractual relationship. This is true, for example, in an

option contract (*see* section 4.13) or a contract that is voidable by one party on such grounds as minority (*see* section 14.2.1), incapacity (*see* section 14.3.3), bargaining impropriety (*see* section 13.3), or mistake (*see* section 15.5). It is also quite valid to provide in a contract for a party to have the right to terminate the contract by giving notice.

Therefore, in modern law, "mutuality" does not mean that both parties must make a future commitment or, if they do, that each must be bound with the same degree of firmness. It also does not mean that the parties must have equal and coextensive obligations under the contract. Because there need not be economic equivalence in the exchange, it is permissible and common for one party to incur far more numerous, extensive, or onerous obligations than the other.[15]

If "mutuality" does not carry any of these implications, what does it mean? In modern law, it is nothing more than a specific application of the general principle of consideration: When consideration consists of the exchange of mutual promises, the undertakings on both sides must be real and meaningful. If the promise of one party has qualifications or limitations so strong that they negate it, it is really no commitment at all. Because it does not bind that party, this lack of consideration voids the apparent contract, so neither party is bound. For example, Buster promises to buy Al's skis for $100, and Al promises to sell them to Buster unless Al changes his mind. This qualification reserves such unlimited discretion to Al that he has really promised nothing. His apparent promise is said to be illusory and hence cannot be consideration. *See* Diagram 7G.

Diagram 7G



Using the language of mutuality, we could say that because Al is not bound, Buster is not bound either. However, we do not need to formulate it this way. The real problem is that Al has suffered no detriment because he

has neither given nor actually promised anything to Buster. Therefore, Buster's return promise is not supported by consideration and is not binding. Because "mutuality" is redundant and misleading, Restatement, Second, §79(c) and Comment f disavow the concept and stress that it should not be thought of as a separate or additional requirement for consideration.

In the above example, Al may have thought that he was being very clever in getting a promise from Buster while keeping his own options open, but his lack of commitment removes binding force from Buster's promise as well, so Al cannot hold Buster to his promise if Al decides to exercise his discretion to go through with the sale. This is a mistake sometimes made in commercial contracts by a party that uses its dominant bargaining power to retain its freedom of action while trying to firmly bind the other party. For example, in *Harris v. Blockbuster, Inc.*, 622 F. Supp. 2d 396 (N.D. Tex. 2009), a subscriber to Blockbuster's online video rental program sued it, claiming that it had violated a federal statute protecting the subscriber's privacy. Blockbuster sought to invoke an arbitration provision in its standard terms, to which the subscriber had signified assent at the time of subscribing by clicking an "I agree" box on Blockbuster's website. (That is, the subscriber bound himself to Blockbuster's standard terms through a clickwrap agreement, as discussed in sections 5.2 and 5.3.) Notwithstanding the subscriber's signification of assent, Blockbuster was not able to enforce the arbitration clause because the court found that it lacked consideration. In its standard terms, Blockbuster had reserved the right to modify the terms, including the arbitration clause, at its discretion. It had no duty to notify its subscribers of the modification, which would take effect immediately and which would be deemed assented to if the subscriber continued to use the service following the modification. Furthermore, modifications were not stated to be prospective, which meant that changes relating to the arbitration provision could affect disputes that had arisen prior to the modification. The court held that by retaining such broad power to change the terms, Blockbuster had in fact not committed itself to anything, so that any apparent promise that it made was illusory. *See also Hooters of America, Inc. v. Phillips*, 39 F. Supp. 2d 582 (D.S.C. 1998),[16] in which the court held that an arbitration agreement between Hooters and its employee lacked consideration because Hooters' promise was illusory. The agreement was structured to absolutely bind the employee to arbitrate but left Hooters with the discretion to terminate the agreement on notice and to change the arbitration rules and

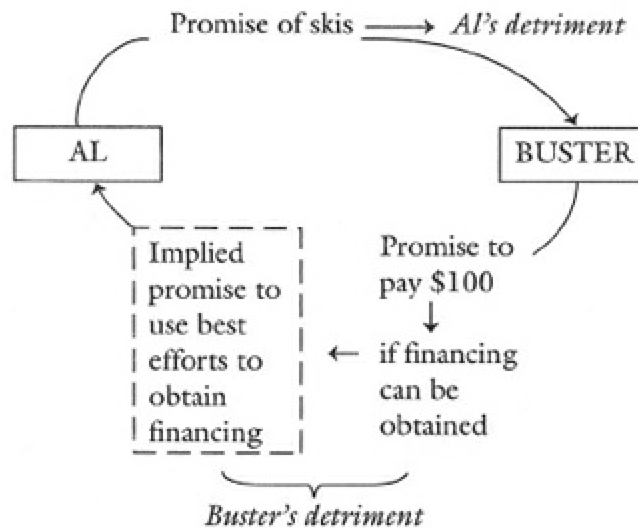
procedures without notice.

The example and cases in the previous paragraph illustrate situations in which a promise is illusory because the party retained unlimited discretion to perform. This is possibly the most obvious illustration of an illusory promise. However, a promise could also be illusory for other reasons. For example, it is also an illusion to promise something based on a condition that cannot occur. Buster does give consideration to Al for Al's promise to deliver his skis to Buster if they agree that Buster will pay $100 for them if it snows on the ski slope on December 1 but can keep them for free if it does not. Buster incurs a detriment by committing himself to pay $100 if the possible condition occurs. However, Buster would suffer no detriment and will not have given consideration to Al if his promise to pay for the skis is conditional on a troupe of polar bears showing up on the ski slope on December 1 and singing "Jingle Bells" in harmony.

§7.9.2 Interpretation and the Use of Implied Terms to Cure an Apparently Illusory Promise

The examples given so far try to provide obvious illustrations of the absence or presence of commitment. It is not always this easy to tell if a qualification so eviscerates a promise as to make it illusory: The promise could be subject to some degree of discretion that may not be broad enough to negate commitment. For example, Al and Buster agree that Buster will buy Al's skis for $100 cash, to be paid against delivery of the skis next Monday on condition that Buster can obtain a loan of $100 by then. Al's promise to sell the skis is firm, but Buster's promise to buy is subject to a condition. It could be argued that Buster has made no real commitment. He can prevent fulfillment of the condition simply by not trying to borrow the money. However, if we imply into Buster's undertaking a promise to use best efforts to secure a loan, we impose a detriment on him and cure the lack of commitment. This promise to make best efforts is not the same as a promise to buy the skis, so that Buster has no obligation to consummate the sale if he tries conscientiously but unsuccessfully to secure the loan. But if he makes no effort at all, he is liable for breach of contract. *See* Diagram 7H.

Diagram 7H



This brings to mind one of the most cherished cases in the contracts repertoire—*Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88 (1917)—in which Judge Cardozo implied an obligation to use best efforts to validate an exclusive dealing contract between Lucy, a fashion maven of her time, and Wood, her business agent. Wood had agreed to pay Lucy half the profits earned from placing her endorsements and selling her designs, but had not, in so many words, promised to promote her wares. When Lucy breached the exclusive agency by endorsing products on her own and keeping all the profits for herself, Wood sued for his share. Lucy argued that there was no contract: Although Wood had undertaken to pay half the profits to her, he had not actually promised to do anything to earn those profits. In light of the obviously commercial intent of the agreement, the court concluded that Lucy's grant of an exclusive agency necessarily gave rise to the implication that Wood was obliged to use best efforts in generating profits. UCC §2.306(2) follows this approach by implying an obligation of best efforts in exclusive dealing contracts involving goods.

We look more closely at the principles of interpretation—including the implication of terms by a court—in Chapter 10. The point to note here is that in most transactions with a commercial purpose, apparently discretionary promises can fairly be interpreted as subject to some implied limitation. When contracting, the parties usually intend their promises to be meaningful, and a later assertion that one of them is illusory is probably just a pretext to escape a bargain that is no longer desired. The process of implying terms to give content to apparently vacuous language comes up in many types of

cases, and you will find many examples of this as you read through this book. However, there are some situations in which absolute discretion is exactly what was intended, because one of the parties takes the gamble that the attractiveness of the product or service will be enough to motivate the other to exercise discretion favorably. In such a case, if a court imposes unintended limitations on that discretion, it creates a contract out of an informal relationship that was not intended to be one.

§7.9.3 "Mutuality" in Requirements and Output Contracts Under UCC §2.306

Most sales contracts involve a single item or a specified quantity of goods. In some situations, however, it may suit the parties to leave the quantity of goods open-ended on the understanding that the quantity to be supplied under the contract will be determined either by the buyer's requirements or by the seller's output. The parties are likely to find a requirements contract most desirable if the seller is confident that it can produce enough to satisfy the buyer's demands, and the buyer is unsure of its exact needs and wishes to avoid the risk of ordering a specified quantity which may turn out to be short or excessive. An output contract suits the parties when the seller wishes to dispose of its full production in one transaction, and the buyer is confident that it can use all that the seller can supply.

For example, assume that the seller is a vineyard and the buyer is a winery. The buyer is not exactly sure what quantity of grapes it will need next year because it only buys grapes to supplement what it produces on its own vines. The quantity it needs will depend on its own crop yield. The winery therefore does not want to try to predict its needs in advance by contracting for a set quantity of grapes because this could lead to waste if its own grapes are plentiful, and a shortfall if they are scarce. The buyer therefore makes a requirements contract with the seller, covering a specific year or period of years, under which the buyer promises to buy and the seller to supply the buyer's total demand for grapes in excess of the buyer's own harvest. By contrast, an output contract better suits the parties' needs if the buyer knows that it can use everything that the seller produces—it can never grow enough of its own grapes to satisfy its needs, and it has enough capacity to use all its own grapes plus all the grapes that the seller can produce. The seller is happy to sell its entire crop to the buyer, because this saves the costs

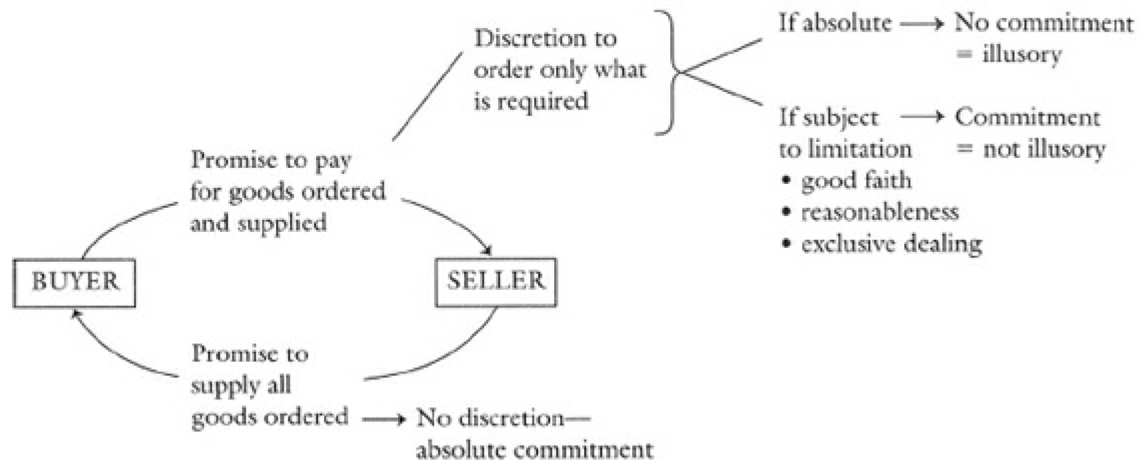
of multiple transactions with different buyers. The parties therefore enter an output contract under which the seller promises to sell and the buyer to take all the grapes grown by the seller during a specified period.

It may seem at first glance that the flexible quantity term in an output or requirements contract could be an illusory promise because a requirements buyer could elect to have no requirements and an output seller could decide to produce no goods. However, this problem is overcome by recognizing that even if the contract does not say so expressly, the discretion to determine quantity is limited by an implied obligation of good faith or reasonableness and by an implied obligation of exclusive dealing.

The obligation of exclusive dealing is essential for an arrangement to qualify as a requirements or output contract. The promise to buy requirements or to sell output is meaningless if the party with the discretion could simply manipulate the extent of the requirements or output by buying or selling elsewhere.[17] As noted above, even if there is no express promise of exclusive dealing, it is often possible to imply it from the language of the contract in context. *See*, for example, *Essco Geometric v. Harvard Industries,* 46 F.3d 718 (8th Cir. 1995). However, sometimes the language used in the agreement or the context may preclude such an interpretation. For example, in *Brooklyn Bagel Boys, Inc. v. Earthgrains Refrigerated Dough Products, Inc.*, 212 F.3d 373 (7th Cir. 2000), the court could not find any basis for interpreting the contract to require the buyer to buy all its bagel requirements exclusively from the seller, so it found the arrangement to be merely a "buyer's option" under which the seller made an ongoing offer to sell bagels at a stated price, accepted by the buyer each time it placed an order. This means that there was no requirements contract, but rather a series of discrete contracts that imposed no ongoing obligation on the buyer to buy bagels.

The relationship between a buyer and seller in a requirements contract is illustrated by Diagram 7I. (In an output contract, the discretionary performance would be on the seller's side of the exchange.)

Diagram 7I



This approach forms the basis of UCC §2.306(1) that implicitly recognizes the exclusive dealing obligation and imposes both a good faith and a reasonable expectations test on the party who determines quantity. It states that when a contract measures quantity by the seller's output or the buyer's requirements, this means the actual output or requirements as may occur in good faith. In addition, it provides that the quantity tendered or demanded may not be disproportionate to any estimate, or if no estimate was stated, to any normal or otherwise comparable output or requirements. This language sets out two tests: The disproportionality standard is an objective measure that prevents the buyer in a requirements contract or the seller in an output contract from demanding or tendering a quantity of the goods that is disproportionate to an estimated or historic requirement or output. In essence, the purpose of this standard is to protect the output buyer or requirements seller by pegging the quantity of goods at a level approximate to what might reasonably be expected, based on an estimate or on prior dealings under the contract. The disproportionality standard does not apply in every case. It is relevant only where the parties have stated an estimate or where prior dealings under the contract have established a comparable prior quantity. Also, a number of courts have interpreted §2.306 as applicable only to increases in demand or output, so it is not helpful where a disproportionally small quantity is demanded or tendered.

By contrast, the good faith test applies in all situations and is therefore the broader and more important test. Because good faith is such an open-ended and relative standard, courts often struggle to decide whether particular conduct crosses the line that separates acceptable self-interest from bad faith.

The good faith standard therefore merits special attention.[18]

"Good faith" is defined in the same terms in both Articles 1 and 2.[19] Both sections define good faith to mean "honesty in fact" as well as "the observance of reasonable commercial standards of fair dealing in the trade." That is, good faith requires conformity to both a subjective honesty standard and an objective reasonableness standard.

One of the principal problems in enforcing the obligation of good faith is that honesty and fair dealing are such elastic and relative standards. It is therefore difficult to apply those broad standards to particular conduct and to predict whether a court will find that conduct to satisfy or fall short of them. To decide whether action is honestly motivated and commercially reasonable, the court must evaluate all the circumstances under which the contract was made and the requirements or output were determined. Clearly, the very fact that the parties have made a requirements or output contract means that they must contemplate that the buyer or seller is not bound to fixed quantities, and that it may make a decision that significantly changes its requirements or output. The crucial question is therefore to determine if that decision was made in good faith. *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988), is one of the leading cases on this issue. The court said that it would clearly not be good faith for a buyer to reduce its requirements by buying the goods from another seller, or to reduce orders simply because it has second thoughts about the contract or because the contract is not as advantageous as it had hoped. However, a buyer may be in good faith in reducing its requirements for legitimate and compelling business reasons, such as technological advances that change fundamental needs or dramatic changes in market demand for the buyer's products. In *Wiseco, Inc. v. Johnson Controls, Inc.* 155 Fed. Appx. 815 (6th Cir. 2005), the buyer entered into a requirements contract with the seller to buy components used by the buyer to make headrests for Jeeps. The buyer's orders for the parts dropped dramatically when Jeep changed the headrest design, making the particular components supplied under the requirements contract inappropriate. The court applied the good faith test and concluded that the buyer had legitimate business reasons for its reduced requirements. It no longer needed the parts because its customer had changed the design of the headrest. The seller bore the burden of proving that the buyer's reduction in requirements was in bad faith, and it had not sustained that burden.

§7.9.4 Conditional Promises

Recall the illustration in section 7.9.1 in which Al promises to deliver his skis to Buster, and Buster agrees to pay $100 for them if a troupe of polar bears shows up on the ski slope on December 1 and sings “Jingle Bells” in harmony but can keep them for free if they do not. It is stated in section 7.9.1 that because the condition is impossible, Buster has really made no promise at all and has therefore suffered no detriment. However, in that same illustration, it is stated that Buster’s promise would not be illusory if the condition may possibly incur, because Buster now makes a firm, albeit conditional, commitment. Therefore, his promise to pay for the skis if it snows on the ski slope on December 1 is consideration for Al’s promise of the skis. Therefore, a promise is not illusory merely because it is conditional. A qualified or conditional promise is good consideration provided that the contingency is genuine. That is, it is an uncertain future event within the realm of possibility and outside the complete and discretionary control of the promisor. If these requirements are satisfied, the conditional promise is a commitment. A legal detriment is suffered, even though the obligation to perform the promise only comes into effect upon fulfillment of the condition.

A second illustration may help reinforce this point: Al and Buster make an agreement under which Al promises to give his skis to Buster, and Buster promises to pay $100 for them on condition that he win this week’s state lottery, in which he has already bought a ticket. If Buster does not win the lottery, the parties agree that he need not pay anything for the skis. Although Al’s promise to give the skis to Buster is absolute, Buster’s return promise is conditional. If he wins, he must pay. If not, he gets the skis free. The contingent nature of his promise does not prevent it from being consideration, because he suffers the detriment of binding himself to pay on the happening of an uncertain future event outside his control.

§7.9.5 Conditions of Satisfaction

A type of conditional promise that appears to involve very wide discretion is a condition of satisfaction. This is a condition that allows one of the parties to reject a performance by the other (and to refuse to perform his own undertaking) if he is not satisfied with it.[20] For example, on February 1, Al and Buster enter an agreement under which Al sells his skis to Buster for

$100. The agreement provides that Al will deliver the skis to Buster on February 15 and Buster will pay for them in installments of $10 per month for ten months, beginning on March 1. The agreement authorizes Al to examine Buster's credit record and to cancel the contract by February 14 if the credit report is not satisfactory to him. Such a condition might appear to render Al's promise illusory because he could simply negate his promise to sell the skis by declaring himself dissatisfied with Buster's credit record. However, unless the only plausible interpretation of the agreement is that the parties intended to give unrestrained discretion to the party making the judgment of satisfaction, a court will imply a term that limits the discretion enough to avoid the problem of illusory promise. Therefore, even if the contract does not expressly say so, the party who determines satisfaction is obliged to exercise his judgment either in good faith or reasonably.

To decide whether to apply the subjective good faith standard or the objective reasonableness standard, the court looks at all the circumstances of the transaction. The rule of thumb is that dissatisfaction must be in good faith where the performance involves a matter of personal taste, but it must be reasonable where the performance is of a technical, mechanical, or commercial nature. Stated differently, a court may conclude that the parties contemplated good faith subjective judgment where the performance involves a matter of personal taste. However, the party whose performance is to be judged would not reasonably expect such an idiosyncratic standard to be applied to a commercial or technical performance. (Of course, parties who want to avoid the uncertainty of allowing the court to decide on the proper standard can simply express in the contract which standard is to be used.)

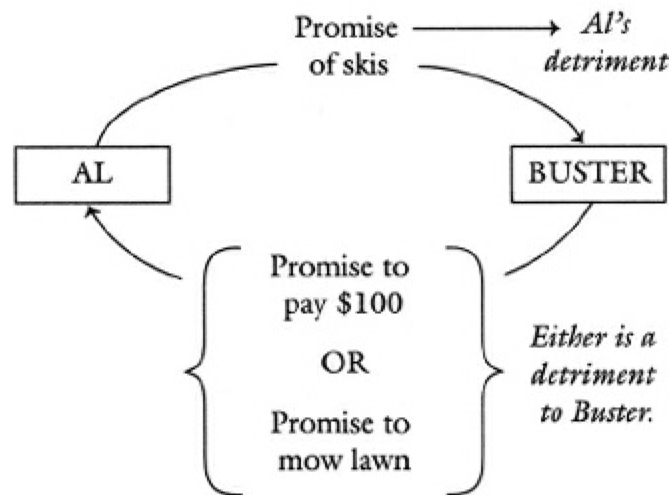
The evaluation of a person's creditworthiness is a matter of commercial judgment, which means that an objective approach would usually be more appropriate. Had Al been a finance company, in the business of making such loans, the objective standard would be based on what would be regarded as satisfactory in the consumer finance industry. However, because Al is a casual, nonprofessional lender, this standard likely is too stringent, so the standard is better based on what a person who is not in the business of extending credit would consider to be reasonable creditworthiness. It is likely that such a person may be more risk-averse and would reasonably demand a stronger credit report than a commercial lender. Alternatively, a court may decide that in this casual, nonprofessional transaction, the best standard to use is a subjective test based on good faith satisfaction. Whatever test is used, the

point for present purposes is that the implication of a standard to control Al's judgment prevents his promise from being illusory.

§7.9.6 Promises of Alternative Performances

A form of discretionary promise is one involving alternative performances. For example, Al promises to sell his skis to Buster in exchange for Buster's promise, in his discretion, to pay $100 or to mow Al's lawn for two months. Provided that each of the promises, on its own, would be consideration, there is nothing objectionable in permitting a party to select between alternative promises. This is illustrated by Diagram 7J.

Diagram 7J



The case is more difficult if one of the alternatives imposes so small a burden on the party who has the choice that it would not likely have induced the promise on its own. For example, Buster may make the alternative promises either to buy the skis for $100 or to give Al notice of cancellation of the sale. The purpose of this is to give Buster the discretion to escape the contract if he so desires, and he is really no more firmly bound than if he promised to buy the skis if he feels like it. Although the obligation to give notice is a detriment, it is such a slight detriment that it would not on its own be likely to have induced Al to commit himself to sell the skis. Nevertheless, seen as a package with the more burdensome alternative, one can understand that the parties could have been satisfied with the commercial utility of this

arrangement, and Al may have bargained for the chance that Buster would exercise his discretion in favor of completing the sale. By refusing to inquire into the adequacy of Buster's alternative detriment of giving notice, a court can uphold the transaction. This may seem like the exultation of form over substance when compared to the invalid purely discretionary promise, but the provision of notice gives the court a basis for validation, if it deems the agreement to have been fairly bargained for.[21]

Examples

1. Penny Less entered college two years ago at the age of 22. At the time, her Uncle Rich, concerned about reports of excessive drinking by college students, promised her that if she did not drink any alcoholic beverages in her first year of college, he would give her $5,000 at the end of that year. Penny thanked Uncle Rich, stating that it would be easy money because she hated the taste of alcohol.

   Penny did not consume any alcohol during her first year of college. When she reported this to Uncle Rich at the end of the year and asked for her reward, he said, "I have changed my mind about giving you the money. Don't be disappointed. Sobriety is its own reward." Was Uncle Rich free to change his mind?

2. Would your answer to Example 1 change if Penny was 19 years old at the time that she made her agreement with Uncle Rich? At that time she was old enough to be a major for the purposes of contracting. However, state law prohibits a person below the age of 21 years from consuming alcohol and provides for penalties to be imposed on a minor who violates the prohibition.

3. In January 2016, Dotty Com borrowed $500,000 from Angel Investor to finance her new startup business. The loan bore 6 percent interest and was due for repayment on June 1, 2016. In late May 2016 Dotty told Angel that the business was struggling and she did not have the cash to repay the loan. She believed, however, that if her creditors would give her a break she could save the business, but if they refused to cooperate, she would have to liquidate it. Because the business was presently insolvent, creditors would receive only about 50 percent of their claims on liquidation. Dotty asked Angel to accept 80 percent of the debt in full settlement, and to wait six months for payment. Dotty told Angel that

she planned to ask all her other creditors for the same concession. Angel agreed and the parties executed a written agreement reflecting that Dotty would pay Angel $400,000 in full settlement of the debt, with interest at 6 percent, by no later than December 1, 2016. Did Angel receive consideration for this agreement?

4. When Chevy K. Marro was 29 years old, his Aunt Charity expressed the intention of buying him a new car for his thirtieth birthday. Chevy knew that Aunt Charity always talked big but never did what she promised, so he suggested that if Charity really meant what she said, she would write out the promise and sign it. Charity agreed, and Chevy (known for his shrewd business sense) drew up the document. It stated that Charity, "in consideration for value received" from Chevy, undertook to deliver the car (which was specifically described by make, model, and year) to Chevy on his thirtieth birthday. Charity and Chevy signed the writing. True to form, Aunt Charity gave Chevy a sweater for his thirtieth birthday and did not deliver the car.
   a. Is Aunt Charity obligated by her promise of the car?
   b. Change the facts to the following extent: The writing stated that Charity undertook to deliver the car "in consideration for a cheeseburger, which Chevy delivered to Charity upon signing this agreement." Chevy did in fact deliver the cheeseburger to Charity. Is she obligated by her promise of the car?
   c. When Chevy threatened to sue her for the car, Aunt Charity became very annoyed. She demands that he return the sweater that she gave him as a thirtieth birthday present on the basis that Chevy gave her no consideration for it. Does she have the right to reclaim it?

5. Hunter Fortune used to work as a gardener on the country estate of Buck Plentiful, a billionaire. After Hunter was discharged by the groundskeeper for incompetence, he sued Buck for $1 million, alleging that he was sexually harassed and emotionally abused by the groundskeeper while in Buck's employ. Buck believed that the claim was without substance but did not want any scandal in his household, so he offered to settle the claim out of court for $10,000. Hunter accepted, and a settlement agreement was executed. After the agreement, Buck had second thoughts and refused to pay Hunter. Does Hunter have a valid claim arising from the agreement?

6. Ivor E. Keyes is a gifted pianist. On hearing him play, his beloved Aunt Charity determined to do something to help him advance his career. Ivor told her that he needed to get some training from a really fine pianist to improve his interpretation and style. He had contacted the celebrated Maestro Molto Bravissimo but had not engaged him as a teacher because he could not afford his fee of $150 an hour. Aunt Charity declared: “You shall have him as your teacher. I will send you a check for $15,000 tomorrow. That should cover 100 lessons.” Ivor thanked her and said, “Auntie, if I ever make it to Carnegie Hall, I will get you the best seat in the house.” She replied, “Yes, that will be nice, dear. I’ll hold you to it.” Do Ivor and Aunt Charity have a contract?
7. Cat Advancement and Training Society (CATS) is a nonprofit organization formed to educate and train cats. One evening an articulate and persuasive fund-raiser for the organization called on Kitty Kuddle to solicit a contribution. Kitty liked cats and thought that the goals of the society were admirable. She therefore decided to promise a contribution. The fund-raiser gave her a preprinted pledge card, which Kitty signed after inserting her name, the amount of her contribution, and the date. The completed pledge card read as follows:

    > In consideration of my love of and respect for our feline friends, and in consideration for the promise of CATS to use my contribution to advance the cause for which it was constituted, I, Kitty Kuddle, hereby pledge the sum of $500 to CATS, payable in ten equal monthly installments, beginning on December 1, 2016. I understand that this contribution is tax deductible.
    > Signed: Kitty Kuddle, November 30, 2016

    The next day, Kitty realized that she had been irresponsible in making the pledge, which she really cannot afford. She would like to cancel her pledge. Is she bound by it?
8. Gutter Press, Inc., publishes a weekly tabloid newspaper. It plans to publish a series of articles on the sordid life of Sally Bratty, a famous singer who just died of a drug overdose. It needs a manuscript for the serialized story as soon as possible so that the series can begin before the inevitable lapse of the public attention span.

    Gutter Press engaged Tabb Lloyd, a journalist, to write the manuscript for the serial. The parties signed a written agreement, which included the following terms:

a. Tabb promised to submit a completed manuscript within four weeks.
b. Gutter Press promised to publish the manuscript in serialized form over five issues of its newspaper provided that it found it to be satisfactory.
c. If it did not find the manuscript to be satisfactory and did not publish it for that reason, Gutter Press would have no obligation to pay Tabb anything. However, if it found the manuscript to be satisfactory, it would publish it and would pay Tabb $500,000.
d. During the first week following execution of the agreement, Gutter Press had the right, for any reason, to cancel it by delivering written notice of termination to Tabb.

The day after signing the agreement, Tabb decided that he did not wish to write the manuscript. Is he contractually bound to Gutter Press?

9. Constance De Votion decided to retire after working for the Turn Coat Corporation for 40 years. After the close of business on her last day of work, Turn Coat held a retirement party for her during which the president of the company made a speech thanking her for her long and faithful service. At the end of the speech, the president held up a large photograph of a gold Rolex watch and announced that the company would be giving Constance the watch to show its appreciation for her years of service. Constance thanked him tearfully. Turn Coat never gave Constance the watch. Does she have the legal right to demand it?

10. Stifle Enterprises, Inc. hired Abel Salesmann as a sales representative under a two-year employment contract. A year after the employment contract was executed, Stifle offered Abel a promotion to sales manager on condition that Abel agreed to sign a noncompetition agreement, under which Abel would agree, for a period of one year after leaving the employ of Stifle, not to engage in any business in the state that competed directly with Stifle.[22] Abel agreed to this condition and signed the noncompetition agreement. Six months later, Abel resigned and immediately set up his own competing business in the same city. Does Stifle have the legal right to enforce the noncompetition agreement against Abel?

11. Peters Pickled Peppers manufactures pickled peppers. Last fall it made an agreement with Hal Apeno, a farmer, under which Hal undertook to supply all the peppers Peters would need for its bottling operations next

season, and Peters agreed to buy peppers only from Hal. During negotiations preceding the agreement, Peters told Hal that its average needs in the last five years had been between seven and ten tons of peppers. Hal was satisfied that he could grow sufficient quantities to meet this range of demand. This range of expected requirements was recorded as an estimate in the written contract.

A short time later, Peters's Board met to discuss disappointing sales in the prior year. Studies showed that new and aggressive competitors had gained the lion's share of the pickled pepper market, and all indications were that next year would be even worse. The Board decided to switch from peppers to persimmons, for which there was very little competition. Peters's existing plant was suitable for the processing of persimmons, so the conversion could be achieved at small cost.

Because of this decision, Peters had no need for peppers, and it wrote to Hal telling him so. Hal sued Peters for breach of contract and Peters defended the suit on the basis that it had the right under the contract to order no pickles if it had no requirements. The trial court granted summary judgment to Peters on the theory that there was no contract because the transaction lacks mutuality of obligation. Is the judge right?

Explanations

1. This Example pays homage to cases such as *Hamer v. Sidway*, discussed in section 7.3.1, in which a well-to-do family member promises some reward for specified behavior. Like Willie, the nephew in *Hamer*, Penny's detriment is not "detrimental" in the usual sense because it is really in her best interests. In fact (apparently unlike Willie) she does not even "suffer" in the usual sense because she has no desire to engage in the activity. Notwithstanding, she suffers a legal detriment simply by forgoing something that she is entitled to do. She exchanges this for Uncle Rich's promise of payment, providing him with a noneconomic but identifiable benefit. Therefore, Penny has given consideration to Uncle Rich. Because she performed her part of the bargain, Uncle Rich is contractually bound to pay her the $5,000 that he promised her. (The parties have entered into a unilateral contract in which Penny gave no promise to Uncle Rich but accepted his offer by rendering the performance, which she completed at the end of her first year of

college.[23])

Because the benefit to Uncle Rich has no commercial purpose and is apparently motivated by his concern for Penny's well-being, one may be tempted to see his promise as the promise of a conditional gift. However, Penny's promise is not related to the manner in which the gift is to be used; nor is it a means of taking delivery of the gift. Even a noncommercial promise may be bargained for if it reasonably appears intended to induce particular action desired by the promisor.

2. In Example 1, Penny had the legal right to drink alcohol, so there is no question that her forbearance from drinking it was consideration. However, on this change of facts, she is a minor and does not have that legal right because the state prohibits her from consuming alcohol. Because she does not actually give up any legal right, she suffers no legal detriment by promising to abstain. In fact, she has a preexisting duty to the state not to drink. Of course, Penny could disobey the law, so the question is whether it is good consideration to forbear from unlawful activity. As a matter of both doctrine and policy, the law could justify holding that Penny's forbearance from violating the law is not a legal detriment and therefore not consideration for Uncle Rich's promise.[24]

   However, there is an argument for finding consideration: There is value to Uncle Rich in Penny's obedience to the law, so, despite what is said above, she may be able to persuade a court to treat her desisting from the power to drink as a legal detriment. In addition, there is a basis for not applying the preexisting duty rule where the duty is not owed to the promisor. Unless an agreement may risk the corruption of a public official (such as an official's promise to perform his job in exchange for a promise of additional reward) or is otherwise a violation of public policy, the public interest is not necessarily harmed by upholding a promise meant to give a person an added incentive to comply with the law.

3. The principal focus of this Example is the application of the preexisting duty rule to contract modification.[25] The general rule is that a creditor's promise to accept less than the amount owing on an admitted debt or to extend the due date of the debt is not binding, because the debtor incurs no legal detriment in exchange for that promise. (*See* Restatement, Second, §73.) The debtor had a preexisting duty to pay the debt when it

fell due on June 1, and her promise to pay it over time after that date adds nothing to that duty.[26] As noted in sections 7.5.2 and 7.6, if the agreement to reduce and extend the debt was fairly bargained, it is hard to justify the policy of invalidating the agreement under the preexisting duty rule. However, a strict application of doctrine will invalidate it unless the court can find that Dotty incurred some new detriment in exchange for Angel's promise to reduce and extend the debt.

It is not easy to find any new detriment on Dotty's part. Her undertaking to pay interest at 6 percent is not a new detriment because she was already obliged to pay interest at that rate under the original contract. (The fact that she will pay the 6 percent interest over a longer period may seem like an added detriment, but the original agreement would have obliged her, expressly or impliedly, to pay that interest beyond the repayment date if her repayment was late.) Dotty's statement that she intended to approach other creditors with the same proposal could be a detriment if she made a promise to do that. However, as described in the facts, this seems more a statement of intent than a commitment. Finally, a promise not to liquidate a business could be consideration provided that the business is truly in financial trouble and Dotty had the legal right to liquidate it. The liquidation must be a legitimate solution to the financial problems, and not suggested in bad faith as a form of blackmail. However, again, Dotty's vague reference to the possibility of liquidation does not seem to rise to the level of a promise.

The common law recognizes a narrow exception to the requirement that a modification must be supported by consideration: It dispenses with the need for consideration if the modification is in response to unforeseen difficulties that have imposed an unexpected burden on the promisee. However, financial adversity is usually not unforeseen in a new business venture unless Dotty can establish some significant and unexpected external cause for the difficulty.

4. a. Chevy has given no consideration to Aunt Charity for her promise, which is clearly intended as a gift, not an exchange. The parties have attempted to validate the transaction by reciting that an unspecified consideration has been given. Restatement, Second, §71, Comment *b*, regards such a false recital as ineffective. Some courts may be more sympathetic to this kind of effort at satisfying the formal function of

consideration, but other courts will only uphold a formal recitation of consideration if a promise to furnish the recited consideration can be implied (which cannot be done when the recital does not specify what the purported consideration is), or the promisee's reliance on the promise creates grounds for estopping the promisor from denying the receipt of consideration.

b. There is obviously a huge disparity in value between a new car and a cheeseburger. However, the cheeseburger could qualify as consideration if the court adopts the approach of refusing to inquire into the adequacy of consideration. The court applied this principle in *Harris v. Time, Inc.*, 191 Cal. App. 3d 449 (1987). Recall that this case was discussed in Explanation 10(a) of Chapter 4 in relation to the question of whether an advertisement could constitute an offer. The court decided that Time did make an offer by stating on the mailer envelope that it would give the recipient a calculator watch "just for opening this envelope." In addition to the offer and acceptance issue, the court considered whether the recipient of the mailer had given consideration for the promise of the calculator watch. Time argued that the mere act of opening an envelope was too slight and valueless to constitute a bargained-for detriment. The court disagreed—Time obviously attached some value to enticing the recipient to open the envelope and, in any event, the court would not enquire into the adequacy of consideration.

   If we assume that the calculator watch in *Harris* was a cheap trinket, the disparity between the value of the detriment of opening an envelope and the value of a promise of the watch may not be that great. By contrast, the value difference between the cheeseburger and the new car is monumental. In the absence of evidence that Aunt Charity had some special reason for craving the burger, we have to assume that it was exchanged simply as a formality, in an attempt to validate her promise of a gift. Some courts respect the parties' use of this formal device and decline to enquire into the adequacy of the exchange. Others refuse to employ the rule against measuring the adequacy of consideration where the consideration is so slight as to be nominal.

c. The gift of the sweater has already been given, and there is no longer a promise to be enforced. Although the absence of consideration

precludes enforcement of a promise, it is not grounds for recovering an executed gift. (We need not concern ourselves with any grounds outside contract law for reclaiming a gift.)

5. Unlike the agreement between Dotty and Angel in Example 3, this settlement agreement compromises a claim disputed on the merits and unliquidated in amount.[27] An agreement to settle a disputed claim is supported by consideration because each party forbears from persisting in the full claim and defense. However, as discussed in section 7.6, for consideration to exist the dispute must be genuine. A person has no legal right to assert a bogus claim or defense, so suffers no legal detriment in forbearing from a false claim. This technical explanation accords with a more compelling public policy concern: A person should not be allowed to assert a vexatious claim or defense and then to argue that he gave consideration by settling it. Restatement, Second, §74 applies an alternative objective or subjective test to decide if a dispute is genuine. Either the claim or defense must be reasonably tenable because of uncertainty in law or fact, or the party asserting it must have a good faith belief in its merits. Some courts require both these standards to be met, and some focus only on subjective good faith.

   The Example is deliberately ambiguous on Hunter's claim. The claim appears to be based on alleged sexual harassment, the intentional infliction of emotional distress, and possibly wrongful discharge. If the wrongful acts were committed by Buck's agent, he could be liable for damages. There is, doubtless, a plausible basis in law to make the claim for damages. The crucial question is whether there is a genuine dispute on the facts. If Hunter was in fact discharged for incompetence and his claim is fabricated for revenge or to extort a nuisance payment from his wealthy ex-employer, his forbearance from asserting this bogus claim cannot furnish consideration for the settlement on either a good faith or a reasonableness test.

6. Aunt Charity clearly has suffered a detriment in promising to pay $15,000 to Ivor. However, this is nothing more than a gratuitous promise, like her promise to Chevy in Example 4, unless Ivor has given consideration in exchange for it. The only undertaking that could conceivably qualify as consideration is his assertion that he will get her the best seat in the house if he ever makes it to Carnegie Hall. (His

implicit undertaking to use the money for piano instruction is best treated as nothing more than a condition of the gift and should not qualify as consideration.)

It is not clear that Ivor's statement was really a serious promise at all. The context in which it was made and its tone suggest that it may have been nothing more than an expression of gratitude and hope for spectacular success. Even if it is a real promise, it has several problems. First, it is very vague. It does not make it clear what is meant by the "best seat"; nor does it specify the concert or concerts for which it will be obtained. Second, it is contingent on a very uncertain future event. A conditional promise could qualify as consideration unless the fulfillment of the condition is entirely at the will of the promisor or the condition is a sham because it could not possibly occur. Here the condition is not impossible, so not a sham, but it is remote enough to add doubt to its validity as true consideration. Third, unless Ivor can be interpreted to have promised a large number of free concerts, the value of his apparent consideration is disproportionately small in relation to Aunt Charity's promise. (It is worth even less than the face amount of a ticket because its value must be discounted to take account of the uncertainty of the condition occurring.) Courts normally do not evaluate the adequacy of consideration, and a court may decline to do so in this case. However, sometimes (especially when there are other indications of gratuitous intent) a court could take a significant discrepancy in values into account, and may find that the transaction is really not an exchange but a gift formalized by a nominal return.

Finally, even if Ivor did make a promise and Aunt Charity accepted it by her response, it does not seem that his promise was in exchange for Aunt Charity's promise. He made it after she had already told him she would give him $15,000, so it cannot be said to have induced her promise.

The basis for holding that Ivor gave consideration for Aunt Charity's promise is therefore quite thin, and the transaction really seems to be nothing more than a promise of a gift. An argument for consideration is not inconceivable, but it is shaky.

7. The pledge suggests three forms of purported consideration, but none of them likely qualifies as consideration.

   First, the pledge form recites that the pledge is in consideration for

Kitty's love of and respect for our feline friends. This may have motivated Kitty to make the pledge (and even this is suspect, given that it is a standard recitation on the pledge form), but motive must be distinguished from consideration that must consist of a legal detriment suffered by CATS in exchange for her promise.

Second, the pledge form recites as consideration CATS's promise to use the contribution to further the purpose for which it was established. Even if this commitment by CATS is a promise, given in exchange for Kitty's promise to donate money, CATS's promise may not qualify as a detriment to it for two reasons. One is that CATS may have a preexisting duty, under its charter as a nonprofit organization, to use donated funds to further the purpose for which it is established. This duty likely is owed not only to the state, but also to the public, including contributors. The other is that to suffer a detriment, CATS must have had the legal right not to use Kitty's contribution for the promised purpose. However, at the time of making the promise, and until Kitty actually gives the funds to CATS, it has no legal right to use them at all. Therefore, its undertaking to use them for the purpose specified by Kitty seems more in the nature of an undertaking to use a gift for the purpose designated by the donor. As noted in section 7.3.5, it can be very tricky to distinguish a promise that is a legal detriment from one that is merely a condition of gift. A court may underplay this distinction so that it can validate a charitable promise. The task of finding consideration for a rather obvious gift is made easier if the donee makes a commitment that extends even slightly beyond the mere promise to use the gift as specified. That small additional detriment could qualify as consideration, even if it is implausible that it really induced the promise. In this case, no such additional detriment is apparent.

Third, the pledge form indicates that the contribution is tax deductible, which may suggest that Kitty receives consideration for her pledge in the form of the benefit of a tax deduction. However, it is important to remember that a benefit to the promisor is not enough for consideration. The benefit must be linked to a detriment suffered by the promisee. The benefit of a reduction in taxes, gained from the government, does not translate into a legal detriment suffered by CATS.

It would be a stretch to find that CATS gave consideration for Kitty's pledge. If the pledge is not supported by consideration, she can

cancel it without liability. Consideration doctrine has fulfilled its cautionary function by enabling the donor to escape her generous impulse.

8. Gutter Press and Tabb have exchanged promises. The issue is whether Gutter Press's discretion to escape its commitment to publish the manuscript and pay for it is so wide as to make its promise illusory. The agreement gives Gutter Press two grounds for escaping its commitment. First, it can refuse to publish the manuscript if it finds it unsatisfactory. Second, it has the absolute right to terminate the agreement in the week after execution by giving notice.

   Conditions of satisfaction were explained in section 7.9.5. Unless the contract made it clear that Gutter Press would have unbridled discretion to be dissatisfied (which it does not) the satisfaction clause obliges Gutter Press to exercise its discretion either in good faith or reasonably. Even if this commitment is not expressed in the agreement, it is readily implied. The implication of either a good faith or a reasonableness standard cures the problem of unbridled discretion, so Gutter Press's promise is not illusory. On these facts, we do not have to choose between a good faith and reasonableness standard, because Gutter Press has not rejected the manuscript. Our concern is purely whether its promise constitutes consideration that creates a contract binding on Tabb. (Had Tabb written a manuscript that Gutter Press rejected as unsatisfactory, we would have had to decide what standard to use to decide if its dissatisfaction was justified. Because the agreement does not specify the standard, the court must determine whether it is subjective or objective. The rule of thumb is that a subjective standard is used if the purpose of the contract is to serve the party's personal taste, but an objective test is used if the satisfaction clause relates to matters of technical or commercial utility. This is a commercial venture, so Tabb would not reasonably expect that the publisher could reject the manuscript on the basis for purely subjective reasons. The proper inquiry would therefore be objective—whether a reasonable publisher would find the manuscript up to the generally acceptable journalistic and literary standards expected of this kind of writing in the trade.)

   Apart from the condition of satisfaction, the agreement also gives Gutter Press the right to terminate the transaction for any reason within the first week after execution of the agreement. This termination right

may seem to be an unbridled right to escape the contract, but courts usually uphold agreements subject to such termination provisions provided that notice of termination must be given. The provision of notice is essential and the right to terminate without notice makes the promise illusory. (Even where there is no express requirement of notice, a court may have the basis to imply a promise of reasonable notice if the implication is consistent with the express language of the agreement and supported by the context in which the agreement was made.) The giving of the notice is regarded as a detriment because it is a new duty assumed under the agreement. This may sound a little flimsy and Tabb surely would not have bargained for this as the exclusive consideration for his promise. However, the prospect of earning a significant fee for a satisfactory manuscript if the contract is not terminated in its first week could be an incentive to enter into the bargain. A court is not likely to question the adequacy of notice as consideration where it is part of a potentially lucrative commercial bargain.

In this contract, only Gutter Press has the right to terminate, and Tabb has no equivalent right. However, this does not cause a consideration problem because the parties' obligations do not have to be coextensive. "Mutuality" in that sense is not required, and as long as each party has given consideration in some form, it does not matter that one of them has greater rights under the contract.

In short, neither the satisfaction clause nor the termination provisions should invalidate the contract and Tabb cannot escape his commitment to Gutter Press.

9. The relationship between Constance and Turn Coat is commercial, and Turn Coat's promise is in recognition of valuable work. Nevertheless, the promise is donative and unsupported by consideration. Constance's services were rendered prior to the promise, and not in exchange for it. Her work preceding the promise is "past consideration," and she suffers no new detriment to support the promise. As much as a court might wish to help Constance to get the watch from faithless Turn Coat, there is no basis on these facts to find consideration for its promise.

10. As the footnote in the Example explains, courts are wary of enforcing noncompetition agreements in employment contracts. In some states such agreements are per se invalid, but even where they are not

absolutely unenforceable, the court will uphold the agreement only if it is reasonable in its scope (as to the period, geographic area, and type of restrained activity) and it protects a legitimate interest of the employer. It is therefore possible that, even if the agreement is otherwise a valid contract under contract formation principles, a court may refuse to enforce Abel's undertaking on the grounds that the restraint fails this test.

However, here, we are concerned not with this question but with the more basic question of whether Abel's undertaking not to compete with Stifle Enterprises is supported by consideration. If a noncompetition agreement is included in the original employment contract, there is no consideration problem because it is part of the bundle of obligations undertaken by the employee in exchange for the employer's promise to employ and pay him. (Both cases cited below so held.) However where, as here, the noncompetition agreement is entered into after the employment has commenced, it is a modification of that agreement, and the employer must give the employee new consideration in exchange for the undertaking not to compete. Stifle has given Abel new consideration because it promised Abel a promotion in exchange for his undertaking. By contrast, in *Socko v. Mid-Atlantic Systems of CPA, Inc.*, 99 A.3d 928 (Pa. Super. 2014), the court held a noncompetition agreement signed by an employee during the course of employment to be invalid because there was no change in the employee's employment status or any other consideration given to the employee in exchange for it. The court also held that because the law disfavors noncompetition agreements by employees, the court must inquire into the adequacy of consideration in this situation—the consideration given to the employee must be new, real, and valuable. It may not be nominal or of disproportionally small value.

In *Socko* the employee was an at-will employee,[28] and the court said that the mere fact that the employer continued to employ him was not in itself enough to constitute consideration. However, in *Runzheimer International, Ltd. v. Friedlen*, 2015 WL 1933300 (Wisc. 2015), the court reached the opposite conclusion. Friedlen had been employed by Runzheimer for 15 years as an at-will employee when it required all employees, including him, to sign a noncompetition agreement. Runzheimer told Friedlen that if he did not sign the agreement, he would

be fired. Although Friedlen was an at-will employee, it was enough for consideration purposes that Runzheimer forbore from firing him at the time in exchange for the undertaking not to compete. That is, as an at-will employee, Friedlen had no guarantee of continued employment in the future, yet the mere forbearance from firing him immediately qualified as consideration. Contrary to *Socko*, the court applied the usual rule that it would not inquire into the adequacy of Runzheimer's consideration.[29] Abel was not an at-will employee at the time of the agreement—he was in the middle of a two-year employment contract. Therefore, in the absence of the promotion, continued employment would not have been consideration unless Stifle extended Abel's contract beyond the two-year period. It had a preexisting duty to employ him for the contract period.

11. The trial judge should not have used the phrase "mutuality of obligation," which is imprecise and misleading. What she meant was that Peters's promise is illusory because Peters had too broad a discretion to determine its requirements. This is wrong. The parties have entered into a requirements contract governed by UCC §2.306, which makes it clear that a contract giving the buyer discretion to determine the quantity of goods ordered is not subject to the buyer's unbridled discretion, and therefore does not create a consideration problem. Peters's requirements must be its actual requirements as may occur in good faith. Furthermore, as there is a stated estimate, this sets the range of permissible variation. (Even had there not been an estimate, any normal or prior comparable requirements that Peters may have had would set the range.)

    For §2.306 to apply, the contract must in fact be intended by the parties to be a requirements contract. If the buyer does not agree to buy its requirements only from the seller, leaving the buyer free to buy from other parties, there is no restriction on the buyer's discretion and its promise is illusory. That is, although §2.306(1) does not say so expressly, one of the hallmarks of a requirements contract is that the buyer must commit to fill those requirements exclusively from the seller. Peters has made this commitment. The contract is therefore valid. The next question is whether Peters breached the requirements contract by deciding to eliminate its requirement for peppers. The fact that an estimate has been made may suggest that this case can simply be

resolved on the disproportionality test. However, most courts have said that the disproportionality test applies only to increases in demand and not to decreases.

Therefore, Peters's elimination of its requirements must be measured on the good faith standard. Good faith is defined in UCC §§1.201(20) and 2.103(b) to include both subjective honesty in fact and the observance of commercially reasonable standards of fair dealing. Is Peters' decision, based on a business judgment to discontinue production of pickled peppers, in good faith? Comment 2 to UCC §2.306 indicates that the good faith standard permits an honest discontinuance of requirements resulting from lack of demand. It draws a distinction between the justifiable shutdown of the buyer's plant for lack of orders and an impermissible shutdown merely to curtail losses. This suggests that the good faith standard may not be satisfied merely because Peters has made a sensible business judgment based on profitability. A court may find that this hardship is not serious enough to overcome Peters's duty to honor Hal's reasonable expectations. This seems to be a close case, and good faith is notoriously difficult to determine under these circumstances. While Peters's decision to cease pickled pepper production is a legitimate business decision, a court may decide that the downturn in sales because of increased competition is not so severe as to necessitate the change in product line as a matter of survival.

---

1. Obviously, this depends on your idea of fun. It does help to be deranged.

2. It is beyond our scope to delve into the history of consideration doctrine, but its origins are mentioned briefly in section 7.2. As section 7.4.1 explains, the doctrine is peculiar to common law and does not exist in civilian jurisdictions. (*See* section 2.4.1 for an explanation of the distinction between common law and civil law.)

3. An obligee is a person to whom an obligation is owed.

4. In discussions of consideration, the person who makes the promise is called the promisor and the person to whom it is made, the promisee. This terminology is clear where only one party has made a promise, and the issue is whether some immediate performance of the other is consideration. However, in many contracts, both parties make promises and each is therefore both promisee and promisor. In such a case, common usage is that the word "promisor" denotes the person whose promise is sought to be enforced, and "promisee" refers to the recipient of that promise whose return promise is challenged as insufficient to constitute consideration.

5. Justice O. W. Holmes is credited with being primarily responsible for articulating the bargain theory, but it has been plausibly argued that he simply recognized what was already happening in the cases, rather than created a new requirement for consideration.

6. You may be wondering if it could not have been argued that Dr. King's deposit of his papers with the university was an executed gift, making consideration doctrine irrelevant. Although the university had possession of the papers, it held them only as bailee. The promise that required consideration was Dr.

King’s promise to transfer ownership of the papers to the university.
7. In both *King* and *Massachusetts Eye and Ear Infirmary*, the court also discussed the issue of whether the promise would be enforceable had there been no consideration, but the donee had acted in reliance on the promise. In such a situation, the doctrine of promissory estoppel may provide relief. We cover this issue in Chapter 8.
8. Contrary to the *King* case, it seems that the argument could have been made here that even if Doozie was a gift, the gift had been executed when McCutcheon originally gave possession of the dog to Bono, so there was no need to find consideration. This issue was not raised in the opinion.
9. In this respect, modern law has moved away from older common law, which did have a formal device—the seal—that could be used to make a promise binding without consideration. The promisor could create a binding gratuitous promise by sealing the document. Originally, the seal was made by dripping sealing wax on the document and impressing the hot wax with a signet ring. In time it became acceptable simply to append the letters “L.S.” (*locus sigilli*—meaning “in place of a seal”) to a signature. The seal did not develop as an exception to consideration doctrine but predates the doctrine, which applied only to “informal” (i.e., unsealed) promises. Today, the seal has been abolished or given only residual evidentiary effect in most jurisdictions. In only a few states has the formal device of the seal been replaced by a statutory method of formally validating a gift promise.
10. Furthermore, she need not tip him, either.
11. Al also forbears from the power to breach his contract with Buster. However, this should not constitute consideration for Ava’s promise because Al has no legal right to breach that contract. Accordingly, he does not suffer a legal detriment by giving up that power.
12. In addition to challenging Sue’s consideration, the hotel has grounds for avoiding the agreement for fraud. (Fraud is discussed in section 13.6.) Sue’s fraud is also a criminal offense.
13. Estoppel is explained in section 8.4. In short, its impact in this context is that because the promisor has participated in setting up the pretense of consideration, he or she cannot now deny that consideration was given if the promisor’s earlier conduct induced the promisee reasonably to rely on the validity of the promise. If such reasonable reliance can be shown, the promisor is held accountable for that conduct and is precluded from asserting that the consideration is a sham.
14. *See* section 4.13.4. As explained in that section, consideration is required for a firm offer that does not comply with UCC §2.205 because, for example, the offeror is not a merchant or because the offer is held open for more than three months.
15. If the imbalance in commitments has been caused by unfair bargaining, the doctrine of unconscionability (*see* section 13.12) may be used to address the problem of unfair imposition.
16. The case was affirmed without discussion of the consideration question at 173 F.3d 933 (4th Cir. 1999).
17. The obligation for exclusive dealing need not necessarily relate to the party’s entire requirements or output of a product. It is permissible to confine it to a defined portion of the requirements or output, provided that the scope of the exclusive dealing is clear and identifiable. For example, a seller of corn could agree to commit only the output from particular fields, or a buyer of office stationery could commit to take only its requirements of copier paper from the seller.
18. In addition to the discussion in this section, the good faith standard is also raised in section 10.8.2.
19. Because “good faith” is defined in the same way in Articles 1 and 2, we do not need the special definition in Article 2 that applies only to merchants, and it is redundant. The cause of this redundancy is that the definitions used to be different, but the difference was eliminated by an amendment to the Article 1 definition. That definition, applicable to all parties, used to require only subjective honesty, while the definition in Article 2, applicable only to merchants, has a stricter test that requires both subjective honesty and commercial reasonableness. When Article 1 was revised in 2001, the drafters felt that the purely subjective test of good faith was too lenient, so they changed the definition in §1.201(20) to conform to that in §2.103(b). The drafters intended to remove the now redundant Article 2 definition, but the planned revision of Article 2 was never enacted. Note, however, that the Article 2

definition is not redundant in all states. Some states objected to the stricter Article 1 definition when it was drafted and declined to adopt it. In those states, there is still a distinction in the definitions of good faith applicable to merchants and nonmerchants.

20. Conditions of satisfaction are discussed further in section 16.8.2.

21. For example, in *Johnson Lakes Development, Inc. v. Central Nebraska Pub. Power & Irrigation Dist.*, 576 N.W.2d 806 (Neb. 1998), the court held that an obligation to give advance notice of termination was enough to prevent a party's promise from being illusory, provided that the party was irrevocably bound for an appreciable period of time or otherwise rendered some performance that would qualify as consideration.

22. Noncompetition agreements are discussed in section 13.13.3. In short, a noncompetition agreement is an undertaking by a person associated with a business (such as the seller of a business, a partner in a business, or an employee of a business) that upon leaving the business he will not engage in work in competition with the business in a specified area for a specified time. Such agreements are carefully regulated by courts because they have the harmful effect of stifling competition and restricting the promisor's freedom to make a living. In some states a noncompetition agreement by an employee is per se invalid. Even where the agreement is not absolutely unenforceable, a court will only enforce it to the extent that it is reasonable in its scope and protects a genuine economic interest of the promisee, such as customer goodwill or confidential information.

23. The acceptance of an offer for a unilateral contract is explained in section 4.12. In short, if Uncle Rich's offer could be accepted only by the completion of Penny's performance (forbearing from drinking for the entire year), no contract comes into existence until completion of Penny's performance. Once the performance is complete, a unilateral contract arises in which only Uncle Rich's obligation remains outstanding. If Penny does not perform, she never accepts the offer, and Uncle Rich has no contractual right to enforce. To protect Penny from having the offer revoked after she has begun her performance in reliance on it, the law deems the offer irrevocable as soon as Penny begins her performance.

24. This issue did not come up in the *Hamer* case.

25. In addition to the discussion in this chapter, contract modification is dealt with in section 13.9.

26. Had the debt been disputed, an agreement to compromise the dispute would likely be supported by consideration, as discussed in section 7.6 and Example 5.

27. A claim is unliquidated where its amount is uncertain and cannot be determined by simple arithmetic means. The only way that the amount of Hunter's damages can be determined is by a trial.

28. An at-will employment contract (as opposed to a contract for a stated term, such as Abel's two-year contract with Stifle) is one in which either party can terminate the employment at any time—the employee may resign, or the employer may fire him.

29. As it happened, Runzheimer continued to employ Friedlen for 29 months after he signed the agreement.

CHAPTER 8

Promissory Estoppel as the Basis for Enforcing Promises

§8.1 INTRODUCTION

As Chapter 7 shows, consideration is a prerequisite to a valid contract. A promise that has not been bargained for in exchange for some detriment cannot be enforced as a contract. Of course, as we have seen, consideration doctrine has a degree of flexibility that enables courts to stretch the concept of bargained-for exchange to accommodate some deserving cases. But this only works up to a point. Sometimes the facts are such that no manipulation of consideration doctrine could produce a realistic argument that consideration was given for a promise. In many cases the resulting nonenforcement of the promise is an appropriate consequence, but this result can be unfair when the promisee incurred some loss in relying justifiably on the promise. Promissory estoppel has developed to provide relief in such cases. When all its elements are satisfied, a promisor may be held accountable for a promise without consideration, and the court may enforce it either to the same extent as if a contract was made, or to the extent necessary to remedy the unfair result of reliance on it.

Promissory estoppel was first articulated as a distinct basis of liability in §90 of the First Restatement. The original formulation, with subtle revisions, survives in §90 of Restatement, Second. Although the Restatement section does not itself call the doctrine promissory estoppel, this name is firmly established by long usage.

Several factors must be considered in deciding whether promissory estoppel relief is appropriate, as discussed shortly. However, its essential elements can be stated simply: A promise coupled with detrimental reliance on that promise.

In this chapter, we discuss the general principles of promissory estoppel and also look at some specific applications of the doctrine in various contexts such as charitable pledges (section 8.8), negotiations (section 8.9), and options (section 8.11). In addition, promissory estoppel comes up again in other contexts later in the book, for example, in relation to the statute of frauds (section 11.4) and contract modifications (section 13.9).

§8.2 THE NATURE OF PROMISSORY ESTOPPEL AS AN INDEPENDENT BASIS OF RELIEF OR AS A CONSIDERATION SUBSTITUTE

Promissory estoppel is an ancillary basis for upholding a promise that does not qualify as contractual. It is not needed where the promise is supported by consideration and there are no other problems that prevent the promise from being enforced as contractual. When analyzing a problem, it is therefore logical to first consider if a contract has been formed and to turn to promissory estoppel only if that question is answered negatively.

Because it allows for the enforcement of a promise without consideration, promissory estoppel is sometimes called a substitute for consideration. One must approach this phrase carefully, because there is disagreement among both courts and commentators over the categorization of promissory estoppel and its relationship to contract. This debate is partly philosophical, reflecting contrasting opinions on the way that the law should be conceived, and partly empirical, based on different interpretations of how the courts actually treat promissory estoppel. If promissory estoppel is classified as a contractual cause of action, the promise would be enforced as a

contractual undertaking once the elements of promissory estoppel are satisfied. That is, promissory estoppel is treated as an alternative basis for finding contractual liability where consideration is lacking or there is some other defect in the formation process. Comment *d* to Restatement, Second, §90 suggests that the drafters favor this approach by stating that a promise binding under §90 is a contract.

The opposing view is that promissory estoppel does not result in enforcement of the promise as a contract but is an alternative and independent basis for enforcing the promise—a separate theory of obligation, based not on bargain but on accountability for conduct that induces reliance. This conception of promissory estoppel emphasizes its affinity to tort and to equitable estoppel (explained in section 8.4) and sees it more as a redress for injury suffered in reliance than as a contract-like relationship.

The characterization of promissory estoppel is not just a matter of theory, but can have significant practical consequences. As explained in sections 8.3 and 8.7, it has an impact on the remedy awarded to the promisee. Apart from the question of relief, the nature of promissory estoppel could give rise to other legal consequences. For example, if promissory estoppel is classified as a contractual cause of action, it is likely subject to the statute of limitations[1] applicable to contract suits, which is commonly six years. However, if it is classified as a tort-based cause of action, the shorter statute of limitations for tort actions (typically two years) could apply. *Matarazzo v. Millers Mutual Group, Inc.*, 927 A.2d 689 (Pa. Commw. 2007), provides a second example of a practical consequence of classification. The Matarazzos sued a municipality for damage caused to a vacant property by the municipality's failure to turn off the water supply to the property. They sued on the basis of promissory estoppel, not contract, claiming that they had relied to their detriment on the municipality's promise to turn off the water. The municipality argued that the suit was really just a disguised tort suit, and it sought to dismiss the suit on the basis of the doctrine of sovereign immunity. (This doctrine precludes a tort action against a governmental authority without its consent, and it applies only to tort claims, not to contractual claims.) The majority of the court recognized that promissory estoppel sounds in contract, and that a governmental unit would not be immune from a promissory estoppel claim. However, it concluded that the underlying basis of the claims in this case was not that the municipality had made a promise, but rather that it had been negligent in failing to turn off the

water. The court therefore concluded that the claim was actually in tort and therefore barred. *Douglas E. Barnhart, Inc. v. CMC Fabricators, Inc.*, 211 Cal. App. 4th 230 (2012), offers a third example: Because the plaintiff had sued to enforce a promise under the theory of promissory estoppel, not contract, the court held that the plaintiff was not entitled to attorney's fees under a statute that allowed such an award to the prevailing party "in an action on a contract."

§8.3 THE DIFFERENCE IN REMEDIAL EMPHASIS BETWEEN CONTRACT AND PROMISSORY ESTOPPEL

The way in which promissory estoppel is characterized—as a contract-based doctrine or an independent tort-like theory—has a bearing on the question of its most appropriate remedial goal. As discussed more fully in section 8.7, if promissory estoppel creates contractual liability, the normal relief for promissory estoppel should be the full enforcement of the promise, and it is only appropriate to limit relief under special circumstances. Conversely, if one focuses on the protection of reliance, the remedy should usually be confined to reimbursement of actual loss, with fuller enforcement reserved for cases when justice so demands. This could make a substantial difference in recovery: Expectation damages, the primary form of contract damages, look toward the future and aim to place the promisee in the position he would have been in had the contract been honored. Their goal is to give the promisee the benefit of the bargain by awarding the money equivalent of what the promisee would have gained as a result of the contract.[2] On the other hand, if the principal focus of promissory estoppel is merely to reimburse for loss caused by reliance, the most appropriate form of relief is an award of damages that looks toward the past and aims to restore the promisee to the position he was in before the promise was made. Damages that reimburse loss or expense incurred in reliance on a promise are called reliance damages. The aim of reliance damages is similar to that of tort damages, which also aim to restore the victim to the position he was in before the tort was committed.

§8.4 AN INTRODUCTION TO EQUITABLE ESTOPPEL AND ITS LINK TO PROMISSORY ESTOPPEL

As intimated above, the essential function of promissory estoppel is to provide relief for justifiable reliance on a promise given without consideration. Promissory estoppel derives from the much older principle of equitable estoppel, also known as estoppel in pais. It is therefore helpful to understand the basic idea of equitable estoppel. Equity is introduced in section 2.5. Because a court of equity exercises its discretion to do justice between the parties, it is a general principle of equity that the litigants must themselves behave equitably in seeking the court's assistance. Relief that may otherwise be available is barred by the claimant's unworthy conduct.

Equitable estoppel reflects this principle. Its basic purpose is to preclude (i.e., "estop") a person from asserting a right when, by deliberate words or conduct, he or she has misled the other party into the justifiable belief that the right does not exist or would not be asserted. Like many equitable doctrines, estoppel involves a balancing of the equities between the parties and a comparative evaluation of the fault and responsibility of the parties. Therefore, it generally only bars relief when the party asserting the rights deliberately engaged in the misleading behavior with knowledge or reason to know it could be misleading and could induce reliance by the other. In addition, the other, unaware of the true facts, must have relied on the apparent facts in a way that would result in some loss or prejudice if the claimant is permitted to assert the right.

For example, the syllabus for Professor Punctilio's law school class on equitable remedies states that students will be evaluated in the class by four short written papers, to be assigned during the course of the semester. The syllabus declares, in bold print, that all assignments must be submitted by the due date and that the professor will refuse to accept a late submission and will record a failing grade for it. Di Latory struggled with the first assignment and could not finish it on time. Although it was two days late, she put it in the box outside Professor Punctilio's office and hoped for the best. The professor did not reject it and later returned it with a B grade. Di was delayed in completing her second paper by trouble with her computer. She placed the second paper in the box three days late. Again, the paper was returned a short while later with an A-grade. When it was time for the submission of the third

paper, Di did not worry about getting it in exactly by the due date, and she submitted it two days late. Professor Punctilio returned it the next day with a note stating, "Rejected as untimely. Grade: F." When Di goes to Professor Punctilio's office to confront him over the failing grade, she should be able to persuade him, as a scholar of equitable remedies, that he is estopped from rejecting her third paper on grounds of tardiness: She suffered prejudice by submitting the third paper late in reasonable reliance on his deliberate conduct. It does not matter that Professor Punctilio did not intend his conduct to mislead Di. Estoppel is based not on fraud but on accountability for deliberate words or conduct that induced reliance and consequent detriment.

This is a case of equitable, not promissory, estoppel, because Professor Punctilio did not promise Di that he would accept her late paper. However, equitable estoppel is the doctrine from which promissory estoppel developed. Courts originally refused to apply estoppel to promises and confined it to conduct or factual speech that was not promissory in nature. However, during the nineteenth century (and possibly even before that) some courts began to recognize that reliance on a promise was just as worthy of protection as reliance on a factual assertion, and they began to apply equitable estoppel to promises. The theory of these cases was that the promisor was estopped from asserting a lack of consideration for the promise, hence consideration was deemed to be present. Therefore the early cases did treat estoppel as a consideration substitute. Not all courts followed this approach. Some refused relief despite reliance if consideration was absent, and others sought to protect reliance indirectly by bending over backward to find consideration in the most tenuous of detriments.

By the time of the drafting of the First Restatement, there was enough caselaw to support the inclusion of a new doctrine that came to be called promissory estoppel. The Restatement's formulation (in §90) did not treat the promise as estopping the denial of consideration but simply recognized detrimental reliance on the promise as a basis of enforcing it. Therefore, while the drafters of the Restatement did not necessarily conceive of promissory estoppel as a theory of liability separate from contract, they planted the seeds of this idea. Following publication of the Restatement, the judicial recognition of promissory estoppel grew, and the doctrine has become well established, even though courts differ on its scope and range. Its formulation in Restatement, Second, §90 follows that of the original Restatement quite closely but makes changes to reflect its development over

the intervening years.

The derivation of promissory estoppel from equitable estoppel means that it has an equitable basis. Depending on the nature of relief sought, this could have an impact on the parties' rights at trial. For example, in *InCompass IT, Inc. v. XO Communications Services, Inc.*, 719 F.3d 891 (8th Cir. 2013), the court held that where promissory estoppel is used as the basis of claiming reliance damages, rather than as a consideration substitute seeking expectation damages, the suit is equitable in nature. As a result the court held that the plaintiff was not entitled to a jury trial, because jury trials are available only in law and not in equity.

§8.5 THE RANGE OF PROMISSORY ESTOPPEL: GIFTS AND COMMERCIAL TRANSACTIONS

When promissory estoppel first developed, it was primarily used to validate gratuitous promises such as family gifts and charitable donations. It was not thought to be applicable to promises made during the course of commercial interaction. It continues to have application to donative promises, but the tendency has been to expand it. Promissory estoppel is now commonly invoked as a basis for enforcing a commercial promise in appropriate circumstances. Of course, promissory estoppel has no role in most commercial transactions. No gift is intended and once agreement is reached, consideration is present. However, we have already seen that consideration problems do sometimes arise in the commercial setting, or other factors may prevent a promise from being enforceable as a contract.

There are at least three broad types of situation in which promissory estoppel may be applicable to a commercial promise. Although these situations technically involve a lack of consideration, the real reason for the absence of contractual liability is usually something else, and the real issue is whether it is appropriate to enforce the noncontractual promises.

1. A promise made for good consideration is not enforceable because of noncompliance with legal formality such as the statute of frauds. Promissory estoppel may permit the enforcement of the informal promise when fairness demands that the promisor not be allowed to

escape liability. Discussion of this ground is deferred to section 11.4, where it is treated in conjunction with the statute of frauds. (Although it could technically be argued that consideration is absent here because an unenforceable informal promise is not a legal detriment, the real issue is whether a promise should be enforced despite the failure to comply with required formalities.)

2. Promissory estoppel may be used to hold a party to a promise made during negotiations for an abortive contract. When parties negotiate, they may make tentative commitments, not intended to bind unless and until final agreement is reached. Therefore, as a general rule, statements of intent made during negotiations are not treated as promises, and a party who incurs expense or relinquishes an opportunity on the strength of such a statement usually assumes the risk of loss if no contract comes about. Sometimes, however, a precontractual statement may reasonably be intended as a binding commitment, justifying reliance and attracting liability if not honored. The situations in which this might happen are discussed in section 8.9.
3. Promissory estoppel may afford relief for reliance on a promise that falls short of becoming contractual because of some defect or omission in the agreement formed by the parties. For example, there may be a fatal vagueness in the terms of the putative contract, or it may have an escape clause that negates commitment, yet there is enough of a commitment to justify reliance. One could say that this is also a consideration issue, and that the vague or discretionary promise is not consideration. However, the real issue is whether fairness demands accountability even in the absence of a binding contract. In short, the role of promissory estoppel goes beyond the enforcement of gift promises and covers a variety of promises that do not qualify as contractual, either because they lack consideration or because of some other deficiency or missing element in the process of contract formation.

---

§8.6 THE ELEMENTS OF PROMISSORY ESTOPPEL

§8.6.1 Introduction and Overview of the Elements

Assume that Uncle Rich says to his niece, Penny Less, "I think it is very important for you to get a college education, and I would like to help you do that. If you enroll in college, I will pay you $40,000 to help cover the costs of tuition." On the strength of this promise, Penny enrolls in college, committing herself to the payment of $40,000 tuition for her first year, but Uncle Rich fails to honor his promise to her. It is plausible to argue that the parties have entered into a contract. Penny's enrollment in college appears to have been bargained for in exchange for the promise and, as she had no legal obligation to enroll, this is a legal detriment. Penny could therefore seek enforcement of the promise as a contractual obligation. However, she may not succeed on that ground. As we have seen, in family transactions it is sometimes difficult to distinguish a bargained-for exchange from a gift given subject to conditions as to its use. A court could conclude that Uncle Rich merely promised a gift of money to be used for a specified purpose. On these facts, while Penny may ultimately be found not to have given consideration, she does at least have some basis for arguing that she did. However, in many family transactions, there is no basis at all for finding consideration. For example, if Uncle Rich simply promised to give Penny an unconditional gift of $40,000, and if she decided, on the strength of the promise, to enroll in college, she would have no grounds for asserting that Uncle Rich had bargained for anything in return.

Once consideration is lacking, the promise cannot be enforced as a contract, yet in both these examples Penny has relied on it by incurring a debt for tuition. Promissory estoppel developed as a response to situations like this and affords relief to the promisee when the equities favor holding the promisor accountable for the promise.

The elements for promissory estoppel, set out in Restatement, Second, §90, center around the promise and detrimental reliance on it. In short, §90 calls for the following factors to be taken into account in deciding whether and to what extent a promise without consideration should be binding:

1. A promise was made by the promisor with the reasonable expectation that the promisee would rely on it. (This element focuses on the promisor's conduct and evaluates his intent objectively.)
2. The promise did in fact induce the promisee's action or forbearance. Although §90 does not say so expressly, this reliance must be justified. (This element focuses on the promisee's reaction and

evaluates his reliance largely on an objective standard.)

3. The enforcement of the promise is necessary to avoid injustice. (This element focuses on the consequence of reliance. Although §90 does not refer expressly to the detriment—that is, harm or loss—suffered by the promise as a result of reliance, this is a crucial factor.)
4. The remedy may be limited as justice requires. (This focuses on the appropriate form of relief. The nature and extent of the promisee's detriment is relevant here too.)

As this suggests, the decision to enforce a promise involves an evaluation of the conduct and reasonable understanding of each party and the fairness of holding the promisor accountable for a promise that would not otherwise be binding in contract law. While separate elements can be identified, their nature is such that they flow into and affect each other. Thus, for example, if the promise is clear and express, it is easier to infer intent to induce reliance and to justify reliance, and enforcement is more likely to be needed to avert injustice. Conversely, if there is doubt about the apparent promise, it is harder to show these other elements convincingly. We now survey each of the factors outlined above.

§8.6.2 A Promise Must Have Been Made

Section 1.2.3 introduced the meaning of promise and pointed out that not every assertion or statement of intent qualifies as a promise. Unless clear language of commitment is used, it can be difficult to decide if a promise has been made. Words and conduct must be interpreted in all the relevant circumstances of the case to determine if the alleged promisor manifested an intent to commit to a particular performance or course of action. *Norton v. McOsker*, 407 F.3d 501 (5th Cir. 2005), illustrates some of the issues that can arise in deciding if a promise was made. A woman had been involved in a 23-year adulterous relationship with a married man. When he ended the relationship, she sued him under various theories. Her promissory estoppel claim was based on the grounds that he had frequently promised during the relationship to divorce his wife and marry her and also that, both during and at the end of the relationship, he had promised to support her for life. The court of appeals upheld the trial court's grant of summary judgment against the woman. Neither of the alleged undertakings established an enforceable

promise. The man's promise to divorce his wife and marry the woman was void as against public policy. His undertaking of lifetime support was too general and nonspecific to qualify as an enforceable promise.

Note that it is manifested, rather than actual, intent that is determinative. As in contract, intent for the purpose of promissory estoppel is gauged by an objective test. The question is not what the promisor actually intended but what the promisee was justified in understanding that intent to be, based on the promisor's utterances and conduct. This could not be otherwise because promissory estoppel aims to protect reliance that necessarily is based on a reasonable perception of exhibited intent rather than on the undisclosed thoughts and beliefs of the promisor. The objective evaluation of whether a promise was intended could therefore trap a party into a promise that he did not actually intend as a commitment.

The objective determination of intent in this context is subject to the same qualification that applies in deciding on contractual intent—the promise must have been voluntarily and deliberately made. Therefore, as in contract, doctrines such as fraud, duress, and mistake (covered in Chapters 13 and 15) may be used to go behind the objective appearance of a promise. In addition to affecting the quality of the promise, any improper conduct by the promisee would also, of course, impact his justifiable reliance.

Also bear in mind the evidentiary, cautionary, and channeling functions served by consideration doctrine. The fact that consideration was not given for the promise means that these functions are not fulfilled by any act of exchange. Therefore, a court must exercise particular care before finding a promise when there is little or no formality in its execution or the circumstances suggest that the promisor may have acted on impulse or with rash generosity.

§8.6.3 The Promisor Should Reasonably Have Expected the Promise to Induce Action or Forbearance by the Promisee

This element is so closely connected to the inquiry into promise that it is a little artificial to treat it separately. However, it is helpful to split the evaluation of promisor accountability into two issues for the purpose of building a framework for analysis. Because the promisor is accountable only for a deliberate and voluntary promise, one must go beyond simply interpreting the meaning of the manifestation and must also evaluate the

promisor's justifiable understanding of the likely impact of the promise. The circumstances must be such as to warrant holding the promisor accountable for creating the situation leading to reliance and the resulting loss.

This means that the promisor knew or reasonably should have realized that the promisee would likely understand that a promise had been made and would thereby be induced to take or refrain from action of the kind that occurred. (Thus, not only the likelihood of reliance but also the general nature and extent of the response must have been reasonably foreseeable by the promisor.) Again, an objective standard is used, so the promisor is held to a standard of reasonableness, whether or not he actually intended the promise to be relied on.

§8.6.4 The Promise Must Have Induced Justifiable Action or Forbearance by the Promisee

We now move from the promisor's accountability to the promisee's reliance. In dealing with inducement, the text of §90 does not expressly require the reliance to be justifiable, but this principle is referred to in the comments and is inherent in the purpose of promissory estoppel. To decide if the promisee justifiably relied on the promise, we must ask two questions. First, we must ask if the promise did in fact induce the promisee's action or forbearance. There must have been a cause and effect between the promise and the conduct, so there is no inducement if the promisee would have incurred the loss or expense even had the promise not been made, or incurred it before the promise was made.

Second, even if the promise did induce the promisee's conduct, he should not be given relief unless his particular response was a justifiable reaction to the promise. Justification is evaluated under a largely objective standard with some subjective aspects. It allows weight to be given to the personal attributes and situation of the promisee. The essential question is whether a reasonable person in the promisee's position would have so acted or refrained from acting as a result of the promise. Because the promissor's liability under promissory estoppel is based on a noncontractual promise, the justifiability standard is an essential safeguard. It protects the promisor from being held accountable for consequences caused by a promisee's reaction that could not have been anticipated fairly because it was rash, quirky, or unreasonable. If the promisee behaves in this way, he should bear the risk of

having made the judgment to incur loss or expense in the absence of a contract.

As you can see, the inquiry into the nature and strength of the promise, the promisor's reasonable expectation of reliance on it, and the promisee's justification in relying on it tend to meld together. They are frequently just different aspects of the same overall pattern: The stronger the sense of commitment, the greater the likelihood of a reasonable expectation of inducement and, consequently, of justifiable reliance. For example, in the *Norton* case, discussed in section 8.6.2, the court found that the man had made no enforceable promise to marry or to support the woman during or at the end of their 23-year affair. The court also noted that even had his undertakings qualified as promises, the woman would not have been justified in relying on them. His promise of lifelong support was too vague to induce reliance. She could not have had any reliance on his promises to leave his wife and marry her because he had made and broken that promise countless times over the 23 years of their relationship.

Section 90 dispenses with proof of reliance for charitable pledges and marriage settlements. (Marriage settlements are beyond our scope and are not discussed here.) A few courts have followed this rule and have upheld promises of charitable contributions, even where reliance cannot be established. However, most courts have not adopted the Restatement, Second's position and still require charitable organizations to show justifiable reliance on the gratuitous promise. (This serves as a reminder that the Restatement, Second, although highly influential, is just secondary authority that may sometimes reflect what the drafters feel the law should be, rather than what it is.) Of course, even those courts that disavow the Restatement, Second's exception are sometimes able to give promissory estoppel relief by stretching the facts to find justifiable reliance.

§8.6.5 The Promise Is Binding If Injustice Can Be Avoided Only by Its Enforcement

This element reflects the total balance that the court must draw after evaluating the equities, so that its decision achieves a fair result in all the circumstances. (This balancing is an aspect of the equitable roots of promissory estoppel.) It takes into account not only the issues of promise and reliance discussed above but also any other factors that bear on the

appropriateness of enforcing the promise.

The most significant of these is the detriment or harm suffered by the promisee in relying on the promise. Because the protection of reliance is the fundamental purpose of promissory estoppel, it is not enough that the promisee had merely a generalized expectation of gain which has been disappointed. The promisee must have suffered some actual harm by relying on the promise. Therefore, “detriment” in this context is usually not used in the attenuated sense associated with consideration doctrine but describes a real economic loss such as an expenditure, a sacrificed opportunity, a commitment or some other prejudice of a substantial kind. While some courts may accept less, especially if the other equities strongly favor enforcement, the need to avert injustice by enforcement of the promise is not very strong if there is no loss that needs redress and the only effect of nonenforcement is the failure to receive the promised benefit.

Another important factor that weighs in the balance was mentioned earlier in connection with the promise in section 8.6.2 but should be reemphasized here in dealing with the general equities of enforcement. Comment *b* to §90 stresses that the promisor needs protection from an ill-considered promise or a bogus claim of promise. Because consideration is absent, its safeguards—the channeling, cautionary, and evidentiary functions—are missing. The court should therefore weigh the lack or presence of formality and the apparent deliberateness of the commitment in deciding whether the equities favor enforcement, and if so, to what extent.

§8.7 THE REMEDY WHEN PROMISSORY ESTOPPEL IS APPLIED

Restatement, Second, §90 states that the remedy for breach of the promise may be limited as justice requires. Although Comment *d* to that section says that a promise binding under the section is a contract, this limitation of remedy means that the promisee is not necessarily entitled to full contractual relief. That is, the court could grant the promisee full contractual relief, which typically takes the form of expectation damages, designed to compensate for loss of gains resulting from the breach and to place the promisee in the position he would have been in had the promise been performed. However, it

has the discretion to provide a lesser remedy. Typically, this lesser remedy takes the form of reliance damages, which focus on the reimbursement of the actual loss or expense incurred in reliance on the promise.

Although §90 suggests a range of damages and makes it clear that the balance of the equities affects the extent of relief, there is some debate on the correct emphasis to be placed on the choice of remedy. If the role of promissory estoppel is to estop the promisor from denying the existence of a contract, it follows that the law should treat the promise as if it was a contract, and the remedy for breach of contract (usually expectation damages) should be the normal measure of relief. The lesser remedy, restricting relief to the reimbursement of reliance losses, would therefore be appropriate only in exceptional cases. However, if promissory estoppel is an independent tortlike theory of liability, reimbursement of actual reliance losses should be the normal relief, with full enforcement confined to cases in which the lesser remedy is clearly inadequate. Some studies suggest that courts do in fact incline to full enforcement except when there is some problem in proving expectation damages. In short, it is difficult to say for sure where the primary focus is, given the spectrum of damages available to courts. It is important to recognize, however, that courts have a discretionary range of relief. Some of the factors that a court may consider in exercising this discretion are illustrated by *Tynan v. JBVBB, LLC*, 743 N.W. 2d 730 (Wis. App. 2007). Tynan began working for the defendant as a consultant before the parties had settled the terms of an employment contract. The parties never reached agreement on the terms of the employment contract, and Tynan's consultancy was eventually terminated. He sued the defendant for specific performance of promises to pay various bonuses to him.[3] The jury found that the promises had been made and that Tynan had relied on them. However, the court refused to award expectation relief to him and confined his relief to reliance losses. The court acknowledged that it had the discretion to award expectation relief but declined to do so because it found that the promises were somewhat vague, Tynan had not been employed as a consultant for very long, and the defendant had not acted unfairly. The court then gave Tynan the opportunity to prove reliance damages. He tried to show that he had lost opportunities for employment in reliance on the promise, but he could not prove this with sufficient certainty, and ended up with no award of damages.

As a further illustration of the possible range of remedies for promissory estoppel and the distinction between full contractual damages and reliance

recovery, consider Penny's enrollment in college on the strength of Uncle Rich's promise to give her $40,000 to pay for tuition if she enrolled in college: Penny's expectation is $40,000, and full contractual enforcement would give her this amount. By contrast, reliance damages would depend on the extent of her actual loss or prejudice. Therefore, if she enrolled in college on the strength of Uncle Rich's promise and committed herself to pay $40,000 for her first year's tuition, injustice might be averted only by full enforcement of the promise. However, say that Penny received a scholarship so that her annual tuition is only $10,000 and Penny is committed for only one year's tuition. Enforcement to the extent of $10,000 may be enough to prevent injustice. Although Penny, in a sense, may have relied on having the balance of $30,000 to pay for future years' tuition, the broken promise of future funding disappoints her expectation but does not constitute an actual out-of-pocket loss. The facts become more complicated if, in addition to committing herself for $10,000 tuition, she gave up a job to attend college, because her sacrificed earnings are also a reliance loss and should be taken into account in deciding her recovery. The court's ability to award reliance damages where full enforcement of the promise would be excessive gives the court the flexibility to avoid an "all or nothing" resolution. This allows some measure of relief to a promisee who can show losses resulting from reliance but cannot justify enforcement of the promise as if it was a contract.

Penny Less is not the only person to be disappointed by the breach of a promise to pay tuition. In *Conrad v. Fields*, 2007 WL 2106302 (Minn. App. 2007), Walter Fields, a wealthy man, encouraged his friend, Marjorie Conrad, to attend law school and promised to pay her tuition. Conrad enrolled in law school on the basis of this promise, giving up a job that paid her an annual salary of $45,000. Fields made a relatively small tuition payment immediately after Conrad entered law school but then claimed temporary financial difficulties and made no further payments. However, he did say that he would pay Conrad's tuition after she graduated and passed the bar. She did graduate and pass the bar, but Fields refused to pay. Conrad sued him on a theory of promissory estoppel for reimbursement of $87,314 that she had paid for her tuition. (She did not claim loss of the earnings.) The trial court found that all the elements of promissory estoppel were satisfied and awarded her the damages claimed. It concluded that Fields made the promise to Conrad intending her to rely on it. He knew that she would have to quit her job to attend law school and that she could not afford to pay for law school

herself. Conrad knew that Fields was wealthy and generous, and she trusted him. On the faith of his promise, she did stop working and enroll in law school. The court of appeals affirmed. Because Fields had told Conrad that his financial difficulties were temporary and that he would pay her tuition after she graduated, the court was not persuaded by his argument that Conrad was not justified in relying on his promise when she continued to incur tuition expenses after he stopped paying. The court also noted that the $87,314 was a reimbursement of actual reliance losses and was therefore an appropriate promissory estoppel award. It rejected Field's argument that Conrad suffered no real detriment because she received a valuable law degree: Although the degree was beneficial to her, her detriment was the debt that she incurred in acquiring it. Note that the $87,314 qualifies as reliance damages because it is an actual expense incurred in reliance on the promise. However, in this case, the reliance damages are in fact equivalent to Conrad's full expectation. If the situation had been different—say that Fields clearly repudiated his promise during Conrad's first year, and she sued him then—her actual reliance damages (her tuition payments up to the time of repudiation) would have been considerably less than her expectation damages. Under those circumstances, the court may have considered it appropriate to confine her recovery to that lesser amount.

§8.8 CHARITABLE PLEDGES AND PROMISSORY ESTOPPEL

Section 7.3.5 raises the sometimes difficult and subtle distinction between an act or promise that constitutes bargained-for exchange, and one that would merely be an incident of receiving the gift, or an undertaking to use the gift for the purposes for which it was given. Sometimes a court may resolve this ambiguity by finding that the promisee did suffer some detriment, so that the promise can be enforced as a contract. However, where there is no basis for finding consideration, the pledge or promise of a gift may still be enforced under the doctrine of promissory estoppel, provided that the donee can establish that the elements of promissory estoppel are satisfied.[4]

Allegheny College v. National Chautauqua County Bank, 159 N.E. 173 (N.Y. 1927), illustrates well the interplay between consideration doctrine and

promissory estoppel where a donee gives undertakings in return for a pledge. Mary Yates Johnston pledged $5,000 to be paid to the college on her death. The pledge required the money to be used to educate students preparing for the ministry. It also stipulated that the fund would be known as the "Mary Yates Johnston Memorial Fund." She paid $1,000 of this amount while she was alive, and the college set it aside for a scholarship fund as stipulated but did nothing further in reliance on the pledge. The donor repudiated the pledge before her death. After she died, the college sued her estate for the balance of the pledged amount. Judge Cardozo found that the college had given consideration for the pledge because the college, by accepting the $1,000, impliedly promised to memorialize the donor's name. (He did not rely on the college's implied promise to use the fund for the purpose stipulated, possibly because that seems too clearly to be a condition of the gift.) Because he found consideration for the promise, Judge Cardozo did not have to deal with promissory estoppel. However, he suggested in dictum that promissory estoppel could have been used as an alternative basis for enforcing the gift. It is clear from the opinion that the underlying motivation for the court's conclusion was its belief that the charitable pledge should be upheld as a matter of public policy. To get this result, the court strained to fit the facts into a theory of recovery, but those facts do not provide much support for either basis of relief. The legal detriment found by the court is quite flimsy, and it is difficult to see grounds for promissory estoppel. There is no indication that the donor reasonably intended to induce reliance until the money was paid out on her death, or that the college took any action in reliance on the pledge. The mere banking of the money cannot really be seen as the kind of detrimental reliance that would support a claim of promissory estoppel.

King v. Trustees of Boston University, 420 Mass. 52 (1995), also involved a transaction that could have been interpreted as a gift subject to conditions but that was enforced by the court under consideration theory and, in the alternative, under the theory of promissory estoppel. This case is discussed in connection with consideration doctrine in section 7.3.5. It is noted there that the court found that by undertaking to index and care for Dr. King's papers and to make them available to researchers, the university had given consideration for Dr. King's promise to transfer ownership of his papers. Although the court disposed of the case on consideration grounds, it also addressed the university's alternative claim based on promissory

estoppel. The court stressed that despite Restatement, Second, §90(2), it did require a charitable organization to show justifiable reliance for promissory estoppel relief. However, that reliance was apparent in the actions that the university took (indexing and taking care of the papers and making them available for research) beyond just retaining custody of the papers.

By contrast, in *Congregation Kadimah Toras-Moshe v. DeLeo*, 540 N.E.2d 691 (Mass. 1989), the court adopted a purely doctrinal approach. The donor had promised $25,000 to the synagogue. The synagogue planned to use the money to convert a storage room into a library to be named for the donor. However, there was no indication that the donor had attached any conditions to his promise or that the synagogue had promised to use the money for this purpose or to name the library for the donor. The donor died without paying, and the synagogue sued his estate. The court found no consideration because the synagogue had not made any promise or suffered any other detriment in exchange for the promise. It also found no basis for enforcing the donor's promise under the doctrine of promissory estoppel because the synagogue had not yet begun the renovation or taken any other action in reliance on the promise. It had merely allocated the fund to the library renovation in its budget, which was nothing more than an accounting entry with no prejudicial effect.

Because *Allegheny College* and *King* both found consideration, they fully enforced the promises as contracts. Had they not found consideration, but had given relief on the basis of promissory estoppel, the remedy may have been the same if the court decided that nothing short of full enforcement would prevent injustice. However, the court would have had the option of awarding the lesser relief of reimbursing reliance costs. For many courts, the lesser remedy is more appropriate unless the detriment to the promisee cannot be undone except by full enforcement. *Estate Timco v. Oral Roberts Evangelical Assn.*, 215 N.W.2d 750 (Mi. 1974) is an example of a case in which the court found full enforcement of the promise to be necessary to avert injustice. The court awarded judgment to the promisee for the balance of the price of a building where the promisor, as a member of the association's board, proposed and collaborated in the purchase and induced the association to buy the building by undertaking to pay the balance of the price.

§8.9 PROMISSORY ESTOPPEL AS A MEANS OF ENFORCING PROMISES MADE IN NEGOTIATIONS

Section 8.5 introduced the idea that promissory estoppel may sometimes provide relief for promises made during negotiations. It must be stressed that it is rarely appropriate to apply promissory estoppel to any statement made while the parties are working toward the formation of a contract. In most situations, negotiating parties understand or reasonably should understand that nothing said in negotiations is to be taken as a promise, and no commitment is made until a contract is formed. Even though a statement made during negotiations may sound like a promise, a reasonable party should normally realize that it is nothing more than an expression of intention or a proposal for a term that will become an undertaking in the contract if the negotiations culminate in final agreement. Therefore, if a party takes action on an apparent promise made during negotiations, the usual assumption, in the absence of clear understanding to the contrary, is that she bears the cost and risk of acting. For example, a buyer and seller are negotiating the sale of a business. They have agreed on the price of $10 million, but the buyer does not have enough cash to pay the price. He therefore suggests that the seller sell the business to him on credit, and that he will pay the price over a two-year period from profits gained from operating the business. After considering this proposal the seller tells the buyer that she will not give him credit for the full $10 million price, but if he can find an investor who can provide half the price, she will be amenable to a credit sale for the balance. The buyer makes great efforts to find an investor. In doing so he incurs considerable expense in researching prospects, seeking legal advice on how to set up the investment, and preparing materials to show potential investors. While he is in the process of doing this, the seller notifies him that she has found another buyer for the business and is terminating the negotiations. Because the parties had not yet concluded a contract, the buyer has no claim against the seller for breach of contract. He should not have a promissory estoppel claim either. In the negotiating phase, unless the seller has clearly committed to do so, the buyer is not usually justified in expecting that the seller will pay the buyer's expenses in trying to secure investors. Nor can the buyer use promissory estoppel to enforce the seller's nonbinding expression of intent to proceed with the sale if the buyer does find investors. Although it

may be reasonable, in a business sense, for the buyer to rely on this statement of intention by making efforts to find the financing, he should understand that in the absence of a contractual commitment, he bears the risk that he will incur expenses in trying to set up the deal and may not secure the contract in the end.

Although apparent promises during negotiations are not typically enforceable under the doctrine of promissory estoppel, there are some situations in which a party really does make a precontractual commitment on which the other party reasonably places compensable reliance. One of the best-known cases to apply promissory estoppel to uphold a promise made in the course of negotiations is *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267 (Wisc. 1965). Hoffman approached Red Owl to set him up with a Red Owl grocery store franchise. After reviewing and approving his proposed financial arrangements, Red Owl encouraged Hoffman to take a series of actions to prepare to open a store. Hoffman conscientiously followed Red Owl's guidance, incurring expenses in the process. After some considerable time, negotiations eventually collapsed, primarily because Red Owl had not been entirely straight with Hoffman about the financing of the business. The parties had not yet made a contract, and Red Owl had never expressly promised Hoffman that he would receive a franchise. Nevertheless, the court awarded Hoffman his wasted reliance expenses on the basis of promissory estoppel. (The court made it clear that relief was confined to the recovery of wasted expenses, and could not include any claim for lost profits.) The court found that Hoffman had placed faith in Red Owl's expertise and good faith, and it had been careless of his interests. Red Owl's indifference to Hoffman's welfare outweighed his naiveté in unquestioningly following its advice. *Hoffman* is distinguishable from the usual negotiation situation because Red Owl so strongly influenced Hoffman's actions that a relationship of trust was created that is not normally present where parties approach each other as adversaries in negotiations. Indeed, the underlying rationale of *Hoffman* and the more recent cases discussed below is that the promisor had violated a duty to bargain in good faith. These cases have an affinity with other cases on this principle that you will encounter in section 10.11.

Pop's Cones, Inc. v. Resorts International Hotel, Inc., 307 N.J. Super. 461 (1998), and *Carey v. FedEx Ground Package System, Inc.*, 321 F. Supp. 2d 902 (S.D. Ohio 2004), are more recent cases in which the dominant negotiating party was able to induce the other party's detrimental reliance on

its precontractual promises. In both cases, the court refused to grant the promisor's motion for summary judgment and allowed the promisee to proceed to trial on a claim of promissory estoppel. *Pop's Cones* involved negotiations for a lease. Pop's operated a frozen yogurt store in a town near Atlantic City. It entered into negotiations with Resorts International (RI) to move the store into RI's casino in Atlantic City. Pop's told RI on several occasions during their protracted negotiations that the time for it to renew the lease on its current premises was approaching. RI assured Pop's that it would obtain a lease in the casino and that completion of the transaction was no more than a formality. On the strength of that, Pop's gave up its current lease. In the end, RI failed to follow through with the transaction and negotiations terminated. Pop's sued RI for damages, and the court held, on the motion for summary judgment, that Pop's allegations made out a case for relief on grounds of promissory estoppel.

Carey is a mind-boggling example of a runaround that makes Red Owl's conduct seem mild by comparison. Carey had approached FedEx in January 2001 in the hope of acquiring a FedEx delivery route. For a period of almost two years, FedEx led him on with assurances that he would receive the route. Carey was in constant contact with FedEx. He followed its many suggestions and directions to qualify as a carrier, and was repeatedly told that he would get a route when it became available. During this period, FedEx induced Carey to buy a truck (which was ultimately repossessed because Carey could not afford payments on it without the income from a delivery route). In addition, to the knowledge of FedEx, Carey's wife gave up her job in reliance on the prospective extra income that Carey would earn once he had the route. When routes did become available, FedEx gave them to other drivers, while reassuring Carey that he was in line for the next route to become available. In the end, Carey never received the route and he sued FedEx on several theories[5] including promissory estoppel. The court denied summary judgment to FedEx on these claims. As to promissory estoppel, the court said that on the facts alleged, a jury could find that Carey had justifiably relied on FedEx's precontractual promise that he would get a route. The court stressed that relief would be confined to reimbursement for Carey's reasonable reliance losses, and would not cover any profits he might have lost as a result of not obtaining the route. Lost profits are contractual expectation damages, which would not be appropriately awarded for reliance on promises made at the stage of negotiations.

§8.10 PROMISSORY ESTOPPEL AND AT-WILL EMPLOYMENT AGREEMENTS

Employment is at will if either party can terminate the employment at any time for any reason (except for a reason, such as race or gender discrimination, that violates a statute or other law). The default rule under common law is that employment is at will unless the parties agree to employment for a definite term, or agree that employment cannot be terminated except for cause or following a specified period of notice.[6] At-will employment agreements present particular problems of both consideration and promissory estoppel during the period after the employment agreement has been made, but before the employee begins work. Even where employment has been offered and accepted, courts commonly hold that before the employment actually begins, there is no contract because consideration is absent.[7] They reason that since both parties have complete discretion to terminate an at-will employment agreement, neither party makes any future commitment.

In addition, many courts hold that the at-will nature of the prospective employment precludes promissory estoppel relief for the reimbursement of loss for actions taken in reliance on the promise to employ. Although it is readily apparent that an employee is likely to incur some detriment in reliance on a promise of at-will employment, such as leaving an existing job, moving to the location of the new job, or forgoing other opportunities, these courts hold that the employee must bear the risk of this reliance because he has no assurance of job security. *See*, for example, *Leonardi v. City of Hollywood*, 715 So. 2d 1007 (Fla. App. 1998).

Other courts—for example, the court in *Grouse v. Group Health Plan, Inc.*, 306 N.W.2d 114 (Minn. 1981)—find this approach unduly harsh and have been more sympathetic to the disappointed employee. In *Grouse*, a pharmacist gave notice to his current employer and declined another offer of employment on the strength of the health plan's promise of employment. Before he began work, the health plan withdrew its commitment to hire him. Although the court found that the pharmacist had no contractual cause of action because the employment could be terminated at will, the health plan had at least committed itself to allow the pharmacist an opportunity to begin, which induced him to take the detrimental action. He was therefore entitled to

promissory estoppel relief. In *Cocchiara v. Lithia Motors*, 297 P.3d 1277 (Or. 2013), a salesman who was a current at-will employee needed to change to a less stressful job for health reasons. On the strength of a promise by his employer that he would be given such a position, he turned down a job offer from another company. When the employer failed to give him the new job, he found a lower-paying job elsewhere and sued the employer in promissory estoppel for damages. (Although the employee was still employed by the employer at the time of the promise of a different job, the employer's promise was treated in the case as a promise of prospective at-will employment.) The Court of Appeals granted summary judgment to the employer on the grounds that a prospective employee could not reasonably have relied on a promise of at-will employment and, because he had no security of employment, could also not prove any damages. The Supreme Court reversed the summary judgment. It held that the mere fact that the promised job was for at-will employment does not mean that the employer would have fired the employee, so the at-will nature of the employment should not absolutely preclude promissory estoppel relief. The prospective employee should be allowed the opportunity to prove that his reliance on the promise of at-will employment was justifiable. He could do this if he can show, with a reasonable degree of certainty, that had he been allowed to start the job, he probably would not have been dismissed for a period of time.

Even where a court applies promissory estoppel in this context, the relief is likely to be modest. The employee would find it difficult to prove damages based on his expected salary because he could be terminated at will. (But *Cocchiara* noted that he should at least be given the opportunity to try to prove those damages with reasonable certainty.) Damages such as opportunity losses are usually difficult to prove, and damages for giving up the prior employment may be nonexistent if it was also at will. Therefore, relief is likely to be confined to actual out-of-pocket losses such as wasted moving expenses.

---

§8.11 RELIANCE ON AN OPTION WITHOUT CONSIDERATION: THE APPLICATION OF PROMISSORY ESTOPPEL TO PROMISES OF IRREVOCABILITY

We have already seen one situation in which reliance on a revocable offer has created an option: Section 4.12.5 explains how the commencement of a noninstantaneous performance creates an option in favor of the offeree when the offer is for a unilateral contract. (That is, the offer requires performance as the exclusive mode of acceptance.) Although no consideration was given for this option (and indeed, there may not even have been an express promise to keep the offer open), an option is created by law to protect the reliance of the offeree in beginning the combined act of acceptance and performance.

Quite apart from this type of case, the doctrine of promissory estoppel can sometimes be used to create an enforceable option, even though no consideration was given for the promise of irrevocability. The circumstances under which a court will uphold an option on the basis of promissory estoppel are narrow, because in most cases the absence of consideration for the promise of irrevocability means that the offeror should not reasonably be held to have induced reliance, and the offeree should not be treated as having relied justifiably on the promise. For example, the seller offers to sell her farm, Bleakacre, to the buyer for $2 million and undertakes to hold the offer open until Friday. The promise not to revoke the offer until Friday is not a binding option because the buyer has given no consideration for it. The buyer intends to accept the offer by Friday. On Tuesday, believing he still has time to accept, he quits his job in the city so that he can devote full attention to his new farm. On Wednesday, before the buyer has had the chance to communicate his acceptance, the seller revokes the offer. The buyer disregards the revocation and accepts the offer on Thursday morning. He asserts that the acceptance is effective because the seller could not revoke the offer. Although he gave no consideration for the promise not to revoke, he argues that it should be enforceable on grounds of promissory estoppel because he detrimentally relied on it. Restatement, Second, §87(2) recognizes the possibility of applying promissory estoppel in this kind of situation. It sets forth requirements modeled on §90. It states that an offer is binding as an option to the extent necessary to avoid injustice if the offeror “should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance.” Although he has suffered prejudice in reliance on the promise, the buyer will likely not succeed in satisfying the elements of §87(2) because he was probably not justified in quitting his job in reliance on a promise of irrevocability for which he had paid or given nothing.

The issue of applying promissory estoppel to create an option has come up periodically in cases involving subcontractor bids. Although there is some variation in the facts of these cases, this is their typical pattern: Reliant Contracting Co., a prime contractor, plans to bid on contract to build an apartment building for City Housing Corp. Reliant needs subcontractors to perform many aspects of the project, so on June 1 it calls for subcontractor bids for various parts of the work, to be submitted by June 15. One of the jobs to be subcontracted is the supply and installation of a central heating system. Several heating companies submit bids for this aspect of the construction. One of them, Lobidder Heating Co., submits a bid for $2.5 million on June 14. This is the lowest bid for the heating, and it is $200,000 less than the next lowest bid. On June 16, Reliant uses Lobidder's bid in formulating its own bid to City Housing. On June 25, Reliant is awarded the contract to build the building. On June 26, Lobidder discovers that it made an error in calculating its bid, which should really have been $2.9 million. On that same day, Lobidder tells Reliant of the error. It withdraws its bid and refuses to perform the work for less than $2.9 million. This places Reliant in a very difficult position. It is now committed to its contract price with City Housing, but it has to pay $200,000 more to the next highest bidder for the heating work. There are a few possible arguments that Reliant could make in claiming damages from Lobidder.

Breach of Contract Reliant might argue that Lobidder's bid was an offer, which Reliant accepted by using the bid in making its own bid. The problem with this argument is that even if Lobidder's bid was an offer, Reliant did not communicate acceptance of it before Lobidder revoked it. Communication of acceptance is required unless the offeror dispensed with it either expressly or by implication. In the absence of such a waiver of communication, use of the bid on its own is not enough to constitute acceptance.

Actual Option Reliant might argue that Lobidder impliedly promised that it would not revoke the bid until Reliant had a reasonable time to accept it after the award of the prime contract. The problem with this argument is, first, that there would need to be some factual basis to imply such a promise. Second, even if it could be implied, Reliant would have trouble showing that it gave Lobidder the consideration necessary to validate it. The best argument for consideration is that Reliant made an implied promise that if it used the bid, it

would be committed to accept it. However, Reliant probably did not consider itself bound by use of the bid, and unless usage or other circumstances show otherwise, it would be difficult to imply such a promise.

Promissory Estoppel The argument that has been most successful in cases like this is that although there is no contract or option, the promise to hold open the offer should be enforced under the doctrine of promissory estoppel, which, in effect, serves as a substitute for consideration in creating an enforceable option. To enforce the option under promissory estoppel, Reliant must establish that all of its elements are satisfied: First, Lobidder must have made a promise. There is no express promise here, but all the circumstances could give rise to an implied promise by Lobidder to keep its bid open for a reasonable time to enable Reliant to accept it expeditiously as soon as it is awarded the construction contract. Second, Lobidder must reasonably have expected that Reliant would rely on its promise. Reasonable expectations are based on the entire context in which the promise was made, including not only the language and apparent firmness of the promise but also the prevailing practices in the industry and any prior relationship that the parties may have had. Reliant must establish that, under all these circumstances, a reasonable person in Lobidder's position would have realized that Reliant might rely on its bid in formulating the bid to City Housing. Third, Reliant must have relied justifiably on this promise. This requirement not only examines the question of whether there were reasonable grounds for Reliant to believe that a serious promise was made and could be relied on but also requires consideration of the nature and justification of the action taken in reliance. It precludes recovery if Reliance reasonably should have realized, in comparing Lobidder's bid with others, that Lobidder likely made an error. Fourth, enforcement of the promise must be necessary to avoid injustice. This element is usually satisfied if all the other elements are present and the prime contractor suffers the significant detriment of being bound to the owner for a price based on the subcontractor's bid. However, it also takes other equities into account, such as whether Reliant acted in good faith in accepting the bid as soon as possible, and did not try to speculate at Lobidder's expense, say, by bid shopping (that is, using the bid to shop around for a lower bid from competing subcontractors).

If all these elements are satisfied, the remedy is the enforcement of the promise not to revoke the offer. Because the offer is treated as a valid option,

Lobidder's attempt to revoke failed. Reliant is therefore still able to accept the bid, even after Lobidder's attempted revocation on June 26. However, Reliant must actually take the step of accepting the offer, and must do so within a reasonable time after June 26. It may sound pointless to accept an offer after the offeror has made it clear that it will not perform at the bid price, but the formal act of acceptance is legally required to create a contract for the performance of the work at the price bid. If Reliant does not accept within a reasonable time, its claim for damages will fail because promissory estoppel is used here only to validate the option—it does not validate the underlying contract, which must be created by acceptance of the offer. As noted above, if Reliant delays beyond a reasonable time in accepting, or if it acts in bad faith by bid shopping, it will not benefit from the option that was created by promissory estoppel.

Two famous cases, separated in time by about 25 years, are usually used to contrast the differing approaches that courts may take in resolving a situation like this. The facts of the cases were similar to those outlined above, and in both the courts found that there was no basis for finding an accepted offer and no consideration for a valid option. They differed on the propriety of using promissory estoppel to validate the option. In *James Baird Co. v. Gimbel Bros., Inc.*, 64 F.2d 344 (2d Cir. 1933), the court refused to adopt a promissory estoppel theory to make the subcontractor's bid irrevocable. In part, this approach can be explained by the fact that the promissory estoppel doctrine was much less developed at the time and had been largely confined to situations in which a donee had taken action in reliance on a promise to make a gift. The court was reluctant to extend it to the commercial context. However, even if it was appropriate to use the doctrine in a commercial case, the court felt that the contractor was not justified in relying on an unaccepted offer. If it wanted to bind the offeree to the offer, it should have purchased an option. As it did not do this, it assumed the risk of committing itself before securing its subcontract.

By contrast, in *Drennan v. Star Paving*, 333 P.2d 757 (Cal. 1958), the court did apply promissory estoppel doctrine to hold the subcontractor to an implied promise not to revoke its bid. The court saw no reason to confine the doctrine to donative promises, but recognized the protection of justifiable reliance as a general value of the law. (This position has since become well accepted.) The court saw the creation of an option in this situation as analogous to the legal recognition of an option to protect an offeree who

begins to accept a unilateral offer by commencing a noninstantaneous performance. (*See* section 4.12.5.) The court held that in the commercial context, the subcontractor must have understood that the prime contractor might use its bid in calculating the bid for the prime contract. The prime contractor did rely justifiably on the bid. The discrepancy between the bid of this subcontractor and others did not alert the prime contractor to the possibility of a mistake. The court made it clear that the doctrine should be applied carefully and selectively in the precontractual context because promises are not normally made during negotiations prior to making a contract, and a party is not normally justified in acting in reliance until the contract is concluded. The court also stressed that the prime contractor must attempt to accept the bid within a reasonable time of being awarded the prime contract.

There are a number of more recent decisions that have followed the approach in *Drennan.* In *Pavel Enterprises, Inc. v. A.S. Johnson & Co., Inc.*, 674 A.2d 521 (Md. App. 1996), the court accepted that where usage creates an expectation that a general contractor will rely on a subcontractor's bid in formulating its own bid, promissory estoppel can be used to validate the option without consideration. The court stressed that the general contractor must behave fairly to merit the protection of promissory estoppel. Any manipulation such as bid shopping[8] will defeat reasonable reliance. In *Deide Construction v. Monterey Mechanical Co.*, 22 Cal. Rptr. 3d 763 (Cal. App. 2005), the court of appeals found the doctrine of promissory estoppel to be applicable where the prime contractor had committed itself to the property owner on the basis of the subcontractor's bid. The trial court had held that when the prime contractor discovered the error in the subcontractor's bid, it should have asked the owner to release it from its contract. The court of appeals disagreed. It would be unjust to require the prime contractor to sacrifice its profit and reputation. However, because the variance between the bids of the subcontractor and its next lowest competitor was $425,000, the court remanded the case for a determination of whether the prime contractor was reasonable in relying on such a low bid. In *I&R Mechanical, Inc. v. Hazelton Mfg. Co.*, 817 N.E.2d 799 (Mass. App. 2004), the court found that the elements of promissory estoppel were not satisfied. Applying offer and acceptance principles, the court found that the subcontractor's bid did not amount to an offer, but merely solicited an offer from the prime contractor. This in itself precluded the use of promissory estoppel because there was no

promise. Even if promissory estoppel was applicable, the discrepancy between the subcontractor's price and other bids was so great that it should have alerted the contractor to an error. In addition, the contractor had also engaged in bid shopping, which was inequitable and indicated that it was not relying on the bid.

---

§8.12 A TRANSNATIONAL PERSPECTIVE ON PROMISSORY ESTOPPEL

Because civilian legal systems do not require consideration for contract formation, they have no need for a doctrine like promissory estoppel to enforce promises that lack consideration. However, there may be other reasons why a promise does not qualify as contractual, so an equivalent doctrine does have some role to play. In civilian jurisdictions, this doctrine does not derive from equitable estoppel. As explained in section 2.5, the distinction between law and equity is peculiar to the common law and has its origins in the particular historical circumstances under which English courts developed. Nevertheless, civil law recognizes a principle similar to estoppel under which a person is held accountable for conduct and cannot claim to enforce a right that is asserted in contradiction of that conduct. Under this principle, detrimental reliance on a promise can give rise to liability to honor the promise.

Although neither the CISG nor the UNIDROIT Principles articulate a general doctrine of detrimental reliance, equivalent to Restatement, Second, §90, they do contain a number of provisions that protect reliance on conduct or promise in specific situations. For example, CISG Article 16(2)(b) makes an offer irrevocable if the offeree acted in reasonable reliance on its irrevocability. Article 2.1.4(2)(b) of the UNIDROIT Principles is to the same effect. CISG Article 29 provides that where a contract has a provision requiring modifications to be in writing, a party is precluded from enforcing that provision where its conduct led the other party to reasonably rely on the effectiveness of an oral modification. Article 2.1.15 of the UNIDROIT Principles recognizes a principle similar to that articulated in *Hoffman v. Red Owl Stores* (*see* section 8.9) by providing that a party may be held liable for losses resulting from the bad faith termination of negotiations.

Examples

1. Aunt Jenny Rouse was very fond of her nephew, Juan El. After Juan graduated from college, he took a job as a sales representative. He earned well, but did not think of this as a permanent career. He really wanted to become a lawyer. Juan told Aunt Jenny that he wanted to quit his job and go to law school, but he was worried about the huge debt that he would have to incur to pay tuition and living expenses for the three years. During this conversation, Aunt Jenny was very sympathetic and told Juan that she wanted to think about what she could do to help. About a week later, Aunt Jenny wrote a letter to Juan in which she said, "I have been thinking about your ambition to become a lawyer and would love to see you achieve what you want. I realize that you will not be able to work while studying and that the cost of a legal education is high. Therefore, if you do decide to go to law school, I will give you $20,000 toward your first-year tuition and living expenses, which I will pay to you when you begin law school."

   After receiving this letter, Juan immediately applied for admission to law school, paying the required nonrefundable $100 application fee. In April he was offered admission for the next academic year, beginning at the end of August. Juan told Aunt Jenny about the offer and said he was going to accept it. She was delighted and reaffirmed her intention to pay him $20,000 when he began school. A week later, Juan accepted the law school's offer and paid a nonrefundable $500 deposit. He planned to work until the end of July, and did not yet resign from his job. In May, Aunt Jenny died. In June, the executor of Aunt Jenny's estate told Juan that because Aunt Jenny's promise of $20,000 was gratuitous, the estate would not honor it. Notwithstanding, Juan quit his job in July and entered law school at the end of August. He then sued the estate to enforce the promise. Will he likely succeed?

2. Faith Reliance owns a motorbike, which she has kept comprehensively insured. However, she recently lost her job and cannot afford to pay the insurance premium due on August 1. On July 20, she asked her father to help her by paying the premium. He agreed and took the policy renewal notice from her, promising to pay it the next day. Sadly, it is well known in the family that Faith's father is a big talker, but he almost never does what he promises. True to form, he did not pay the premium on July 21

and Faith received a final warning from the insurer on July 25 that the policy would lapse if the premium was not paid by August 1. When she showed it to her father, he apologized for forgetting to pay it and assured her that he would mail the check to the insurer the next morning. Hearing nothing further from the insurer, Faith assumed that matters had been taken care of. A couple of weeks later, the bike was stolen. Faith then discovered that her father had never paid the premium. Can Faith recover anything from her father? If so, what is she entitled to claim?

3. Bo Vine owned a large ranch. His only daughter, Justine, was a tenured law professor at a law school in a distant city. Bo's wife died some years ago, and Bo had lived alone on the ranch since then. As Bo got older, he developed health problems and found it difficult to manage the ranch, so he suggested to Justine that she give up her job as a law professor and come to live on the ranch so that she could take over its management. Justine was reluctant to give up her interesting and challenging career and a secure job that paid her a good salary. However, she was concerned about Bo's health and his increasing inability to cope with the farm. She therefore had a conversation with Bo in which she expressed her dilemma. Bo told her that if she came to help him with the ranch, she could live with him in the ranch house, and he would pay her a modest monthly salary (much less than she was earning as a law professor). He also told her that she should not worry about her long-term financial security because he would, in due course, give her ownership of the ranch, worth several million dollars.

   As a result of this conversation, Justine resigned from her tenured professorship and moved to the ranch. The arrangement did not work. Almost from the start, Bo and Justine clashed on every issue relating to the management of the ranch. After a particularly ugly dispute, three months after Justine had moved to the ranch, Bo fired her. Justine returned to the city but could not recover her former tenured position at the law school. She sought a job as a lawyer in practice, but the market was tight, and her lack of practical experience made her an unattractive candidate. As if this was not depressing enough, she then discovered that Bo had donated the ranch to a charitable foundation.

   As a former law professor, Justine realized that she had slim prospects of winning a suit claiming the ranch or its value—Bo's promise to transfer the ranch to her was quite vague and was also most

likely unenforceable under the statute of frauds, which requires contracts for the transfer of real property to be in writing. However, she did sue Bo for damages based on the earnings she lost as a result of giving up her tenured law professorship. Does this suit have a better chance of success?

4. Since graduating from the Elmo Mater College a few years ago, Al Lumnis has been very successful in business. Toward the end of the financial year, he decided to share a little of his wealth with his old college. As he thought back to his days on campus, he remembered how difficult it had been to find a good cup of coffee. The bilge in the cafeteria was undrinkable, and the closest source of espresso was ten blocks away. He therefore decided that his gift to the college would be a fully equipped espresso bar. He wrote a letter to the president in which he stated, "In consideration of my desire to enhance and ennoble the quality of campus life at the Elmo Mater College, I hereby pledge to the College the sum of $40,000, to be paid as soon as the College submits plans to me for the construction of a fully equipped espresso bar in the Student Union building. The bar shall be known as the 'Al Lumnis Mochamorial.'"

   The president of the college wrote back, thanking Al for the pledge and undertaking to begin work immediately on planning the coffee bar. The president appointed a joint faculty-student committee to consult with architects. She also instructed the editor of the alumni magazine to prepare a flattering article on Al and his gift for the next edition of the magazine.

   It is now a couple of weeks later. The committee has met a few times and has had one consultation with an architect. Copy has been written for the magazine which has not yet been published. The president has just received another letter from Al which states, "My offer to fund an espresso bar was a bad idea. The trouble with kids today is that life is too easy. My character was built by trudging through the snow to get my cappuccino. This hardship gave me the resilience to succeed in business. Please disregard my last letter. I withdraw my pledge."

   Can the College hold Al to his pledge?

5. Chilly Winters lives in Rustburg, a cold and congested northern city.

Sonny Climes, his college roommate, moved south a few years ago and lives in Tropicana, a balmy southwestern metropolis. Sonny had established a flourishing high-tech business and often told Chilly that if he ever decided to escape the snow and smog, a job would be waiting for him at Sonny's company. After suffering through a particularly harsh winter, Chilly decided that it was time to move south. He called Sonny and asked if a job was still available. Sonny responded, "You bet! Get down here as soon as you can and I'll put you to work. I can start you off as a trainee at a salary of $40,000 a year. Your salary will increase as you become more experienced and assume more responsibility." Chilly agreed and told Sonny that he would give notice to his present employer and would be in Tropicana in a month.

Chilly immediately gave notice to his employer and his landlord and bought a one-way air ticket to Tropicana. When he called Sonny a week later to tell him his exact time of arrival, he received an unpleasant surprise. Sonny told him that he had just received an offer for the sale of his business that was too good to resist. He had accepted it and planned to retire. He was sorry, but he could no longer employ Chilly.

Having lost his employment opportunity in Tropicana, Chilly decided to remain in Rustburg. He tried to retract his notice to his employer and his landlord, but his employer had already hired a replacement and his apartment had been relet. Chilly found a new apartment at a higher rental. After two months searching, he found a new job that paid the same salary as the old one. He cannot obtain a refund of his airfare, but airline policy allows him to cancel his booking and to use the ticket for travel within the United States at any time within the next year.

What recourse, if any, does Chilly have against Sonny?

6. In August, Primo Contracting Co., a building contractor, was invited by a developer to submit a bid for the construction of a new building. Primo was given until September 15 to submit the bid. To produce an accurate bid, Primo needed to know what it would have to pay plumbers, electricians, and other specialists to whom work would be subcontracted. On September 1, Primo sent the building specifications to a number of potential subcontractors and invited them to submit bids by September 13, explaining that it required the bids by that time to enable it to submit its own bid for the whole project on time.

Lois Bidder was one of the electricians invited to bid on the electrical work. After studying the specifications, Lois calculated the amount of material and labor required and submitted a written bid to Primo for $100,000. The bid stated: “This bid is open for your acceptance within a reasonable time after you have been awarded the prime contract.”

Upon receiving the bid on September 13, Primo compared it to others received and saw that it was $20,000 cheaper than the next lowest bid. It therefore decided to use Lois for the electrical work and included her figure in the bid to the owner. Primo submitted its bid on September 14, and the owner accepted it on September 15.

Primo immediately prepared letters to all the selected subcontractors, notifying them that their bids had been successful and that the project would proceed. On September 16, just before the letters were mailed, Primo received a fax from Lois, stating that on checking her calculations after submitting her bid, she had discovered that she had mistakenly overlooked the cost of some of the materials that would be required. As a result, she had underestimated her costs by $30,000, and she could not profitably perform the work for the bid price. Lois apologized for the error, which resulted from having to get her bid ready in a rush, and regretted that she must withdraw her previous bid. She was willing, however, to perform the work for $130,000.

On September 16, Primo faxed back, informing Lois that it had already committed to the owner on the basis of electrical subcontracting costs of $100,000 and it considered Lois bound by her original bid. Immediately after sending the fax, Primo mailed the letter of acceptance to Lois.

Is Lois bound to Primo by her bid?

Explanations

1. Aunt Jenny undoubtedly made a promise to Juan. The promise was expressed clearly and definitely in writing after Aunt Jenny had time to think about it carefully, but Juan would be hard-pressed to argue that he entered a contract with Aunt Jenny because he gave no consideration for the promise. Quitting a job and enrolling in law school could qualify as a detriment for consideration purposes, but Juan made no promise to do this, and it was therefore not bargained for in exchange for Aunt Jenny’s

promise. Although Aunt Jenny's promised performance was conditional on Juan going to law school, this is more properly interpreted as a condition of the gift.

If Aunt Jenny's promise was gratuitous, Juan's only basis for relief is promissory estoppel. Judged on an objective standard, Aunt Jenny, in making a clear promise, must reasonably have expected that it would induce Juan's reliance. This expectation is reinforced by her reaffirmation of the promise when Juan told her he had been offered admission to law school. The more difficult question is whether Juan's conduct was induced by the promise and was justifiable. The fact of inducement and the justification for inducement tend to flow together on these facts. In deciding on whether these elements are satisfied, we have to consider separately each action taken by Juan after the promise, because he may have taken some, but not others in justifiable reliance on the promise. Juan's actions before Aunt Jenny's death—his application to law school, his acceptance of the law school's offer of admission, and his payment of the nonrefundable fee and the deposit—are causally linked to the promise and are justifiable. Aunt Jenny's promise was clear, carefully considered, and reaffirmed before Juan accepted the law school's offer. He had no reason to doubt that he could take the action that the letter encouraged.

Juan's further action—resigning from his job at the end of July and entering law school at the end of August—were taken after Aunt Jenny had died and her executor had made it clear that the estate would not honor her promise. If Aunt Jenny's promise was not binding because it was gratuitous, the estate had the legal right to refuse payment, thereby breaking the causal link between the promise and Juan's actions, and removing his justification for relying on the promise.

This being so, his claim for promissory estoppel should be confined to the detriment incurred before Aunt Jenny died. At that stage, Juan had done nothing more than complete the law school application process and pay the fee and deposit. Nothing in the facts indicates that he was committed to the law school beyond the forfeiture of the nonrefundable fee and deposit. However, on the facts of this case, even these expenses may not be recoverable because Juan did ultimately enroll in law school, and they were therefore not wasted. True, he lost the hope and expectation of receiving help toward his tuition, but this is in the nature

of an expectation interest, more properly confined to a case in which a contract is established. Given that Juan incurred only a modest financial expense and could have avoided any further economic detriment, this does not seem to be a case in which injustice can be averted only by enforcing the promise to its full extent. (It is conceivable that a court that treats promissory estoppel as a consideration substitute may take a different view. That is, it could hold that Aunt Jenny became contractually bound to pay the $20,000 once Juan took action in reliance on her promise by accepting the offer of admission. On this theory, a contract was formed at that time, and the estate's subsequent action in reneging on the promise is merely a breach of that contract.)

This Example is inspired by *Alden v. Presley*, 637 S.W.2d. 862 (Tenn. 1982). The Presley in this case was none other than the King and the plaintiff was his fiancée's mother. When the plaintiff decided to divorce her husband, Elvis undertook to pay the expenses of her divorce, to pay out her husband's share of their house, and to pay off the mortgage so she would own the house free and clear. Elvis died after the divorce proceedings had begun, but before the divorce settlement had become legally binding. His estate notified the plaintiff that it would not honor Elvis's promise to pay off the mortgage. Notwithstanding, the plaintiff committed herself to the divorce settlement that released her husband from the mortgage. The court refused to enforce the promise to pay off the mortgage. It was gratuitous, so it was not a contract. It was also not enforceable on grounds of promissory estoppel because the plaintiff was no longer justified in finalizing the settlement in reliance on the promise once she knew that the estate would not honor it.

2. Faith gave no consideration for her father's undertaking to pay the premium. It was simply a gift promise motivated by family relationship and cannot be enforced as a contract. Promissory estoppel was developed to provide a basis for enforcing this kind of gratuitous promise, relied on by the promisee to her detriment.

   Are the elements of promissory estoppel satisfied? Whether or not Faith's father subjectively intended to honor his undertaking, his words, interpreted objectively, convey a clear commitment to pay the premium. There can be little doubt that he did or reasonably should have expected Faith to rely on it. It was an unequivocal response to her need for financial assistance, made with knowledge of her circumstances and

reiterated when the cancellation warning was received.

The promise apparently induced forbearance on Faith's part in that she did not pay the premium herself. There is a suggestion that financial difficulty may have compelled Faith to let the comprehensive coverage lapse had her father not undertaken to help. If that is so, it can be argued that she did not forbear in reliance on the promise because she did not have the financial ability to take the action of renewing the policy. However, we cannot be sure of this. She may have been able to find the money to pay the premium by some other means.

Faith's reliance must have been justified. A daughter would usually be justified in relying on her father's clear and unequivocal promise, made with apparently serious intent. However, she knew that her father had a record of breaking his promises, which was reinforced by his initial failure to pay the premium. This could mean that Faith may not have been entirely justified in relying unquestioningly on his word without checking to see if he had made the payment. This point was made in the *Norton* case mentioned in sections 8.6.2 and 8.6.4. While blind faith on the promise of a person known to be unreliable may weaken the promisee's case, it may not be fatal. After all, the promisor is not likely to motivate a court to balance the equities in his favor by arguing, in effect, that although he made a promise, he should not be held to it because he is untrustworthy.

Although Faith may have difficulty establishing the elements of promissory estoppel, if they are satisfied the remaining task is to select the proper remedy. There are no wasted out-of-pocket costs in this case, so reimbursement of reliance expenses is not a meaningful alternative. Full enforcement of the promise could mean either rather small damages based on the cost of the unpaid premium (this would be direct damages —the value of the performance itself) or a larger damage award based on the loss of the bike (this would be consequential damages—the consequent loss resulting from the failure to honor the promise).[9] Damages confined to the value of the promised premium would undercompensate Faith, so if full contract-like enforcement of the promise is to be awarded, the value of the lost bike would be the more appropriate measure. To decide if the full recovery of the value of the bike is appropriate, the court must weigh all the equities. It must consider the extent to which the elements of promissory estoppel have

been established (here, a strong and unequivocal, albeit oral, promise, but a possibly unjustified reliance). It must also balance the harm Faith will suffer if it refuses enforcement against the hardship to her father if it enforces the promise. It is difficult to predict how a court may strike this balance, but the equities seem to tilt in Faith's favor, so the court could well hold her father liable for the value of the bike.

3. By stating that Justine decided that it was best not to sue for enforcement of Bo's promise, the Example directs you away from the question of whether Justine could seek expectation relief, either in contract or based on promissory estoppel, and calls on you to focus on whether she can establish the elements of promissory estoppel and recover reliance damages.

   The facts suggest that she does have a good prospect of satisfying the elements of promissory estoppel. Bo did promise to transfer the ranch to her. He did not say when he would do it, so the exact terms of his promise are somewhat indefinite but not so uncertain as to preclude this from being a promise for purposes of promissory estoppel. He made the promise in the reasonable (and actual) realization that the promise of long-term financial security was an important incentive to Justine giving up a secure and lucrative career. Although Justine's decision to move to the ranch was partly motivated by her concern for Bo, it is clear that promise of the ranch played a crucial role in inducing Justine to resign and move to the ranch. Her reliance appears to have been justifiable. Bo manifested a serious intent to transfer the ranch to Justine, his only daughter and closest living relative, who would probably have inherited it on his death. Although it turned out that Bo and Justine could not live or work together in harmony, there is no indication in the facts of a history of conflict or temperamental behavior by Bo, which might have made Justine wary of trusting Bo's promise. Justine has suffered a tangible economic detriment (loss of earnings) in reliance on the promise. Therefore, awarding her reliance damages, measured by the value of her lost income, sounds like the appropriate remedy to do justice. Unlike out-of-pocket reliance expenses, lost income (and other lost opportunity damages) can be difficult to prove. Had Justine been an at-will employee, she may not have been able to prove damages at all because an at-will employee cannot establish that she would have kept her job had she not resigned. However, Justine was tenured, so she does

not have that problem. Nevertheless, she will only be entitled to those lost earnings in excess of what she earned from Bo and what she eventually earns from other employment. Also, the period for which she can recover damages will be limited by her earnings from new employment that she eventually obtains or should reasonably obtain.

This Example is based on *Bouton v. Byers*, 321 P.3d 780 (Kan. App. 2014), in which Bouton, the daughter, sued Byers, her father, for earnings that she lost when she resigned from her position as a tenured law professor to move onto his ranch and help him run it. To allay Bouton's concerns about giving up a secure and well-paying job to move to the ranch, Byers told her that he would bequeath the ranch, worth more than a million dollars, to her. Bouton moved to the ranch and helped run it for a small salary, but the parties' relationship eventually broke down, and Byers fired Bouton. He thereafter sold the ranch. Bouton then sued Byers in promissory estoppel for damages based on what she would have earned as a law professor had she not resigned. The trial court granted summary judgment in favor of Byers, principally because it held that Bouton, as a law professor, was not justified in relying on an oral, informal promise to bequeath the ranch to her. As a law professor, she should have insisted on a legally enforceable written agreement to transfer the land. The court of appeals reversed the summary judgment on the grounds that the trial court was wrong in summarily disposing of the question of justifiable reliance, which was a factual question for a jury to decide. Although Bouton's legal training was a relevant factor, so was the fact that this was a family transaction, in which she may have been less inclined to insist on legal formalities. The court indicated that Bouton had made out a prima facie case for promissory estoppel relief and must be allowed to proceed to trial.

4. Again, this problem treads that uncertain line between a promise with consideration and a gift made subject to instructions for its use, but it more likely falls on the latter side of the line. The recited "consideration" is not consideration at all but merely expresses Al's purpose in giving the donation. Although the president replies by promising to use the fund for this purpose, as a matter of strict doctrine, the college suffers no legal detriment in undertaking to use a gift for its designated purpose. It had no right to the money in the absence of the

gift, and hence gives up no legal right by promising to use it in a particular way. The publication of the flattering article in the alumni magazine could have been consideration, had it been bargained for in exchange for the promise. However, Al's letter does not mention the article or any other form of recognition, apart from the naming of the espresso bar. The naming of the bar could itself be consideration because the naming may be far enough removed from the actual use of the funds to be a detriment. This is quite flimsy but may provide a means of finding consideration for a court sympathetic to the college's claim.

This Example raises the different approaches to these ambiguous transactions raised in section 8.8, where *Allegheny College* and *King* found a basis of enforcement either under consideration doctrine or on grounds of promissory estoppel, while *DeLeo* did not. The facts here seem more strongly to point to some degree of reliance than those in *DeLeo* or even *Allegheny College.* Al stipulated that the planning must occur before payment, and the college did begin the planning process in reliance on the promise. However, the reliance had not extended beyond this by the time that Al revoked his promise. This leads to the question of remedy.

Although the court could fully enforce Al's promise to pay the $40,000 under promissory estoppel, it also has the option of providing lesser relief aimed at reimbursing the college's reliance costs. The college should at least be able to recover the fee paid to the architect. It could possibly also receive reimbursement for the value of the time spent by committee members in planning (to the extent that the time of faculty and students has any value at all).[10] If it was reasonably foreseeable that the donation would generate an article in the alumni magazine, the cost of the wasted production effort may also be claimable. Even if all these expenses are awarded, this recovery cannot be more than a fraction of the $40,000 promised.

5. Although the parties were friends at the time of contracting, this is a purely commercial transaction. Sonny appears to have made an offer to Chilly which he accepted. The offer could have been fuller and more precise in setting out the terms of the employment, but there is probably enough specificity to avoid problems of indefiniteness. The agreement does not provide otherwise, so the employment is deemed to be at will,

as explained in section 8.10. As noted there, it can be difficult to persuade a court that there is consideration for a promise of at-will employment, even after offer and acceptance have occurred. A court may find that consideration is lacking as a result of the parties' discretion to terminate at will. Even if consideration is found, expectation damages are likely to be small where the employer has the right to terminate the employment at will.

In the absence of a viable claim on contract, the question is whether promissory estoppel would be a more advantageous basis of recovery. Sonny did promise Chilly a job. His intent was clearly expressed, and because Chilly told him that he was going to quit his job and move, he must have realized that Chilly planned to act in reliance on the promise. Chilly did rely on the promise, but the difficult question is whether this reliance was justified. As discussed in section 8.10, some courts hold that while it may be rational for a promisee to take detrimental action in reliance on a promise of at-will employment, this action does not provide grounds for actionable reliance for promissory estoppel purposes. That is, the employee cannot shift the risk of his reliance to the employer, because he should understand that he is incurring loss or expense without any promise of job security. Other courts consider this approach too harsh, and are willing to give relief, especially where the promise and intent to induce reliance are clear and there are no specific facts that would make the reliance unreasonable.

However, even if the court grants relief, it is likely to be limited. Chilly could possibly recover the two months' lost salary, but only if he had some security of employment at his old job. If he was an at-will employee in that job, he may not be able to show that loss with reasonable certainty. In addition, Chilly's delay in finding a replacement job would have to be reasonable. If he did not make a reasonably diligent effort in seeking new employment, he cannot hold Sonny accountable for loss that he could have prevented. (This is the principle of mitigation of damages, discussed in section 18.6.3.) Chilly may also be able to claim any increase in rent as a result of having ended his apartment lease in reliance on the promise. Again, he would have to show that he would have had a right to retain his old apartment and that the substitute was reasonable. Chilly might have been able to claim the wasted expense of the air ticket, but because the ticket is salvageable, he

has probably not suffered a loss unless he can show that it would not be possible for him to use it within the year or to sell it.

6. By soliciting bids, Primo was inviting subcontractors to make offers. The language used by Lois in her bid creates the reasonable understanding that she intended it as an offer with a promise of irrevocability for a reasonable time after the prime contract was awarded. The undertaking not to revoke does not bind Lois, however, because she received no consideration for it. (There could have been consideration if Primo had bound itself, expressly or impliedly, to use the lowest bid, but there is no indication of such a commitment.) Although Primo used Lois's offer in calculating its own bid, there is no evidence of circumstances that would make this an acceptance of the offer. Lois revoked the offer before Primo had the chance to communicate its acceptance, and there is no indication in the bid that Lois waived communication of acceptance. Because there is no consideration to validate the promise not to revoke, Primo can hold Lois to her promise of irrevocability only if it can validate that promise on grounds of promissory estoppel. As the discussion in section 8.11 indicates, the availability of promissory estoppel in this context is now well established.

   The question is therefore whether the facts satisfy the elements of promissory estoppel. Lois made an express promise of irrevocability, so the element of promise is easily established. It is likely that this promise was made with the reasonable understanding that Primo would rely on it if Primo used Lois's bid. In *Drennan*, the court emphasized that the expectation of reliance is a factual question, to be decided under all the circumstances, including common practice in the industry. We do not have any information about industry practice. If it is a general practice in the industry for subcontractors to protect contractors who use their bids as the basis of bidding on prime contracts, there is a strong likelihood of a reasonable expectation of reliance. Even in the absence of such a clear practice, the language Lois used in her bid suggests a reasonable expectation of reliance—it recognizes that her bid might be used and that Primo needed time to accept after it was awarded the contract.

   There are two factors to be considered in deciding whether Primo's reliance was justified. First, was Primo reasonable in understanding that a promise was made on which it could rely? This question parallels the

above analysis, now examined from the perspective of a reasonable person in Primo's position, and there is no reason to reach a different answer. Second, should Primo have suspected an error when it saw that there was a $20,000 discrepancy between Lois's price and the next lowest bid? Even if it did not know for sure that Lois must have made a mistake, it had a duty to enquire if the low price looked wrong, and it cannot just jump at the bargain. Of course, there could be many explanations for variations in price, so the question is whether, under all the circumstances, Primo was reasonable in not questioning it.

Promissory estoppel relief must be necessary to prevent injustice. This element calls on the court to weigh all the equities of the situation, including the strength of the elements discussed above. A predominant issue here is the degree of detriment that will be suffered by Primo if the promise to hold the offer open is not enforced. As in most of the bid cases, this detriment is an increase in the costs of the job and a corresponding loss of profit. The more dramatic this loss is, and the fewer the reasonable alternatives for averting it, the stronger the injustice. Other factors also enter the determination of injustice. Several of the cases discussed in section 8.11 examined the conduct of the prime contractor in the way it used the bid. An unreasonable delay in acceptance after the award of the prime contract, or any kind of manipulation such as bid shopping, could tip the balance against the grant of relief. In this case, Primo was not guilty of any such misconduct. It accepted the bid the day after being awarded the prime contract and just three days after the bid was submitted.

The appropriate remedy in a case like this is to enforce the promise to keep the bid open so that Primo's acceptance is effective, even though it was made after attempted revocation. Because the acceptance is effective, a contract was created. If Lois failed to perform it, Primo can claim damages measured by the difference between Lois's price and the higher price that Primo reasonably had to pay to another subcontractor for the work.

---

1. A statute of limitations specifies the period within which a person must commence suit on a claim. If suit is not initiated within that period, it is barred.

2. As mentioned in section 1.2.4 and discussed more fully in section 18.10, expectation damages are the usual form of relief for breach of contract. In some situations, it is possible for the victim of a breach to obtain the relief of specific performance—a court order compelling the breacher to perform. However, courts do not award specific performance as a matter of course, and confine that relief to situations where the equities favor it and an award of damages would not adequately compensate for the breach.

3. As mentioned in section 8.3, an order of specific performance is a form of expectation relief under which the court orders the breaching party to render the performance promised under the contract.
4. As stated in section 8.6.4, most courts require all the elements, including justifiable reliance, to be satisfied even where the gift is a charitable gift. They have not adopted the approach of Restatement, Second, §90(2), which treats a charitable pledge as binding even in the absence of reliance.
5. It is worth mentioning the other causes of action because they add to the sense of bad faith dealing and show why this case, like *Hoffman*, is concerned with the duty to bargain in good faith. One of the causes of action was race discrimination. Carey was African American, and the facts suggested that FedEx's actions in giving other drivers routes before Carey could have been racially motivated. The other was fraud. There were indications that FedEx may have led Carey on because he was doing temporary driving work while he waited for his route and FedEx found it convenient to keep him on hand as long as possible as a temporary driver.
6. Many employment agreements do eliminate the default rule of employment at will, either by the express terms of the contract itself, or by virtue of rules in an employee handbook published by the employer, or by collective bargaining agreements, or by implication from usage or conduct. Statutes have also made inroads into the at-will doctrine.
7. This discussion is confined to the period before employment has begun and does not deal with the issue of whether it is easier to find consideration or reliance once the employment has commenced. The problem is that even after the employee starts work, both parties continue to have the discretion to terminate at-will employment, and the employee has no promise of continued employment on which he can rely. Some courts hold that the same principles apply before and after the employment has begun. Other courts do distinguish between promises made before and after the employee has started working, and may find consideration or reliance as a result of conduct or promises made during the course of employment.
8. As explained earlier, bid shopping occurs where the prime contractor does not wish to award the subcontract to the bidder, but instead uses the bid as a means of persuading a competing bidder to reduce its bid, with the intention of awarding the job to the competitor.
9. The distinction between direct and consequential damages is discussed more fully in section 18.5.
10. Just kidding, of course.

CHAPTER 13

The Judicial Regulation of Improper Bargaining and of Violations of Law and Public Policy

§13.1 INTRODUCTION

This chapter and Chapter 14 deal with several related but distinct doctrines. Sections 13.2 through 13.12 cover a group of doctrines that are designed to regulate improper bargaining: misrepresentation, duress, undue influence, and unconscionability. The theme that connects these doctrines is the balance between the policy of protecting reliance that underlies the objective test of contract and the policy of freedom of contract that dictates not only that parties should have the freedom to enter contracts but also that they should not be held to contracts to which they did not voluntarily assent. Although the objective test focuses on the manifested intent of the parties rather than on their subjective states of mind, a rigid adherence to objectivity could mask the fact that the apparent assent was not genuine but was obtained by deceit or improper bargaining tactics. The doctrines mentioned above allow the court to go behind the manifestation of intent to decide if a party's apparent agreement is based on an acceptable degree of volition. They are regulatory in that they allow the court to regulate improper bargaining behavior. They

are sometimes called policing doctrines.

Section 13.13 deals with a different kind of regulation—the policing of contracts for compliance with law and public policy. Although this form of regulation has some affinity to the improper bargaining doctrines, it is distinct. Its focus is not on whether one of the parties induced the other's manifestation of assent by deceit or improper tactics, but whether the contract violates a statute, a rule of common law, or an important public policy. If it does, the court will not enforce it, even though the parties acted with full knowledge and deliberate intent in entering it. The possibility that a court might refuse to enforce a genuinely consensual contract creates tension between the contractual policies of freedom of contract and assent and the other public policy that is implicated in the transaction. Section 13.13 discusses how courts resolve that tension.

Chapter 14 deals with the problem of lack of contractual capacity, either as a result of minority or of mental illness. Although capacity to contract is a subject distinct from those discussed in this chapter, you will see that there are close connections because it also involves fundamental questions of reliance, assent, and public policy.

§13.2 THE OBJECTIVE TEST AND THE VIABILITY OF APPARENT ASSENT

The discussion of the objective test of assent in section 4.1 stressed that although contract is based on consensus, the law does not require a genuine subjective "meeting of the minds." The focus is on apparent assent, as it would reasonably be perceived by one party from the manifested words and actions of the other. This has to be the general rule, otherwise no one could ever rely on overt indications of assent, and the one party's reasonable expectation of agreement could be defeated by a showing that the other really did not mean what those indications reasonably conveyed.

The principal purpose of the objective test is therefore the protection of reasonable expectations. Although a consistent and unbending application of the test would have the merit of certainty, it could lead to great injustice. For example, Lilly Livered signed a memorandum of agreement to sell her casino to Attila "The Animal" Axehacker. She agreed to the sale because Attila

shoved the muzzle of his revolver up her left nostril and indicated his intent to pull the trigger if a signature was not immediately forthcoming. No doubt the signature is a first-class manifestation of assent, but no judge (except for Judge "Greasy" Palmer, who was seen taking a brown paper bag from Attila the other day) would hold Lilly accountable for the reasonable import of her conduct. Not only should she not be held accountable for a manifestation of assent forced out of her, but Attila was responsible for undermining her free will and cannot legitimately claim that he relied on her assent being volitional. That is, a rigid focus on Lilly's manifested assent—her signature—would serve neither justice nor the goals of contract law. Policing doctrines allow the court to go behind the appearance of assent in cases like this, in which the process of contract formation is tainted by improper bargaining behavior. The policing doctrine applicable in this particular example is duress because Attila induced Lilly's apparent assent by illegitimate threat. Other facts may satisfy the elements of one of the other doctrines discussed below. As a general observation, it can be said that all the doctrines are safety valves for the objective test, so that it cannot be used as a tool of oppression, deceit, or advantage-taking.

§13.3 GENERAL NOTE ON REMEDY: AVOIDANCE AND RESTITUTION, ADJUSTMENT OF THE CONTRACT, OR DAMAGES

The remedies available for improper bargaining are covered in the discussion of each of the separate doctrines in the following sections. This overview identifies and introduces the common remedial principles that apply to the granting of relief under the doctrines.

a. Avoidance and Restitution

A contract induced by improper bargaining is voidable. This means that it can be avoided (rescinded) by the party who is the victim of that improper conduct. A voidable contract must be distinguished from a void contract. If a contract is void (as it would be, for example, if one party failed to give consideration), it is a legal nullity, and neither party can sue to enforce it. By

contrast, a voidable contract is a valid contract that remains fully effective unless the aggrieved party elects to exercise the right to terminate it. The aggrieved party therefore has a choice—either she may sue to avoid the contract, or, if she subsequently decides that she wants to keep the contract, despite the other party's improper bargaining, she may do so. If she does not choose to avoid the contract, she may have one of the alternative remedies described below. Note that only the aggrieved party has the election to avoid the contract or keep it in force. Obviously, the party who is guilty of inducing the contract through improper bargaining cannot use his own wrongdoing as the basis of a claim that the contract should not be enforced. The aggrieved party may use the right of avoidance affirmatively, for example, by suing for a declaratory judgment terminating the contract, or defensively, by raising it as a defense when sued on the contract. When a contract is avoided, the general rule is that both parties are entitled to restitution because it would unjustly enrich a party to retain a benefit under an avoided contract. In appropriate cases, the fact that the contract was induced by improper means may affect the equities relevant to restitutionary recovery, resulting in a reduction or elimination of the restitutionary claim of the party at fault.

b. Adjustment of the Terms of the Contract to Correct the Consequences of Improper Bargaining

If the aggrieved party decides not to avoid the contract, but the other party's improper bargaining resulted in terms that are unfair, the aggrieved party may ask the court to enforce the contract after removing its unfair aspects. Offending terms may be removed entirely or may just be altered to eliminate their unfair effect. This alternative is not available in all situations and may not be possible when the problem affects the very basis of the contract. In other cases, it may be the only remedy available because the problem is not serious enough to merit avoidance.

c. Damages

As noted above, restitutionary damages are available where a contract is avoided. However, if the aggrieved party elects not to avoid the contract, there may be the possibility of compensatory damages to remedy the effects of the improper bargaining. Compensatory damages are not available in all

cases, but courts do have remedial discretion to award such relief where appropriate. This relief may be aimed at compensating the aggrieved party for a loss in consequence of the improper bargaining, or it could compensate for tortious injury where the wrongful act is a tort as well as a bargaining impropriety.

§13.4 THE NATURE AND RELATIONSHIP OF THE DOCTRINES REGULATING BARGAINING

The doctrines considered here are regulatory in nature and are often described as policing mechanisms. They allow the court to go behind the apparent manifestation of assent to examine the bargaining conduct of one of the parties and to determine whether that conduct exceeded acceptable bounds. It is important to understand that courts apply these doctrines carefully so as not to intrude more than necessary in the process of contract formation. The contracting parties are expected to try to serve their own interests and to use their available information and resources to obtain the best deal possible. There is nothing inherently wrong in the resourceful use of superior information, clever sales techniques, and the exploitation of market advantage. Furthermore, it is to be expected that transactions routinely occur between parties having great disparity in power, sophistication and resources. Regulation aims, not at "leveling the playing field" by cutting down economic advantage, but rather at allowing the court to step in when behavior crosses the line from hard bargaining to unacceptable exploitation. In obvious cases, such as Attila's gun up Lilly's nostril, it is clear that the line has been crossed. But in more equivocal cases opinions differ on the question of when intervention is appropriate. Some courts and commentators see robust judicial regulation of bargaining practice as a crucial means of curbing abuse. Others favor policing for only the more extreme cases and see judicial regulation as leading to inefficiency and market interference.

In classical contract law the policing doctrines were very clearly distinguishable and each had relatively firm and specific elements, making it applicable to a narrow range of situations. As they have developed in more recent times (some courts having moved further away than others from the categorizations of classical law), the doctrines have become more fluid so

that they have a greater tendency to meld into each other. While they still retain many of their characteristic elements, their points of connection have become more obvious. This means that although the facts of some cases may support the invocation of only one of the doctrines, others may permit alternative analyses under more than one of them. Together, the doctrines form a network of rules that permit courts to deal with a variety of sins that might be committed during the formation of a contract. As we examine the doctrines individually, we will keep an eye on their common ground and interconnections.

---

§13.5 MISREPRESENTATION GENERALLY: THE MEANING OF "MISREPRESENTATION" AND THE DISTINCTION BETWEEN FRAUDULENT AND NONFRAUDULENT MISREPRESENTATIONS

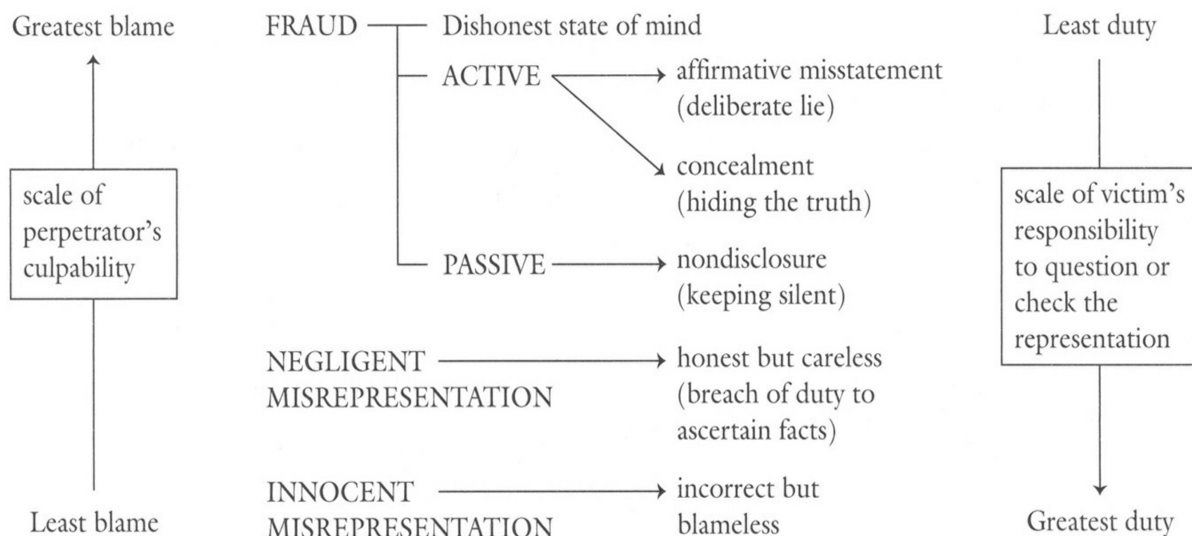
§13.5.1 The Distinction Between Fraudulent, Negligent, and Innocent Misrepresentations

A "misrepresentation" is defined in Restatement, Second, §159 as an assertion not in accord with the facts. It is a factually incorrect representation made by one of the parties at the time of contracting. Misrepresentations fall into one of three categories, each of which has different rules. If the assertion is made with knowledge that it is false (that is, a deliberate lie) and with the intention of inducing the other party's agreement, it is fraudulent. If the misrepresentation is not a deliberate lie, but reflects a genuine, albeit erroneous, belief by the party making the assertion, it is either negligent (the misinformation results from that party's failure to check facts that he had a duty to ascertain) or innocent.

The severity and consequences of a misrepresentation depend on the state of mind of the party making the assertion. A fraudulent misrepresentation is the most serious deviation from legal and ethical obligations, which not only violates the contractual obligation of fair dealing but is also tortious and could have criminal sanctions, too. In addition, a party guilty of fraud cannot be said to have justifiably relied on the other's manifestation of assent. The elements of fraudulent misrepresentation reflect

the law's disapprobation of deliberate falsehood: If a fraudulent assertion is proved to have been made, the remaining prerequisites for relief are comparatively lenient. The court may evaluate the consequent inducement on a more subjective standard and the perpetrator's accountability for purposeful deceit is much more likely to outweigh any culpability the victim may have for gullibility or carelessness. A negligent or innocent misrepresentation is not as morally reprehensible and may not entirely defeat the perpetrator's reliance interest. Therefore, the decision on whether or not to grant relief involves a closer balancing of the relative culpability of the parties, and a stronger focus on the objective importance (materiality) of the misrepresentation and the victim's duty to verify the facts. Obviously, a negligent misrepresentation weighs more heavily against the perpetrator than an innocent one, and negligence may give rise to tort liability, too. This is represented by Diagram 13A.

Diagram 13A



§13.5.2 The Application of the Parol Evidence Rule to Misrepresentations Made Outside a Written Contract

When a contract is recorded on paper or electronically, the misrepresentation may be in the writing[1] itself. If so, the victim of the misrepresentation must prove the falsity of the representation by adducing evidence of facts extrinsic to the writing. The parol evidence rule does not bar this extrinsic evidence because it is not parol evidence. It is offered not to prove a term allegedly

agreed to outside the writing but rather to prove that a fact represented in the writing is wrong.

However, the parol evidence rule does apply where the misrepresentation is not included in the writing but was allegedly made orally before or at the time of execution of the written contract, or was made in a prior written communication. The effect of the parol evidence rule differs depending on whether or not the misrepresentation was fraudulent.

We saw in section 12.12.1 that even where a written agreement is fully integrated, a party may not invoke the parol evidence rule to exclude proof of a fraudulent misrepresentation. The policy of shielding the factfinder from suspect and unreliable parol evidence is usually outweighed by the policy of protecting a party from dishonesty. Although the parol evidence may be admissible, it may not ultimately help the victim of the fraud for the reason explained in section 12.12.1: Although the court may admit the evidence of the alleged parol misrepresentation, the plaintiff may still not be able to win on the fraud claim because the omission of the misrepresentation from the writing could lead to the conclusion that the plaintiff was not justified in relying on it, thereby failing to satisfy that element of fraud. (Justifiable reliance is discussed in section 13.6.6.) This is a particularly serious problem if the alleged oral misrepresentation directly contradicts an express term in the writing or if the written contract contains a merger clause that specifically disclaims reliance on any oral representations. This issue was addressed in *Psenicska v. Twentieth Century Fox Film Corp.*, 2008 WL 4185752 (S.D.N.Y. 2008), the case involving the *Borat* movie discussed in connection with interpretation in section 10.5.1. Recall that the plaintiffs had consented to being filmed for the movie, believing it to be a documentary. They sued the studio and filmmakers when they discovered that the movie was a satire presented in the style of a documentary. The issue was whether the plaintiffs' consent to be filmed was effective. As a matter of interpretation, the court held that the consent did cover the movie because the term "documentary-style film" unambiguously included a faux documentary. As an alternative argument, the plaintiffs sought to avoid the consent on the grounds that the defendants had fraudulently misrepresented the nature of the film in oral discussions. The court rejected that argument as well because the consent specifically stated that the plaintiffs waived reliance on any promises or statements made about the nature of the film or the identity of the other persons involved in it. In light of this language, the court said that the

plaintiffs could not have justifiably relied on any such oral statements that may have been made.

A negligent or innocent misrepresentation is not as morally indefensible as a fraudulent one, and is not covered by the exception to the parol evidence rule. Therefore, the rule applies as usual. It bars evidence of a parol misrepresentation where the written contract is fully integrated (and particularly if it contains not only detailed terms but also a merger clause). If the writing is not fully integrated, evidence of a parol misrepresentation that contradicts the written terms is also inadmissible.

§13.6 FRAUDULENT MISREPRESENTATION

§13.6.1 Introduction

To qualify as fraudulent, a misrepresentation must be made with deliberate dishonest intent. The person making it must know it is false and must intend to induce the other party to enter the contract. The most common type of fraud, called fraud in the inducement, is a fraudulent misrepresentation concerning a fact that forms the basis of the contract, giving the party to whom it is made a false incentive to enter it. A less common type of fraud, fraud in the factum, is a misrepresentation relating to the nature or effect of a document to be signed (for example, persuading someone to sign an order for goods by asserting that it is merely a request for a catalog). The principal difference between them is that fraud in the inducement is generally treated as rendering the contract voidable, but fraud in the factum voids it completely. The discussion and illustrations in this section are concerned only with the more common fraud in the inducement.

For fraudulent misrepresentation to arise, a party must have made a false representation of fact with knowledge of its falsity and with intent to induce the other party to enter the contract. The other party must have relied on it justifiably to his injury. Many courts require also that the misrepresentation is material, but Restatement, Second, followed by some courts, requires materiality only for negligent or innocent misrepresentations, and not for fraud. This is discussed in Section 13.6.5. We now examine each of the elements of fraud.

§13.6.2 Fact, Opinion, Prediction, and Promise

a. What Is a "Fact"?

We usually think of a fact as something that has existence—an objectively ascertainable reality. For example, the seller of a sofa clearly makes a representation of fact if he says "this sofa is made of leather" or "this sofa was made in the U.S.A." If the sofa is actually vinyl or it was made in China, the asserted facts are false. Fact can be distinguished from opinion ("I think this is a very beautiful sofa"), a future prediction ("this sofa will be the envy of your friends and neighbors"), or a promise of future action ("if the sofa does not look good when you put it in your living room, you can return it"). The general rule is that only a misrepresentation of fact constitutes fraud. An opinion or a prediction should be understood as nothing more than an expression of personal belief, taste, or preference, so even if it is not honest, it should not give grounds for relief for fraud. This is particularly true if the expression of opinion or the prediction should be reasonably understood as seller's hype (sometimes called "puffery"). Similarly, a promise of future action is not a representation of fact but an undertaking. If it is breached, the proper remedy is a suit for breach of contract, not an action for fraud. However, the distinction between fact, opinion, and promise is not hard and fast. In some circumstances a dishonest opinion or a false promise can constitute a fraudulent misrepresentation.

b. Opinion

Contemporary courts recognize that it is not always possible to make a clear distinction between fact and opinion because most opinions have a factual basis. This is not always true, of course. A seller's claim that a sofa's green and orange plaid fabric is a "fun color" is clearly just opinion. However, if the seller says "this sofa is fashionable," this suggests some familiarity with facts concerning current market trends. The fact-based opinion constitutes a misrepresentation if the party expressing it knows that it is not supported by the facts on which it is based or if he recklessly makes the statement knowing that he has no clue about the facts on which it is based. Where the opinion of one of the parties is a decisive factor in inducing the other to enter the transaction, the misrepresentation of that opinion goes to the heart of the

contract. This is particularly true where the party expressing the opinion has expertise and the other party relies on his recommendation. For example, an attorney who believes that a prospective client has a weak case on the facts makes a fraudulent misrepresentation if he expresses a contrary opinion to the prospective client with the goal of inducing him to hire the attorney to litigate the case.

Rodi v. Southern New England School of Law, 389 F.3d 5 (1st Cir. 2004) is a good illustration of fraudulent opinion. Rodi was a law student who claimed that he was induced to enroll in the law school on the basis of representations by the dean that the school was "highly confident" that it would receive American Bar Association (ABA) accreditation. The school knew that accreditation was important to Rodi because he could not be admitted to practice in his state of residence if his degree was not from an accredited school. After the school failed to receive the accreditation in Rodi's first year of study, Rodi sent transfer applications to ABA-accredited schools. On hearing of this, the dean (the successor to the dean who made the original representation) assured Rodi that "there was no cause for pessimism" that the school would be accredited before he graduated. It was not, and Rodi sued. The district court dismissed his claim, but the court of appeals reversed and permitted the case to go to trial on a theory of fraudulent misrepresentation. The school knew that it had substantial problems in obtaining accreditation, and Rodi had made a credible preliminary showing that the opinions expressed by school officials were not honest, given their knowledge of the ABA's criteria and the school's prospects of satisfying them. On remand, the trial court granted summary judgment to the law school on the basis that even if the deans had made false statements, Rodi had not reasonably relied on them. The court of appeals affirmed (532 F.3d 11 (1st Cir. 2008)). It turned out that Rodi had not actually relied on the deans' assurances in not transferring to another school. He had tried to transfer, but the other schools had not accepted his transfer applications. In addition, the court found that even if Rodi had relied on the deans' assurances, the reliance would not have been reasonable because he knew that the school had accreditation problems and that there was a distinct possibility that the ABA would not accredit the school, despite the deans' claim of optimism.

c. Prediction

A future prediction is not a misrepresentation of an existing fact but an opinion about what might come to pass after the contract has been executed. It is really no different conceptually than an opinion, and should be approached in the same way. The deans' assertion in *Rodi* and the attorney's assertion about the strength of his client's case in the above illustration are opinions and predictions. If the prediction is based on facts that are known at the time of contracting, it must be an honest assessment of how those facts will lead to the predicted result.

d. Promise

A promise of future performance is not a representation of fact, but an expression of intent. However, it relates to the present state of mind of the party making it and if it dishonestly represents that state of mind, it could qualify as a fraudulent misrepresentation. It can be very difficult to distinguish a mere breach of contract from a fraudulent misrepresentation of intent. To assert fraud it is not enough for the victim to show that the promise was broken. He must prove that at the time the contract was made, the party making the promise intended not to keep it. Although fraud can be proved by circumstantial evidence, so it is not necessary to have direct evidence of the promisor's state of mind in the form of an admission, it can be very difficult to establish that the promisor had already made up his mind to breach, especially if the promisor was careful to keep its intent hidden.

We see an example of a fraudulent promise in *American Directories, Inc. v. Stellhorn One Hour Photo*, 833 N.E.2d 1059 (Ind. App. 2005), discussed in relation to the fraud exception to the parol evidence rule in section 12.12. The court held that it could qualify as fraud where a seller of advertising in a phone directory made a promise that the buyer could cancel the contract after a year, intending at the time of making the promise not to honor it. *Carey. v. FedEx Ground Package System, Inc.*, 321 F. Supp. 2d 902 (S.D. Ohio 2004), discussed in section 8.9 in relation to promissory estoppel, is another example. Recall that FedEx had kept Carey waiting for a delivery route for almost two years. During this period, it induced Carey to incur economic detriment by reiterating the assurance that he would receive the route while it took advantage of his services as a temporary driver. The court denied FedEx's motion for summary judgment and allowed Carey to proceed to trial on the basis of promissory estoppel. In addition, the court held that

Carey had made out a cause of action for fraud. The court noted that although fraud is not usually predicated on a promise of future action, such a promise can qualify as fraudulent if the promisor has no intention of keeping the promise.

Sometimes it is not easy to decide if a misrepresentation related to a fact or to a promise—a representation of future intent. *Kaloti Enterprises, Inc. v. Kellogg Sales Co.*, 699 N.W.2d 205 (Wis. 2005), is a case with such an ambiguity. Kaloti and Kellogg had a longstanding arrangement under which Kaloti bought Kellogg products, which it resold to large stores. Kellogg then decided to change its marketing procedures by selling some of its products directly to the same large stores that were Kaloti's customers. As a result, Kellogg would become Kaloti's competitor in that wholesale market. After it had made this decision, Kellogg accepted an order from Kaloti without telling it that Kellogg was about to devour its market. Kaloti only discovered this upon hearing from its customers that they would be buying directly from Kellogg. Kaloti sued Kellogg when it refused Kaloti's demand for cancellation of the sale and refund of the price. The issue in the case was whether Kellogg's failure to tell Kaloti about its impending change in marketing strategy constituted a fraudulent misrepresentation. The court held that Kaloti had made a sufficient case of fraud to overcome an application for dismissal. The court treated Kellogg's decision to sell its products directly to stores as a fact. However, this is not strictly correct. The real fact in issue is Kellogg's intentions, and the question is whether Kellogg had made an implied promise not to undercut Kaloti, knowing that it was about to break that promise. (The case also presents the question of whether Kellogg committed fraud by failing to disclose that it had begun to sell directly to Kaloti's customers. We discuss this aspect of the case in section 13.6.3.)

§13.6.3 Types of Fraudulent Misrepresentation: Affirmative Statements, Concealment, and Nondisclosure

a. Affirmative False Statement

An affirmative false statement (such as the seller's assertion, mentioned in section 13.6.2, that a vinyl sofa is made of leather) is the most direct and easily identifiable type of fraudulent misrepresentation. *Rozen v. Greenberg*, 886 A.2d 924 (Md. App. 2005), illustrates fraud by affirmative

misrepresentation. Greenberg was a tax preparer. She received an e-mail from Rozen, whom she did not know, suggesting that as they were in the same business, they should enter into a cooperative arrangement. In the e-mail Rozen represented that he had "headed" a tax preparation service for "the last few years." He referred Greenberg to his organization's "powerful" website. On visiting the website, Greenberg read that the organization had a team of account and tax professionals headed by Rozen, who was an experienced CPA. In a subsequent phone conversation, Rozen again told Greenberg that he was very experienced and had many people working for him. Greenberg then met with Rozen, who showed her what he claimed to be his office, which was very impressive. As a result of these representations, Greenberg agreed to sell her client list to Rozen in exchange for a share of the income that he generated from preparing her clients' returns. It turned out that at the time that he contacted Greenberg, Rozen had no business and no clients and had prepared no tax returns. He had been a CPA for only a few weeks, and the office that he showed Greenberg belonged to a tax preparation company at which he was employed. The court of appeals affirmed the trial court's decision that these misrepresentations were fraudulent. (We return to this case shortly in relation to the other elements of fraud.)

Willen v. Hewson, 622 S.E.2d 187 (N.C. App. 2005), is another example of affirmative fraud. The seller of a large house on an estate advertised it as "peaceful" and "serene." When the buyer inspected the estate, he met the seller's niece, who mentioned that there had been problems with "kids coming onto the property after high school football games around Halloween." This caused the buyer some concern, and he called the seller to ask her if there had been trespass problems on the property. She assured him that such incidents occurred only once or twice and that her niece was prone to exaggeration. After the buyers bought and moved into the house, they found that there was a serious and constant problem with trespass and vandalism that they could not eliminate even by installing a security system and fence. The court of appeals upheld the trial court's determination that the seller was aware of the trespass problem and had made a fraudulent misrepresentation by advertising the property as "peaceful" and "serene" and by answering the buyer's inquiry dishonestly.

b. Concealment

Deliberate conduct to hide a fact is also an affirmative act. Although it may not involve any verbal lie, it is just as dishonest and morally reprehensible. *Jablonski v. Rapalje*, 14 A.D.3d 484 (N.Y. 2005), is a good example. In contrast to *Willen*, which involved human pests, *Jablonski* was concerned with trespassing bats, which inhabited the attic of the house bought by the plaintiff. The bat infestation was serious and ongoing. Over the 36 years that the sellers had lived in the house, they had tried to get rid of the bats, but they always returned. During the time that the buyer inspected the house preparatory to buying it, the sellers went to considerable trouble to conceal the bat infestation by using mothballs (which bats apparently dislike) and floodlights to keep them away and by cleaning up the telltale signs of bat presence such as bat droppings and urine. (The case also involved an affirmative misrepresentation. On one occasion the sellers did not do the best job in disposing of droppings, which the buyer noticed. The sellers asserted that they were bird droppings.) The court refused the seller's motion for summary judgment and permitted the buyer to proceed to trial on the basis of fraudulent concealment. *Weintraub v. Krobatsch*, 317 A.2d 68 (N.J. 1974), is an equally delightful case involving a cockroach infestation of nightmarish proportions. The court declined the seller's application for summary judgment and permitted the buyer of a house to proceed to trial on the theory that the seller actively concealed the presence of cockroaches by leaving all the lights on.

c. Nondisclosure (Silence)

Affirmative dishonesty, whether in the form of a false statement or active concealment of the truth, is the clearest case of fraud. However, under some circumstances, a person can commit fraud by keeping silent and failing to disclose a fact. Nondisclosure is the most difficult basis for claiming fraud because it is only fraudulent if the circumstances impose a duty on the party to disclose information. The usual assumption is that where parties contract, each is a free agent in the market, entitled to act out of self-interest. A party may use the advantage of superior information, and owes no duty to the other to reveal facts that motivate her to enter the transaction or that make it particularly attractive to her. Therefore, a buyer of property, having studied the market carefully, is not obliged to tell the seller that the property is underpriced, and the buyer of a commodity does not have to tell the seller

that its research on crop yield indicates that the price will soar after the sale. Notwithstanding, a party does not have the absolute and invariable right to keep information secret. Under some circumstances honesty and fair dealing require disclosure. The difficult question is to determine when the line is crossed between facts that may fairly be kept private and those that must be revealed.

Restatement, Second, §161 provides guidelines to answer this question. It says that nondisclosure amounts to an assertion that a fact does not exist where the party knows that disclosure of that fact is necessary to correct a previous assertion, or where there is a relationship of trust between the parties. It also requires disclosure where the party knows that it is necessary to correct the other party's mistake as to a basic assumption of the contract, and nondisclosure would violate the duty of good faith and fair dealing. The concept of good faith and fair dealing is quite open-ended and fact-based, so it depends on the circumstances of each case. Two significant factors that may be relevant are whether the information should be treated as the property of the party who possesses it (for example, because that party has incurred cost and effort in conducting research or inquiry to obtain it) and whether the information is readily available on diligent inquiry.

A good illustration of the duty to disclose is provided, regrettably, by another creepy-crawly case, this time involving termites. In *Hill v. Jones*, 725 P.2d 1115 (Ariz. 1986), the sellers of a house did not tell the buyers that it had been infested with termites in the past. (The termites had been eradicated, so the problem related to damage that they had caused.) Having gone to the trouble of keeping this quiet, the sellers made the unfortunate mistake of leaving telltale brochures in the kitchen drawer which the buyers discovered after they moved in. The court refused summary judgment for the sellers and allowed the buyers to proceed to trial on the question of whether the duty of fair dealing required the seller to reveal the termite damage.[2]

Just for the sake of getting away from bugs and dealing with a more serious hidden defect in a house, it is worth mentioning everyone's favorite nondisclosure case, *Stambovsky v. Ackley*, 572 N.Y.S.2d 672 (A.D. 1991), in which the court allowed the buyer of a house to proceed to trial on the grounds that the seller failed to disclose that the house was reputed to be haunted. (Unlike the buyers in *Willen* and *Jablonski*, who actually encountered the trespassers and bats, the buyer here did not allege that he met the ghosts. It was the reputation of the house that bothered him.) The seller

was well aware of this reputation and was largely responsible for creating it by including the house in tours of haunted homes and reporting apparitions in the local press and in the *Reader's Digest*. The majority of the court held that while the buyer would have had the duty to inspect the house for structural and physical defects, there was nothing to alert him to the possibility that the house had a reputation for being haunted, so he could not reasonably be expected to inquire into this. The seller had a duty in good faith to disclose the reputation of the house, particularly because she had been instrumental in fostering it. The dissent argued that the reputation of the house as haunted had been widely publicized and could have been ascertained by the buyer on reasonable inquiry. Therefore, he should not be able to rely on the seller's failure to disclose it. Both the majority and the dissent seek to balance the seller's duty to disclose facts against the buyer's duty of reasonable inquiry and reach contrary conclusions on how the balance is to be struck.

In *Kellogg*, discussed in section 13.6.2, the court held that the facts made out a case for nondisclosure as an alternative to affirmative fraud. Although one party is not generally under a duty to disclose its business plans or marketing strategy to the other, commercial mores and the duty of fair dealing do sometimes require disclosure. This appeared to be such a case because Kellogg's action would undermine Kaloti's expectations under the contract, and the information was solely within Kellogg's knowledge, not accessible to Kaloti through diligent inquiry.

Even if a party would not have a duty to disclose a fact and would be entitled to keep silent about it, if the other party asks a direct question relating to that fact, failure to answer it truthfully would constitute affirmative fraud. For example, in *Lerner v. DMB Realty, LLC*, 322 P.3d 909 (Ariz. App. 2014), the sellers of a house decided to sell it because a convicted sex offender lived next door. An Arizona statute provided that a seller is not obliged to disclose certain facts about the property, including that it is located in the vicinity of a sex offender. The deed of sale itself referred to this statutory provision and stated that the buyer had the duty to investigate the presence of sex offenders if a sex offender in the vicinity was material to the buyer. The buyers did not conduct this investigation and discovered the presence of the sex offender only after moving into the home. The buyers sued on several theories, including fraud. The trial court dismissed the fraud claim on the grounds that it was barred by the statute. The court of appeals reversed the dismissal. It noted that the sellers would not have had a duty to disclose the presence of

the neighboring sex offender. However, when the buyers asked them why they were moving, they answered that they wanted to be closer to friends. They thereby misrepresented the true reason for their desire to move. When asked a question that fairly calls for disclosure, a person commits fraud by answering in a manner deliberately calculated to mislead. It did not matter that the question was not specifically about sex offenders; it was a specific enough question that imposed on the sellers the duty not to answer falsely.

§13.6.4 Knowledge of Falsity and Intent to Induce the Contract

A guilty state of mind—knowledge of falsity and intent to mislead—is the essence of fraud. (The word "scienter" is sometimes used to describe this guilty state of mind.) Although it may be possible for one of these elements, but not the other, to exist, in most cases they go hand in hand. In defining knowledge of falsity, Restatement, Second, §162 covers not only an assertion made with the actual knowledge that it is not in accord with the facts but also an assertion made without confidence in its truth or without a known basis in fact. This means that there is some blurring of the line between fraudulent and negligent misrepresentation, because reckless disregard for the truth or an extreme degree of negligence in ascertaining information before making an assertion may qualify as fraud.

For example, in *Jordan v. Knafel*, 880 N.E.2d 1061 (Ill. App. 2007), Michael Jordan, the basketball star, sued for a declaratory judgment avoiding a settlement agreement that he had entered into with Karla Knafel. Knafel had become pregnant after the parties had a sexual relationship. She claimed that Jordan was certainly the father of the baby. On the strength of that assertion, Jordan and Knafel entered into the settlement agreement under which Jordan promised to pay Knafel $5 million in exchange for her not initiating paternity proceedings against him. Subsequent tests revealed that the child was not Jordan's. The court of appeals affirmed the trial court's summary judgment in favor of Jordan. Although Jordan could have been the father of the child, Knafel had made a fraudulent misrepresentation by categorically stating that he was the father, thereby impliedly representing that he was her only sexual partner during the period of conception. Although she did not know that he was not the father, she did know that he might not be. She therefore made the assertion without confidence in its truth.[3] (One could also conceive of this case as involving nondisclosure because Knafel

failed to disclose that Jordan was not her only sexual partner at the crucial time. However, she went beyond mere nondisclosure by asserting unequivocally that he was the father.)

§13.6.5 Materiality

A misrepresentation is material if it substantially contributes to a party's decision to enter the transaction. It must relate to a fact that is important or central enough to the bargain that it is reasonably likely to have had a significant influence on the party's decision to manifest assent to the transaction. It seems logical that materiality must be an element of fraud, because if the misrepresentation did not relate to an important aspect of the transaction, it is less likely to have induced the party to enter the transaction, and presents a less compelling case for relief. (In fact, the link between the elements of materiality and justifiable inducement is very clear and obvious.) However, there is some confusion over the role that materiality plays in the requirements for establishing fraud. Many courts specifically list materiality as one of the elements of fraud. For example, most of the cases mentioned above—*Kellogg*, *Stambovsky*, *Hill*, *Jablonski*, *Willen*, *Jordan*, and *Rozen*—all assert that the misrepresentation must be material. However, Restatement, Second, §§162 and 164 and comment *c* to §162 do not require the victim of fraud to prove materiality. They confine the need to establish materiality to negligent or innocent misrepresentations. Some courts follow this approach and assert that materiality is not an element of fraud. However, even in those cases, it often appears that the materiality of the misrepresentation comes up in the court's discussion and seems to be an influential factor. As mentioned earlier, even if materiality is not identified as a separate element of fraud, the importance of the misrepresented fact inevitably features in the analysis of justifiable inducement.

In light of this confusion in the doctrine, the best approach is to recognize that materiality is commonly identified as an element of fraud but that some courts, following the Restatement, Second, formulation, underplay it or do not articulate it as a requirement. However, even in those cases, some attention is commonly given to materiality in the opinion, either in the overall analysis or in addressing the question of justifiable inducement. The difference between recognizing and not recognizing materiality as a distinct element of fraud may influence the degree to which the court requires

objective proof of materiality, beyond a more subjective focus on what was important to this particular victim. The materiality of the misrepresentation may also affect the degree to which the victim must adduce persuasive evidence to show justifiable reliance. In the *Jordan* case, the court noted that where a misrepresentation is made with regard to a material matter, inducement is more readily presumed.

§13.6.6 Justifiable Inducement

There must be a causal link between the fraud and the contract—that is, the fraud must have motivated the victim to enter the contract or to enter it on the terms that were agreed. If the victim would have entered the contract on those terms anyway had she known the truth, or if the victim was not justified in relying on the misrepresentation, she is not entitled to relief. In *Psenicska*, discussed in section 13.5.2, the court held that the plaintiffs' reliance on an alleged parol fraudulent misrepresentation was not justified in light of a disclaimer of reliance that they had signed. Similarly, lack of justifiable reliance was the ultimate ground for denying relief for fraud in the *Rodi* case, discussed in section 13.6.2.

To determine if the plaintiff was justified in relying on the fraudulent misrepresentation, the court must evaluate the impact of the false fact on the victim's state of mind. The difficult question here is whether this impact should be measured objectively (was the victim reasonable in relying on the misrepresentation) or subjectively (even if a reasonable person may not have been hoodwinked, was this victim in fact induced to enter the contract). Although, as we have seen frequently, the law tends to favor an objective test in most situations, public policy dictates a less objective standard where fraud is involved. When a court balances the fault of the perpetrator, who has deliberately lied, against the fault of the victim, who may have been unduly gullible or even careless in believing the misrepresentation, the balance usually weighs in favor of the victim. The result in most cases is a blend of objective and subjective considerations. That is, the court asks whether the victim was in fact induced but also tests this inducement against the question of whether she would have been induced had she acted reasonably. Often, these inquiries point in the same direction because if a reasonable person would not have relied on the false fact, the victim may have trouble showing, in the absence of some special individual circumstances or attributes, that she

in fact relied on it. One can also detect that courts apply a different degree of objective assessment depending on whether the misrepresentation was active (a statement or concealment) or by nondisclosure. Courts are more likely to impose a tougher standard of reasonable inquiry on the victim where the fraud lies in failure to disclose facts.

The cases discussed in section 13.6.3 illustrate the element of justifiable reliance and the blend of subjective and objective considerations that go into determining justification. *Stambovsky* considered that the buyer could justifiably have been misled by the nondisclosure because he was not local, had no reason to know of the house's reputation, and could not have discovered the ghosts by reasonable inspection of the house. (The court may have been too generous to the buyer in concluding that the house's reputation was not easily discoverable. The haunting was quite widely publicized and was featured in both national and local publications.) In *Rozen*, the court recognized that Greenberg was not experienced in the sale of a business and was rather gullible. However, the court focused on Greenberg's subjective attributes and rejected the argument that she reasonably could and should have investigated Rozen, should have called for references, and should have noticed that the office that she was taken to did not belong to him. In *Willen*, the court approached the buyers' reliance from a reasonableness perspective but rejected the seller's argument that the buyers' reliance on her assertions was unreasonable because her niece's mention of the trespassing problem should have caused them to conduct an independent investigation. The court noted that there were no visible indicia of trespass and vandalism to place the buyers on inquiry and, in any event, even if the buyers were unreasonable, the seller cannot seek to avoid the consequences of her false representation by arguing that the buyers should not have trusted her. In *Jablonski*, the buyer visited the house many times and had it professionally inspected. The buyer observed the bat droppings on one occasion, noticed the floodlights in the attic, and also smelled the mothballs and bat urine.[4] The seller contended that the buyer's reliance was not justifiable because he had ample opportunity to discover the bats. Applying a reasonable diligence standard, the court rejected this argument because there was enough evidence to suggest that the sellers had thwarted the buyer's ability to discover the infestation.

These cases may give you the impression that courts generally treat victims leniently in evaluating justifiable reliance. That is often true, but it would be a mistake to think that it is always so. Courts do hold victims

responsible for exercising due diligence in ascertaining the true facts. As noted above, Rodi ultimately lost his case because the court found his reliance unjustifiable. *Nigro v. Lee*, 882 N.Y.S. 2d 346 (App. Div. 2009), is another example of a case in which the court found a lack of justifiable reliance—in this instance because the victim failed to seek information that would have revealed the falsity of the representations. The plaintiff bought a 1995 Mercedes on an eBay auction. The seller's advertisement described the car as "gorgeous," with three minor blemishes, and stated that it was in the condition as disclosed, to the best of the seller's knowledge. The car was located in Nevada, and the buyer resided in New York, so he did not inspect the car when he bought it. After the car was delivered, the buyer discovered that it was in very poor condition. It had been damaged in an accident, its upholstery was stained, it had areas of rust, and it required extensive and expensive mechanical repairs. The buyer sued the seller, claiming that the despite knowing about all the problems with the car, the seller had fraudulently misrepresented that the car was gorgeous and virtually unblemished. The Appellate Division affirmed the trial court's dismissal of the buyer's suit. The court pointed out that the description of the car as "gorgeous" was a generalized expression of opinion and mere puffery. The court recognized that the remaining misrepresentations were more substantial, but it refused relief to the buyer because they were all easily discoverable by obtaining a vehicle history report and a mechanical inspection. The court said it was no excuse that the car was located in Nevada—the buyer could have arranged for an inspection there.

§13.6.7 Injury and Remedy

Courts commonly require, as a final element of fraud, that the victim must have been injured. Injury is easy to see if misrepresentation caused the victim to overpay for the contractual performance—that is, that the performance is valueless or less valuable than it would have been had the representation been true. For example, the presence of bats, bugs, or vandals very likely diminished the market value of the houses in *Jablonski*, *Weintraub*, and *Willen* or would have resulted in cost to rectify these unpleasant phenomena. In buying Kellogg products that it could not sell, Kaloti surely suffered loss of its anticipated profit and may have been saddled with unsalable goods. However, sometimes the precise economic injury is more difficult to

ascertain. For example, say that the reputed presence of ghosts had no effect on the market price of the house in *Stambovski* or that Rozen did a decent job on the tax returns of Greenberg's clients and generated the expected profits. The fact that there may be no measurable economic loss in these cases does not inevitably mean that there is no injury. The injury could lie simply in the fact that the victim finds herself in a contract that is completely different from what she expected and wanted.

The alternative remedies available for fraud allow a court to give relief whether or not actual economic loss resulted from the fraud. Even if there is no economic loss, a victim who does not desire the contract because of the misrepresentation is entitled to avoid it—to claim rescission. Upon rescission, a claim for restitution arises in favor of a party who has performed in whole or in part. In the absence of a contract, there is no basis for retaining a benefit given under the contract, so principles of unjust enrichment require that benefit to be returned. Benefit is measured by the value of property, which could be different from its contract price. This principle applies whether it is the victim or the perpetrator who has been enriched. However, the law imposes limits on the restitutionary rights of the perpetrator. Any doubts on the value of his performance are resolved against him. In addition, the victim is not obliged to return property or its value to the extent that it was worthless when received or deteriorated as a result of its own defects. (*See* Restatement, Second, §§164, 376, and 385.)

As noted in section 13.3, a contract induced by fraud is voidable, not void. This means that the victim may elect to rescind it if she desires but may choose to keep it in force. If she does so, she can claim damages to compensate for the difference between the actual value of the performance and the value that it would have had as represented. This damages claim includes such losses as reduction in market value or the costs of bringing the property into the condition as represented.

Traditionally, the remedy of rescission and restitution derives from contract law, but the remedy of damages has its roots in tort (fraud being a tort as well as a breach of contract). This could make a difference to remedy. For example, a court that applies the traditional distinction would allow a plaintiff who sues for damages to claim punitive damages as well, because the suit is based on tort. However, punitive damages are not available in contract, so a court following the traditional distinction would not award punitive damages if the plaintiff sued for rescission. This does not make a lot

of sense, since the defendant's wrongful act is exactly the same, whichever form of relief is sought. Also, a rigorous focus on the tort-contract distinction would mean that if a plaintiff sues for rescission, she cannot claim any damages, even if the tort led to economic loss. This distinction between the contract and tort derivation of the alternative remedies has faded, and many modern courts do not apply it. Rather, they simply treat the remedies as available possibilities and provide the relief called for by the harm to the victim. This means that in appropriate circumstances, a court may award rescission together with damages for proven loss beyond restitution (offset by any restitution due to the perpetrator) or that it may permit punitive damages in a rescission suit.

---

§13.7 NEGLIGENT OR INNOCENT MISREPRESENTATION

A misrepresentation made without the deliberate intent to mislead is classified either as negligent or innocent. (As mentioned earlier, a reckless or grossly negligent misrepresentation may qualify as fraud, because knowledge of falsity could be inferred where an assertion is made without confidence in its truth or a known basis in fact.) The distinction between negligence and innocence is not always easy to make, and it depends on the circumstances of each case. A misrepresentation is negligent if the person making it failed to act with reasonable care in ascertaining and communicating the truth, but it is innocent if no such duty was breached.

Although negligent and innocent misrepresentations do not carry the same degree of disapprobation as a deliberate lie, they do permit avoidance if they are material and have induced justifiable reliance. (Although Restatement, Second, §§162 and 164 do not include materiality as an element for fraudulent misrepresentation, they do specifically mention materiality as an element for nonfraudulent misrepresentation.) Thus, an innocent or negligent misrepresentation gives grounds for relief only if it relates to a fact central to the transaction and the party making the misrepresentation knew or had reason to know of its importance. It follows from this that the test of justifiable reliance is correspondingly strengthened, because materiality to the victim is seen from the reasonable perspective of the other. This approach

accords with the general idea that some balance must be struck between the fault of the misrepresenting party and the reasonable expectations of the victim. To the extent that the party making the misrepresentation is less culpable, one would expect a stronger showing of the importance of the misrepresentation and the victim's reasonable reliance. It is also noted in section 13.5.2 that while an exception to the parol evidence rule allows the admission of parol evidence to show fraud, parol evidence relating to a nonfraudulent misrepresentation is excluded by the parol evidence rule if the writing is integrated or the term is inconsistent with a partially integrated writing.

It can be difficult to distinguish an innocent or negligent misrepresentation from a contractual promise. For example, the seller of a house, having inspected it and found no termites, informs the buyer that the house is termite-free. If termites are present this could qualify as a misrepresentation, or it could be a warranty—a contractual promise that the house does not have termites. If it is the former, the remedy of avoidance is appropriate, but if it is the latter, the failure of the house to comply with the warranty is a breach of contract, giving rise to the remedies discussed in Chapter 18. The distinction is largely factual and interpretational. It depends on whether the assertion was merely a statement inducing the contract or was actually incorporated into the contract to become one of the promises made as part of the seller's consideration for the price of the house.

§13.8 DURESS

§13.8.1 The Nature of Duress

In older contract law, duress was available as a ground of avoiding a contract only in extreme circumstances. A party claiming duress had to show that the other had induced the contract by using actual force or an unlawful threat of death or bodily harm (not merely property damage). In addition, the test of inducement was objective: The threat must have been such as would overcome the resistance of a person of "ordinary firmness." The example in section 13.2, involving Lilly Livered's sale of her casino at gunpoint to Attila "The Animal" Axehacker is a classic case of duress in this sense. Even under these strict standards, Lilly should be able to avoid the contract by showing

that Attila engaged in the threatening conduct, that it was unlawful and constituted a credible threat, and that she was not being unduly wimpy in giving in to it.

During the course of the twentieth century, duress moved beyond these narrow confines, and it is now well established that a person's free will can be undermined by unfair pressure short of physical compulsion or a threat of looming personal injury. An illegitimate threat to proprietary or economic interests (sometimes referred to as "economic duress") is accepted in modern cases as a basis for relief. Also, the strongly objective test of "ordinary firmness" has been abandoned in favor of a less rigorous standard that combines objective and subjective factors: Did the victim have no reasonable alternative but to agree? Duress has thus become a much broader doctrine, better able to accommodate situations in which one party uses subtle threats or improper pressure to gain the other's acquiescence to a transaction. As with fraud, the basis of avoidance is consistent with, but an exception to, the general objective test of assent. The underlying rationale is that the victim should not be held accountable for her apparent assent when it is not genuine, and the other party, having improperly induced it, does not have a compelling reliance interest.

The contemporary approach to duress is set out in Restatement, Second, §§174, 175, and 176. Section 174 deals with the rare situation in which a person's manifestation of assent is physically compelled, so that the act of manifesting assent completely lacks free will. For example, instead of Attila placing his gun up Lilly's nostril, inducing her to sign, he actually clasps her fingers around a pen and forces her hand across the paper to make a signature. Because Lilly is rendered like an automaton by the physical compulsion, §174 treats such an apparent contract as void. We need not be further concerned with this unusual situation, and turn to the more common forms of duress, covered by §§175 and 176, in which an improper threat has the effect of making the contract voidable. In essence, these sections set out the following elements: One of the parties must make a threat; the threat must be improper; and it must induce the apparent assent, in that it leaves the victim no reasonable alternative but to agree.

§13.8.2 The Threat

Although the contemporary doctrine of duress still requires an improper

threat, the modern concept of threat has expanded well beyond the confines of its original scope. Today, a threat may be defined as an indication of intent to do or refrain from doing something so as to inflict some harm, loss, injury, or other undesirable consequences that would have an adverse effect on the victim's person or personal or economic interests. This encompasses a wide range of behavior, including not only explicit intimidation but also subtle or even unspoken threats. The presence of an implied threat is determined by interpretation in the usual way, taking into account the circumstances of the relationship between the parties. The transaction is examined in context to ascertain if the words or actions of the one party show a reasonable intent to make a threat, reasonably so understood by the other. The threat may be either to take positive action or to refrain from acting, and the harm may consist of any adverse consequences sufficient to overcome the victim's resistance to the contract. A threat could even be implicit in the transaction when one party knows that the other will suffer undesirable consequences if the contract is not made, and uses this knowledge to take unfair advantage of the other's need.

While this wider and more realistic scope allows courts to police less obvious forms of duress, it is less certain and stable than the earlier, more rigid approach. As a result, it presents the danger of undue judicial interference in borderline cases where the line blurs between legitimate hard bargaining and improper coercion. In this area it must be used cautiously, because duress doctrine should be used only when there has been wrongful bargaining conduct, and should not be misapplied to overturn a tough or burdensome contract simply because one of the parties has managed to use bargaining advantage effectively.

An example will illustrate how difficult it can be to distinguish legally acceptable market behavior from unfair pressure: Say that Lilly needs to sell her casino quickly because she urgently needs money to pay for an operation to cure a dangerous medical condition. Attila knows of her trouble and also knows that she will have difficulty finding a buyer quickly. He therefore offers her less than market price for her casino. Because her need for the money is desperate, she sees no alternative but to sell to Attila for that price. Clearly, Attila has taken advantage of her plight, but the only threat he has made is that unless she meets his terms, he will not contract with her. Such a threat is implicit in all contract negotiations, so it can hardly be viewed as duress. This could simply be treated as a case in which Attila has used his

market position to obtain a favorable deal.[5] In this example, Lilly's bargaining weakness was caused by her need for an operation, so her case invokes easy sympathy. Some needs are less compelling and thus move away from the borderline of duress, more clearly falling into the realm of legally acceptable market interaction. Say, for example, that Attila desperately craved to own Lilly's casino, but Lilly refused to sell it unless he paid an exorbitant price. If Attila succumbs to his desires and agrees to buy at that price, he cannot claim that he acted under duress.

Because relief for duress is premised on wrongful coercion by one of the contracting parties, that party must usually be responsible for the threat. If the threat is made by a nonparty, the victim cannot normally avoid the contract unless the other party is implicated in the threat or knowingly took advantage of it. Outside pressure should not readily defeat the legitimate expectations of an innocent party who relied on the transaction in good faith and without knowledge of the threat. For example, Attila made several fair and increasingly generous offers to buy Lilly's casino but Lilly steadfastly rebuffed him every time until, one day, she received a visit from his godfather, Bull "The Butcher" Bloodbath, who threatened to smash her kneecaps unless she sold to Attila. Duress is clearly present if Attila is in some way implicated in his godfather's threat. However, if Attila's godfather acted entirely independently and without Attila's knowledge, application of the doctrine of duress would defeat Attila's honest reliance interest in the fair contract. This means that in most cases, the victim cannot raise the defense of duress. However, the protection of Attila's reliance is not absolute, and may be outweighed by the public policy of protecting people from violence. Therefore, where the conduct of the nonparty amounts to actual physical force against the victim or the threat of such force, the duress may be serious enough to render the contract void, not just voidable. The effect of this is that the contract is a nullity and cannot be enforced, even though Attila was entirely innocent and did not instigate or have knowledge of the duress. (Restatement, Second, §174 gives some recognition to this principle, but would invoke it only where the physical compulsion is so great as to render the victim a mere instrument of the perpetrator.)

Gascho v. Scheurer Hospital, 400 Fed. Appx. 978 (6th Cir. 2010), provides a good illustration of economic and third-party pressure that did not constitute duress. Gascho was a nurse and a longtime employee of the hospital. She was married to its president and CEO. There were difficulties in

the marriage. Gascho claimed that her husband abused her both physically and emotionally, and that he also had an affair with a hospital vice president. Gascho was fired by her husband after a confrontation at work with him and the vice president with whom he was having the affair. When other hospital executives heard of the circumstances of Gascho's discharge, they converted it into a three-day suspension, followed by a medical leave. About a month later, the hospital offered Gascho a separation agreement under which she would receive a year's salary and benefits in exchange for her voluntary resignation and release of any claims that she may have against the hospital. The hospital's human resources director advised Gascho to consult an employment lawyer and gave her 21 days to sign the agreement, as well as a 7-day period to change her mind if she did sign it. Gascho claimed that after she was offered the separation agreement, her husband threatened and cajoled her on several occasions to accept the hospital's offer. She did seek advice about signing the agreement from various people, but did not consult an employment lawyer. She did eventually sign it. About a year later, she filed suit seeking to rescind it and to claim damages against the hospital for sexual harassment. The trial court dismissed her suit on the basis that she was bound by the release. The court of appeals affirmed. The court found that the bargaining process followed by the hospital was fair—the hospital explained the proposed agreement to her, gave her time to consider it and to seek counsel, and allowed her an opportunity to rescind after signing. The terms of the agreement were clear and she received fair consideration for the resignation and release. Gascho claimed duress on two grounds. First, she argued that if she did not accept the settlement, she would suffer economic hardship and the prospect of uncertain and lengthy litigation to vindicate her rights. The court rejected this argument: The only implicit threat that the hospital made was that if she did not accept its offer, she would not get the severance package and would have to litigate any claim she had. This is not an improper threat, but merely a normal incidence of negotiating a settlement. The fact that Gascho would suffer adverse economic consequences if she did not accept the contract is nothing more than the common form of economic pressure that people have to contend with in deciding whether to enter a contract. Gascho's second ground of duress was that she was intimidated by her husband's abuse and threats. The court recognized that the alleged threats made by her husband could amount to duress, but the hospital did not make those threats and could not be held accountable for them. (The court did not

explain why the threats of the husband, who was the CEO of the hospital, could not be attributed to it. But it seems that the hospital distanced itself sufficiently from its CEO to persuade the court that he should be treated as a third party, not as an agent of the hospital.)

§13.8.3 Impropriety

When is a threat improper? In addition to the obvious threats of criminal or tortious conduct, modern law tends to take a broad view of impropriety, so that it could include any threatened behavior that goes beyond the legitimate rights of the party applying the pressure, or that constitutes an abuse of those rights. This would include, for example, a threat to engage in vexatious litigation, to withhold a performance or property to which the victim is entitled, to disclose information that would embarrass the victim, or otherwise to do something spiteful or vexatious purely for the sake of hurting the victim. It is, of course, not duress to threaten consequences, even dire ones, that may lawfully and properly be pursued in the absence of agreement. For example, at the time for renewal of an employment contract, an employee who has become indispensable may legitimately threaten not to renew the contract unless the employer agrees to a substantial raise. Similarly, a person with a colorable tort claim may justifiably threaten to sue unless the tortfeasor agrees to a settlement. As *Gascho* shows, it is also not improper to threaten (expressly or impliedly) to refuse to enter into a contract unless the other party accepts your terms. However, a threat to file criminal charges is regarded as improper, even if prosecution is warranted, because it is against public policy for a person to use the threat of criminal prosecution as a bargaining chip.

§13.8.4 Inducement

As noted earlier, the older test for inducement was objective. It required not only that the threat was credible but also that it would have overcome the resistance of a person of "ordinary firmness." The contemporary test is not so rigorous. Although it has an objective element, it also takes the subjective attributes of the victim into account, recognizing that a bully should not be able to enforce a contract merely because his victim is easily intimidated. The inquiry is whether, under all the circumstances, the duress substantially

overcame the free will of this party, leaving him no reasonable alternative but to acquiesce. Inducement is therefore considered not in the abstract but in light of the victim's needs, personality, and circumstances.

An alternative is only reasonable if it is a feasible and practical means of evading the consequences of the threat. If it would be unduly burdensome or risky, or would not likely avoid the threatened consequences, the victim cannot be said to have had a reasonable alternative to manifesting assent. For example, say that Attila owes Lilly $1 million from a prior transaction. He threatens not to pay her unless she agrees to sell her casino to him. Lilly does have the alternative of refusing to sell and commencing suit against Attila for the debt. However, this alternative is not reasonable for Lilly if she needs the money immediately and cannot afford the cost and delay of litigating to enforce payment.

Merry Gentleman, LLC v. George and Leona Productions, Inc., 2013 WL 4105578 (N.D. Ill. 2013), provides another example of lack of reasonable alternative. The actor Michael Keaton was engaged by Merry Gentleman, LLC, a production company, to direct the movie *Merry Gentleman*. After completing the shooting of the movie, Keaton did a first cut of the movie, which the production company found to be (and Keaton conceded to be) unsatisfactory. The production company therefore prepared its own cut, which it planned to use instead. Shortly thereafter, the Sundance film festival selected the movie for screening. Sundance insisted that Keaton, as the director, be present at the screening and made it clear that it would not premiere the movie unless he attended. Keaton insisted that his cut of the movie be used at the Sundance screening instead of the production company's cut and refused to attend the screening unless this demand was met. At that point the production company had invested $4 million in the film, and it had very little time (about two months) before the Sundance festival in which to get Keaton to agree to attend the screening so that Sundance would not drop the movie from the festival. The production company therefore entered into a settlement with Keaton under which it agreed to use his cut at Sundance, and each party released all claims against the other arising out of the contract and its performance. After the screening, the production company sued Keaton for breach of contract. He raised the release as a defense and moved to dismiss the claim. The production company argued that the release was invalid because it had been entered into under duress. The court denied Keaton's motion to dismiss the claim, holding

that the production company had made out a sufficient case of duress to go to trial. Keaton's threat to boycott the Sundance film festival unless his cut was used was a wrongful threat—it was an opportunistic exploitation of a situation in which the production company had no meaningful option but to accede to the release. The production company's only alternative to signing the release was to sue Keaton at that stage for his breach of the contract. But given the investment that the company had made in producing the movie, the coveted opportunity to screen it at Sundance, and the very short time to satisfy Sundance's requirement that the director attend the screening, it had no reasonable alternative but to agree to the release.

§13.8.5 Remedy

It is sometimes said that when a contract is induced by an extreme degree of duress, such as actual physical force or a threat of physical violence, the contract is void, because there has been no assent. However, because duress doctrine is designed to protect the victim, the more common and logical approach is to treat it as voidable at the victim's election. (The situations involving a physically compelled signature, mentioned in section 13.8.1, and extreme physical violence by a third party, discussed in section 13.8.2, may be narrow exceptions.) The victim may choose to abide by the contract despite the duress, or may decide to avoid it, claim restitution of any benefit conferred, and tender restoration of any benefit received. The remedy of avoidance and restitution is subject to the same general principles discussed in connection with misrepresentation.

Although in most cases the victim must choose between keeping the contract, subject to all its terms, or avoiding it entirely, there are circumstances in which courts allow a middle path—retention of the contract subject to an adjustment of its terms. For example, if a party desires to keep property purchased, but can show that she was forced to pay an excessive price for it, the court may enforce the contract, subject to a refund to the victim of the amount in excess of fair value. Although, as we see in section 13.11, the adjustment of contract terms is a common method of curing unconscionability, it is not often employed in duress cases. However, the remedy is within the courts' discretion in granting relief for duress. If the act of duress is a tort, the victim is able to obtain damages in tort in addition to any relief under contract law.

§13.9 DURESS IN THE MODIFICATION OF AN EXISTING CONTRACT

§13.9.1 Consideration Doctrine

As explained in section 7.5, under the preexisting duty rule a party does not suffer a legal detriment by promising to do what he is already bound to do under an existing contract. For this reason, a promise by one party to increase or enhance his performance under a contract is not binding unless it is supported by new consideration given by the other. Stated differently, under common law, an agreement to modify a contract is not valid unless both parties have suffered some new detriment under the modification. The preexisting duty rule can serve as a means of refusing enforcement of a coerced modification. The most famous illustration of this use of consideration doctrine is *Alaska Packers Assn. v. Domenico*, 117 F. 99 (9th Cir. 1902). A cannery contracted with a group of fishermen to harvest salmon during the short Alaskan season. After the fishermen had been transported to Alaska and the season had begun, they refused to continue work unless their wages were increased. (Their demand was based on the pretext that working conditions were more burdensome than expected, but this contention was disputed by the employer and not accepted at trial.) The employer had to acquiesce because it would have been impossible to get a replacement crew to Alaska in time for the harvest, but when the fishermen claimed the extra wages at the end of the season, the employer refused to pay. The court found against the fishermen on the basis that they had incurred no new detriment in exchange for the promise of a wage increase. However, the opinion makes it clear that the true reason for nonenforcement was that the court considered the demand for more money to have been extortionate and unjustified.

§13.9.2 Common Law Duress Doctrine in Relation to Modifications

It is pointed out in section 7.5.2 that consideration doctrine is a clumsy tool for policing coerced modifications. It does not allow for easy discrimination between legitimate and improper modifications, and it can be circumvented if the party demanding the modification undertakes some new detriment of relatively small value in relation to the gain to be received, or if the parties go

through the ritual of terminating the original contract and executing a new one. It is more efficient to focus directly on the problem of coerced modification by evaluating it under the rules of duress. That is, the modification should be upheld if it was fairly bargained, but it should be avoided if the one party's assent to provide increased compensation was induced by the other's improper threat to otherwise withhold his promised performance.

This is the approach adopted in another well-known case, *Austin Instrument Co. v. Loral Corp.*, 272 N.E.2d 533 (N.Y. 1971). Loral had been awarded a Navy contract to supply radar equipment. It was subject to strict delivery terms and a substantial liability for late delivery. It subcontracted with Austin for the supply of components. After performance had begun, Austin realized that it had underbid. It threatened not to deliver the parts ordered unless Loral agreed to a price increase. (The extent of the extortion was aggravated by the additional demand that Loral agree to use Austin as the subcontractor in another contract Loral had just made with the Navy.) Loral tried to find another supplier, but it could not obtain the components elsewhere in time. Faced with inevitable delay, liability for damages to the Navy, and harm to its reputation as a reliable contractor, Loral unsuccessfully tried to negotiate with Austin and eventually, under protest, gave in to its demands. After the completion of performance Loral refused to pay the extra price and Austin sued. The majority of the court held that Loral's free will was undermined by the pressure induced by Austin's threat of breach, so the modification was voidable on grounds of duress. However, a dissent expressed the view that the demand for a higher price was commercially reasonable because there had been a genuine escalation of costs, and agreements for price increases were not uncommon under such circumstances.

This difference in view shows that the distinction between a fair modification and an extortionate one is not always self-evident, but involves a careful evaluation of the motivation and business justification of the demand, the commercial expectations and practices, the force with which the demand is asserted, and the pressures to which the acquiescing party is subject. A subtle line separates opportunism and abuse of power from a fair request for an adjustment of terms.

§13.9.3 Modification Under UCC Article 2

Although *Austin Instrument* involved a sale of goods, the court did not refer to Article 2 and resolved the case under principles of common law. This shows that duress (and other common law policing doctrines) enables a court to invalidate unfair contract modifications directly without struggling with consideration issues. However, policing doctrines are only of use in avoiding an unfair modification. They do not overcome the consideration problem at common law where lack of consideration for the modification makes a fairly bargained modification invalid. UCC §2.209 deals with this problem while providing a basis for avoiding a modification that was not obtained in good faith.

UCC §2.209(1) states specifically that the modification of a contract for the sale of goods does not need consideration to be binding. Comment 2 to §2.209 states that although consideration is not needed, a party cannot use bad faith to escape performance on the original contract terms, and that the modification must meet the test of good faith. The "extortion of a 'modification' without legitimate commercial reason is ineffective as a violation of the duty of good faith." Therefore, although the duty of good faith has a broader scope than duress doctrine, Comment 2 makes it clear that the section covers extortion of a modification by duress. As is always true of the good faith standard, the question of what constitutes a lack of good faith can be difficult to decide where the party's conduct falls short of fraud, duress, or other clearly improper conduct. It involves an evaluation of the state of mind of the party who seeks to enforce the modification in light of the overall commercial circumstances and the business justifications or other factors motivating the parties' agreement to a change in the contract terms.

§13.9.4 The Enforcement of Modifications Despite an Absence of Consideration

Even when consideration doctrine is applied to a modification in a common law case, there are two situations recognized by Restatement, Second, §89 in which the modification may be enforced despite the absence of consideration. The first is when the party benefited by the promise of modification has acted to her detriment in reliance on it, under circumstances in which it would be unjust to refuse enforcement. In other words, in appropriate circumstances, the doctrine of promissory estoppel may be applied to enforce a modification fully or in part. The second is when the modification was motivated by

unforeseen supervening difficulties. That is, where a change in circumstances so alters a basic assumption of the contract, that the performance of the party seeking the modification becomes more burdensome than originally expected. For example, say that Loral entered into a contract with an air freight carrier to deliver the radar sets to the Navy. After the contract was executed, but before the date for shipment, the cost of air fuel skyrocketed as a result of a severe and unexpected disturbance in the market. If the carrier, without making any threat of breaching the contract, is able to persuade Loral to agree to an increase in the freight charges, this modification of the contract might be upheld under the supervening difficulties doctrine, even if the carrier suffers no new detriment in exchange for Loral's promise to pay more.[6] If the contract was for the sale of goods, rather than for the carriage of freight, we would not need the supervening difficulties rule because of §2.209. The unexpected price increase would be just one of the factors that the court would take into account in deciding whether the modification was in good faith.

§13.10 UNDUE INFLUENCE

The doctrine of undue influence was developed by courts of equity to deal with situations in which duress was not present but one of the parties had a particularly strong influence over the other and abused this position of dominance to persuade the subservient party to enter a disadvantageous contract. Thus, while duress provides relief to one whose apparent assent has been induced by an unlawful threat, undue influence is concerned with cases of abuse of trust. Like duress, undue influence makes the contract voidable at the instance of the victim. In most jurisdictions, the doctrine has not been extended beyond its original confines and is not available to redress unfair persuasion in arm's-length transactions. Restatement, Second, §177 reflects this narrow scope by confining the doctrine to relationships of dependence and trust. Although it would have been possible for courts to enlarge the scope of undue influence, making it available in all cases of unfair persuasion, the expanded concept of duress and the expansion of unconscionability doctrine in the twentieth century provide a sufficient basis for the general regulation of bargaining, eliminating the need for a broader

application of undue influence. As a result, undue influence has retained its specific character in most states.

To obtain relief for undue influence, the victim must establish three elements: first, that a relationship of trust and dependency existed between the victim and the other party; second, that this relationship gave the other party dominance over the victim and imposed on him the duty not to act contrary to the victim's interests; and third, that the dominant party abused this position by unfairly persuading the victim to enter a contract adverse to the victim's interests.

For example, say that Lilly's father had established and built up the casino. Lilly had never been involved in the business. When her father died and left the casino to her, she had to keep this large and complex enterprise running. Because she had no clue about casino management or business in general, she turned to her father's longtime bookkeeper, Sel "The Skimmer" Short, for assistance in running it. Taking advantage of her inexperience and faith in him, Sel persuaded Lilly to sell him a large amount of stock at a bargain price.

The law does not absolutely bar contracts between a dominant party and the party who depends on him, and relief is available only if the weaker party can show that the dominant party abused his power by unfair persuasion. Unfair persuasion is an elastic concept. When the relationship of dependency is strong and the resulting contract is clearly disadvantageous to the weaker party, unfair persuasion may be inferred from those facts alone, and it may not be necessary to point to any specific underhanded bargaining strategy. However, if the degree of dependency is not as intense or the terms of the contract are not patently unfair, evidence of improper bargaining or oppressive circumstances may be needed to bolster the claim of undue influence. Unseemly bargaining can, as usual, take many forms, including the use of high-pressure tactics, the failure to disclose information, concealment of self-interest, or discouraging recourse to other advisers.

---

§13.11 UNCONSCIONABILITY

§13.11.1 The Role of Unconscionability

As noted earlier, duress does not cover situations in which there is no threat,

express or implied. This means that it does not provide a mechanism for policing contracts that are not induced by threat, yet are the result of unfair pressure or abuse of power. Similarly, unless there is some relationship of trust between the parties, undue influence is not available in most jurisdictions to redress an imposition of terms on a weaker party. Even when imposition is accompanied by some degree of dishonesty, fraud cannot be claimed unless the misrepresentation and its consequent inducement are serious enough to satisfy the elements of fraud. Nevertheless, meaningful and genuine assent may be just as badly undermined when one party is able to impose an unfair contract on the other, using a strong bargaining position or unethical tactics to take advantage of the other's weakness, ignorance, or distress. The law therefore needs a more general doctrine under which courts may provide relief in cases that do not clearly fall within any of the more specific doctrines. The concept of unconscionability helps cater to these situations.

Unconscionability is most commonly associated with consumer transactions in which a relatively large and powerful corporation supplies a standard form contract that is signed by a consumer with little or no opportunity to negotiate its terms. However, it is important to take note of two points. First, as the following discussion shows, a contract is not unconscionable merely because it is on standard terms drafted by an economically powerful party. Second, the doctrine is not confined to consumer transactions. It is equally applicable to commercial transactions between businesses. Bear in mind that many businesses are small, and some are operated by an individual, so there is sometimes not a clear dividing line between an individual who makes a contract as a consumer or as a business. However, the degree to which the party claiming unconscionability has economic power and business sophistication does have an impact on the finding of unconscionability. Therefore, it is often more difficult for a commercial entity to obtain relief under this doctrine.

§13.11.2 The Nature and Origins of Unconscionability

Unconscionability originated as a discretionary bar to equitable relief in a contract suit. It is the function of a court of equity[7] to do justice between the parties, and it would therefore decline relief to a plaintiff who had behaved inequitably. For example, if a party to a contract sued for equitable relief

(such as specific performance) under a contract that was harsh or unfairly bargained, the court would refuse to enforce it on the ground that to do so would offend its conscience. Even after the courts of law and equity were combined, many courts did not recognize unconscionability as generally available and would only consider using the doctrine when the relief sought in the case was equitable in nature. Because most contract cases involve claims for damages or other relief at law, and claims in equity are less common, relief for unconscionability was often unavailable.

This changed dramatically when the UCC was enacted because §2.302 adopted the doctrine as a general rule, applicable to all contracts for the sale of goods. As a result of the strong influence of the UCC on the common law, courts began to apply unconscionability doctrine in cases at law involving contracts other than sales of goods. This trend was recognized and bolstered by Restatement, Second, §208, which closely follows the wording of UCC §2.302. Unconscionability is now firmly established as a general doctrine of contract law, applicable whether the basis of the suit is legal or equitable.

Unconscionability is decided by the judge, not the jury. The origin of this rule is in the equitable derivation of the doctrine, because juries have never been used in cases at equity. However, even though the doctrine is now applicable in law cases as well, the rule has not changed. Both Article 2 and the Restatement, Second, specifically state that unconscionability is a matter of law, to be decided by the judge. The main reason for preserving this rule is that a determination of unconscionability has a strong discretionary content, so it is better left in the hands of the judge.

§13.11.3 The Elements of Unconscionability

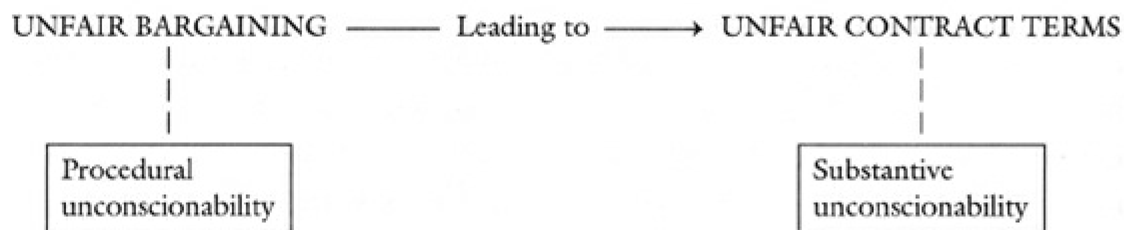
The UCC and Restatement, Second, simply acknowledge that the court has the power to refuse enforcement of an unconscionable contract or to adjust the contract by removing or modifying the unconscionable provision. Neither section attempts to say what constitutes unconscionability, but the Official Comments to §2.302, largely echoed in the comments to §208 of Restatement, Second, provide some general guidance to the court in exercising its discretion to determine whether unconscionability exists. Official Comment 1 to UCC §2.302 states that the basic test is whether, in the context of the commercial background and transactional circumstances, the contract or term is so one-sided as to be unconscionable. It expresses the aim

of the doctrine as the prevention of "oppression and unfair surprise" but not the disturbance of the "allocation of risks because of superior bargaining power." Restatement, Second, Comment *d* to §208 makes a similar observation and expands on it by noting that gross inequality of bargaining power may satisfy the requirement of unconscionability if combined with substantively unfair terms. The Restatement comment also lists some indicia of oppressive bargaining, such as some degree of deception or compulsion, or an awareness by a dominant party of infirmity, ignorance, or lack of understanding on the part of the other. In essence, the comments point to a two-part test that examines both the process of bargaining and the resulting contract terms. *Williams v. Walker Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965), one of the earliest cases to deal with the modern approach to unconscionability, defined unconscionability as the absence of meaningful choice by the one party resulting in contract terms unreasonably favorable to the other.[8]

Over the years, as courts have worked with these vague guidelines, they have given them more content. However, because of the equitable derivation and discretionary nature of doctrine, the test for unconscionability remains quite open-ended and fluid. A very influential law review article,[9] written soon after the enactment of UCC §2.302, has given us the terminology that is now universally used to describe the two-part test of unconscionability. Unfairness in the bargaining process is called procedural unconscionability, and unfairness in the resulting contract is called substantive unconscionability. The relationship between these elements is not entirely clear. Courts generally require that both elements must be satisfied for a finding of unconscionability. That is, the court will not find a contract to be unconscionable unless the party seeking relief can demonstrate both improper conduct of the other party in the bargaining process and substantive unfairness in the resulting contract. However, there are cases in which courts have held that where one of these elements is present in a significant degree, the other need not be established. These cases suggest that if the terms of a contract are patently unfair and one-sided, the party seeking avoidance need not show procedural unconscionability. Similarly, proof of grossly improper bargaining tactics may be enough, even without a showing of substantively unfair terms. However, for the most part, this overstates the case, and it is more accurate to say that both elements are always needed, but in some transactions a powerful showing of one of the elements will allow the court to

make an assumption, without much concrete proof, that the other must be present as well. For example, in a situation involving disparate bargaining power, great unfairness in the terms of the contract may itself lead to the conclusion that the party who benefits from the unfair terms has engaged in procedurally unconscionable conduct by taking unfair advantage of its dominance. Diagram 13B sketches the relationship between the two elements of unconscionability, which we examine more fully in the following sections.

Diagram 13B



§13.11.4 Procedural Unconscionability

As noted in section 13.11.3, this element focuses on the bargaining conduct of the party who is alleged to have behaved unconscionably in the formation of the contract. As we have seen, the doctrines of duress, fraud, and undue influence are all aimed at improper bargaining conduct. However, they all have specific elements. Because the concept of procedural unconscionability is more flexible, it allows the court to deal with pressure, deception, or unfair persuasion that does not fit into the more exacting requirements of duress, fraud, or undue influence. Therefore, the principal value of unconscionability doctrine is that it expands the court's policing power, allowing it to provide relief for unfair bargaining that would not be available under the more specific policing mechanisms.

However, the flexibility of procedural unconscionability presents the risk that it could be too broadly applied. The comments to UCC §2.302 and Restatement, Second, §208 emphasize that mere disparity of bargaining power is not enough to make a contract procedurally unconscionable. It is not the doctrine's purpose to correct an imbalance between the parties in their market advantage, sophistication, or resources. Such a broad use of the doctrine would undermine the policy of protecting reliance by allowing a

party dissatisfied with a contract to request relief just because the other party was smarter, bigger, or wealthier or had better lawyers. But this does not mean that the relative strength of the parties is irrelevant to the issue of unconscionability. Often it is only because of a disparity in power that a dominant party is able to behave in an unfair or oppressive manner or to insist on unfair terms. Similarly, the weaker party's lack of sophistication could make it easier to take advantage of her. Thus the key is not whether one party was more powerful, sophisticated, or knowledgeable than the other but whether it abused its power to impose its will on the other party.

Having said this, it must be acknowledged that there are situations in which the abuse of power is quite subtle. There is no obvious dishonesty or unfair persuasion, yet it is nevertheless clear that one of the parties used its position of dominance to impose the contract or particular contract terms on the weaker. That is, one of the parties enters the transaction with such bargaining power relative to the other, that the stronger party has enough control over the transaction to leave the weaker with no choice but to enter it on the terms proposed by the dominant party. Contracts entered into under these circumstances have come to be known as contracts of adhesion because the weaker party is seen as adhering without choice to terms dictated by the stronger. Contracts of adhesion were introduced in section 5.4 and are examined more fully in section 13.12, but it is useful to anticipate and emphasize the point made in that discussion, that a contract does not become adhesive or unconscionable merely because one of the parties has greater bargaining power. Some degree of procedural impropriety—an abuse of that power—should be present as well. Nevertheless, when substantively unfair terms are present and are attributable to the bargaining dominance of the party favored by the terms, it is relatively easy to conclude that the weaker party was deprived of free choice by a degree of dominance that, in itself, amounted to procedural unfairness.

§13.11.5 Substantive Unconscionability

It should be apparent from the discussion of procedural unconscionability that there is a close relationship of cause and effect between the procedural and substantive elements: By engaging in unconscionable conduct during formation, one of the parties has been able to impose a substantively unconscionable contract or contract term on the other. It is not usually

enough to show merely that the contract is disadvantageous to the complaining party or strongly favorable to the other. As we saw in the discussion of consideration doctrine in section 7.7, courts do not usually inquire into adequacy of consideration and will not normally invalidate or adjust a contract merely because one of the parties overpaid, underbid, or otherwise made a disadvantageous or unwanted deal. Unless this unfortunate state of affairs was caused by the behavior that qualifies as procedurally unconscionable, the parties should both be held to their manifested agreement. Once again, this general rule must be qualified by the caveat that the substantive and procedural elements do not have to be present to an equal degree. When the contract terms are grossly oppressive, procedural unfairness may be found simply in the opportunistic use of a position of dominance.

Most commonly, a contract is substantively unconscionable when its terms are harsh, unfair, or unduly favorable to one of the parties. One could think of endless examples of unfair terms, such as an excessive price for goods or services, exorbitant interest rates, harsh penalties in the event of default, the waiver of legal protection or of the right to seek legal redress in a proper forum, and so on. The test suggested by Comment 1 to §2.302 calls on the court to decide whether, "in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the contract." This is a hopeless circumlocution, but it does at least suggest that a contract or term is unconscionable if it favors one of the parties more than should reasonably be expected, given the commercial context in which the contract was made. The comment goes on to identify one of the goals of the doctrine as the prevention of oppression, which, while also rather vague, gives some further hint of the direction of the inquiry.

Although the conclusion that a contract is substantively unconscionable is normally based on the presence of unfair terms, it is possible for substantive unconscionability to be present even when the contract appears fair and reasonable from an objective standpoint. The unfairness could lie in the fact that the weaker party did not desire the transaction but was unfairly persuaded to enter it. For example, say that the conduct of a door-to-door sales representative is procedurally unconscionable because high-pressure techniques and smooth talk are used to bamboozle a hapless householder into

buying an unneeded home appliance. Even if the price of the appliance and the other terms are reasonable, the contract as a whole may nevertheless be unconscionable, because it was unwanted by and imposed on the buyer.[10] As you can see, we are again looking at that balance between the substantive and procedural aspects of unconscionability.

§13.11.6 The Remedy for Unconscionability

As noted already, both the UCC and the Restatement, Second, leave it to the discretion of the court to devise the most appropriate response to an unconscionable contract or term. In exercising its discretion, the court is influenced, but not bound, by what relief the victim requests.

In some cases, the unconscionability so profoundly affects the quality of the victim's assent that she no longer desires the contract and should not be held to it. This is what would happen in the example of the consumer who was cajoled into buying the unwanted appliance. Here, the most appropriate remedy is for the court to refuse enforcement of the contract as a whole—that is, it avoids the contract. Upon avoidance, each party must restore any performance received under the contract under principles of unjust enrichment.

In other cases (particularly where the victim would like to keep the contract with appropriate adjustments), the better remedy may be to enforce the basic bargain but to change its terms to eliminate its unconscionable aspects. This may involve either severing the unconscionable part of the contract (that is, eliminating the unconscionable provision entirely) or just altering the term to make it fair. For example, a standard form contract for the sale of goods between a large retailer and a consumer requires all disputes to be arbitrated. The court finds that although the contract as a whole is unobjectionable, the arbitration term provides for a procedure that unduly favors the retailer. The consumer does not wish to avoid the contract as a whole but would like to avoid the arbitration term. The court could sever the arbitration term in its entirety, so that there is no longer any requirement to arbitrate and the parties must litigate their dispute before a court. Alternatively, the court could remove the unfair aspects of the arbitration term, but otherwise enforce it. This would mean that the parties are still bound to arbitrate, but the terms governing the arbitration are less one-sided. In deciding whether it is appropriate to sever or alter a term, the court

considers factors such as the degree to which the term was imposed without meaningful choice, the form of relief requested by the victim of unconscionability, and the impact that the change will have on the basis of the parties' bargain. Courts usually aim to interfere as little as possible with the contract's terms, and to correct the contract without fundamentally altering its purpose. Where a term cannot be severed without doing significant harm to the basis of the bargain, alteration of the term may be less intrusive. If neither severance nor alteration can cure the unconscionability, or the change in the terms fundamentally changes the nature of the agreement, avoidance of the contract is probably the only proper remedy.

The flexibility of the remedy for unconscionability often has an impact on the court's decision to find that a term is unconscionable. A court may more readily make a finding of unconscionability because it can craft a remedy that is less drastic than a total avoidance of the entire contract.

§13.11.7 A Final Note on the Temptation to Overuse Unconscionability Doctrine

Because unconscionability is such a vague and discretionary doctrine, a student may be tempted to argue it whenever the parties are not of equal bargaining power and the weaker party complains of an adverse term or contract. It therefore must be stressed that courts are careful in using the doctrine. Although we have seen that the doctrine is broad enough to make it very difficult to predict how a court might react to a claim of unconscionability, most courts do look seriously at the two elements that we have discussed and commonly require a showing of both. This is not to say that a notable discrepancy in bargaining power and sophistication is irrelevant—this often explains why the dominant party was able to take advantage of the weaker one. Bear this in mind as you read the section 13.12, on contracts of adhesion.

---

§13.12 UNCONSCIONABILITY AND ADHESION IN STANDARD CONTRACTS

§13.12.1 The Role of Adhesion in Unconscionability Analysis

Section 5.4 introduces the concept of adhesion in relation to standard contracts,[11] and the concept is referred to again in the discussion of procedural unconscionability in section 13.11.4. As explained in those sections, a contract is described as a contract of adhesion where one of the parties has the market power to refuse to contract except on nonnegotiable terms, and the other has no choice but to adhere to the terms if he wants the contract. It is much harder to label a contract as adhesive if the market for the desired object of the contract (such as goods, services, or employment) is competitive, and the nondrafting party is able to enter into a contract without those terms with someone else. Adhesion is more likely to be present if there is no competing provider who will contract on different terms, especially if the desired object of the contract is not a luxury.

Courts sometimes talk of adhesion in terms that suggest that it is a basis of relief independent of and separate from unconscionability. However, it would be a mistake to take this too literally, and you should not think of adhesion as divorced from unconscionability. Rather, adhesion is one of the factors that may persuade the court that the contract satisfies the elements of procedural and substantive unconscionability. That is, the fact that the dominant party had the power to insist on a contract on its own nonnegotiable terms may allow that party to take advantage of its dominance to impose an unfairly one-sided contract on the other. In effect, the abuse of the power to dictate the terms has resulted in an unfair contract. It is important to keep this perspective in mind, especially when dealing with nonnegotiable terms in standard contracts. As explained in Chapter 5, standard contracts are both widespread and necessary, whether the standard terms are in a signed paper or are presented on a website or in software as clickwrap, browsewrap, or shrinkwrap terms. Few, if any, courts would be willing to go so far as to say that it is per se unconscionable for a party to insist on contracting on nonnegotiable standard terms that it drafted to protect its own interests. This point is illustrated by *Feldman v. Google, Inc.*, 513 F. Supp. 2d 229 (E.D. Pa 2007), cited in section 5.3. The aspect of the opinion discussed in section 5.3 is whether Feldman had assented to a clickwrap forum selection clause by clicking the “I agree” button on Google’s website. The court held that the clause was easily accessible and conspicuously set out on the website, so Feldman was bound by his signification of assent. In addition to arguing that he did not assent to the term, Feldman claimed that the contract was adhesive and the term was unconscionable. The court disagreed. Although the term

was a standard, nonnegotiable term, there was no procedural unconscionability because Feldman did have reasonable notice of the term, and he had not shown that a lack of alternatives in the marketplace left him with no meaningful choice. The court also held that the term was not substantively unconscionable because it was not unreasonable, unexpected, or unduly one-sided.

Although a standard nonnegotiable term is not adhesive or unconscionable by that fact alone, it could satisfy the elements of unconscionability if the dominant party crosses the line that separates acceptable self-serving terms from abusive imposition. For example, in *Mazur v. eBay, Inc.*, 2008 WL 618988 (N.D. Cal. 2008), the court found a clickwrap dispute resolution clause to be unconscionable. The clause was part of a standard agreement required by an auction house (HotJewelryAuctions.com) that operated on the eBay site. The clause required disputes to be resolved by a law firm that was nominated in the standard term, and waived all other forms of dispute resolution. The element of procedural unconscionability was satisfied because the contract was adhesive and the standard terms were laid out on the website in a manner that made them difficult to read. They were presented as a massive block of impenetrable text, without any paragraph, section, or heading breaks, and the text box allowed for only a few single-spaced lines to be read at a time. The court found substantive unconscionability in that the dispute resolution process provided for was not neutral and unduly favored the auction house. The court therefore avoided the provision and allowed the plaintiff to continue the lawsuit.

In summary, adhesion on its own, unaccompanied by any specific improper bargaining conduct, could satisfy the procedural element of unconscionability where it deprives the weaker party of meaningful choice and leads to the conclusion that the stronger party used its market power illegitimately. However, the absence of specific bargaining misbehavior would make this a borderline case of procedural unconscionability. Because the procedural and substantive elements should be balanced against each other, a strong degree of substantive unfairness must be present to compensate for the weak form of procedural unconscionability.

§13.12.2 Terms Made Available Only After the Contract Has Been Entered

Where adhesive standard terms are made available only after the contract has been entered, a court may find that the delay in transmitting the terms is procedurally unconscionable.[12] However, that is not a foregone conclusion. If the terms are reasonably to be expected and the nondrafting party had reasonable notice that the contract was subject to standard terms, the delay in transmitting the terms may not be procedurally unconscionable. If, in addition, the terms are not unfair or unduly one-sided, there may not be substantive unconscionability either. The U.S. Supreme Court considered the validity of standard terms on a cruise ticket in *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991). The Shutes booked a cruise and were not given a copy of the contract's standard terms until they received their cruise tickets, some time later. One of the standard terms was a forum selection clause designating the Florida courts as the agreed forum for resolving disputes. During the cruise, Ms. Shute slipped and was injured. She sued Carnival for damages in the federal district court in Washington, her home state. The district court dismissed her case on the ground that it should have been commenced in Florida. The majority of the Supreme Court agreed. It held that although a standard clause on a ticket should be carefully scrutinized for fairness, it is not presumptively invalid merely because the passenger had no opportunity to (or power to) negotiate it. The court stressed the efficiency and value of standard contracting, which should be facilitated unless it is abused. In the present case, the forum selection clause was reasonable because it centralized litigation in the courts of Carnival's home state and reduced costs of litigation. The forum selected was natural, not alien, and there was no indication that it was chosen to frustrate claims. The dissent disagreed that efficiency and the reduction of Carnival's litigation costs were a good enough justification for depriving the passenger of the right to litigate in the forum that was most convenient and least expensive for her. This unfair result, combined with the likelihood that a passenger would not even notice the clause (it was one of 25 paragraphs on the ticket, not drawn to the passenger's attention at the time of contracting), led the dissent to conclude that the clause should not be enforced. *Carnival Cruise Lines* was decided under principles of federal law, and it did not mention unconscionability. However, it is not difficult to see the conceptual link between unconscionability doctrine and the principles of reasonable expectations and fairness on which the court based its conclusion.

§13.12.3 Adhesion and Unconscionability in Relation to Arbitration Provisions

Sections 4.1.5 and 5.3c discuss standard arbitration provisions in relation to the duty to read. They note that arbitration provisions have become increasingly common in standard contracts (including employment contracts) and that legal challenges to those provisions have become quite common. Because there is a general public policy in favor of arbitration, as reflected in the Federal Arbitration Act, 9 USC §§1-16, a court should uphold a standard arbitration agreement unless the party challenging it can show grounds to invalidate it under principles of contract law. Sections 4.1.5 and 5.3c discuss the possible grounds that the party was not aware of the provision because he did not read it or consent to it. As explained there, the duty to read precludes that argument unless the party can show that the provision was not adequately brought to his notice or reasonably expected. The case of *Morales v. Sun Constructors*, 541 F.3d 218 (3d Cir. 2008), is used as an example of how rigorous a court might be in holding a party to his duty to read: The court held that a Spanish-speaking employee, who could not read English, had a duty to read and ascertain the content and meaning of an arbitration provision written in English.

Courts recognize that in the employment context, where a prospective employee is required to agree to an arbitration agreement (whether in a signed document or in an employee handbook) as a condition of being hired, the contract is commonly adhesive—if the employee needs the job, he has no choice but to agree to the nonnegotiable arbitration provision. However, this is not in itself enough to constitute procedural unconscionability if there is no indication of oppression or surprise in the bargaining context. This was noted, for example, in *Serpa v. California Surety Investigations, Inc.*, 215 Cal. App. 4th 695 (2013), in which a court found that a nonnegotiable arbitration provision in an employment contract was not procedurally unconscionable merely by virtue of being adhesive. The court also held that the arbitration provision was not, as a whole, substantively unconscionable because the arbitration procedure was fair and applied to claims by both parties. The court did find, however, that a provision requiring each party to bear their own attorney's fees was unconscionable because it waived the employee's statutory right to recover attorney's fees if he prevailed on his claim. The court expunged this unconscionable aspect of the agreement by severing the

waiver of attorney's fees. It otherwise left the arbitration agreement in force.

However, a court is likely to react to a challenge to an arbitration provision with more sympathy where the overall circumstances show overreaching by the dominant party in the imposition of an adhesive and unfairly one-sided contract. For example, in *Samaniego v. Empire Today LLC*, 140 Cal. Rptr. 3d 492 (Cal. App. 2012), the employer required employees to sign an employment agreement that contained an arbitration provision. The agreement was dense—11 pages long, single-spaced in a small font, and full of legal terminology. The arbitration provision was the penultimate of 37 sections. The agreement was in English, and the employees were Spanish-speaking with little or no facility in reading English. The employer required the employees to sign the agreement as a condition of employment and gave them little or no opportunity to seek advice. The agreement stated that the arbitration was subject to the rules of the American Arbitration Association, but those rules were not provided to employees. In addition, the terms of the arbitration agreement were strongly favorable to the employer. It shortened the statute of limitations for bringing claims against the employer; it had a unilateral fee-shifting provision that allowed the employer, but not an employee, to recover attorney's fees; and while it bound the employees to arbitrate their claims, it excluded from arbitration any claims that the employer might bring against the employee to safeguard its own interests. The court found that the adhesive manner in which the agreement was presented to employees satisfied the element of procedural unconscionability, and the one-sided nature of the arbitration provision was substantively unconscionable. The court refused to sever the unconscionable provisions and to compel arbitration without them. It found the entire arbitration provision to be permeated with unconscionability— the multiple defects in the agreement showed it to be a systematic effort to impose arbitration on employees as an inferior forum that worked to the employer's advantage.

§13.13 POLICING CONTRACTS FOR ILLEGALITY OR CONTRAVENTION OF PUBLIC POLICY

§13.13.1 Illegality, Public Policy, and Freedom of Contract

It was noted in the introduction that the assent and reliance policies of contract law are not the only policies that may be implicated in the enforcement of a contract. Even when the contract is a full and genuine exercise of both parties' freedom of contract, it may break the law or so offend public policy that the court refuses to enforce it. This distinguishes regulation on grounds of illegality and public policy from the other doctrines discussed in this chapter: The issue here is not that one of the parties dealt wrongly with the other or that one party's assent is deficient (even though this factor could also be present in some cases), but that the contract is forbidden or does some damage to the public good. Therefore, the goal of policing here is different from that in cases where the only issue is bargaining impropriety. The court's concern goes beyond doing justice between the parties, to the protection of the public interest.

It is a bit artificial and sometimes quite difficult to make a firm distinction between illegality and violation of public policy. Courts do not always articulate the distinction and sometimes even use the words interchangeably. For the most part, it is not crucial to make the distinction because in many cases it would not lead to a difference in the analysis or result of the case. However, there is a conceptual distinction between a contract that is illegal and one that offends public policy, which could affect the court's approach to and resolution of a case. (This is explained in section 13.13.3.) It is therefore useful to understand it. A contract is illegal if it contravenes a statute or a rule of common law. A contract violates public policy, where there is no rule of law that forbids the contract, but the contract so harms the public interest that it should not be recognized as valid. In such a situation, the court invokes its discretionary power to refuse to enforce the contract. The principal difference between an illegal contract and one that violates public policy therefore lies in the degree to which a court uses its discretion to avoid the contract. Where a contract is not forbidden by law, the court's decision on whether to avoid it requires an exercise of discretion that comes uncomfortably close to lawmaking. Courts are generally careful in exercising this discretion and usually require a strong showing of clear harm to the public interest before finding that a contract contravenes public policy.

Although the focus here is on the public interest, it is not typically some outside agency or public body that challenges the contract. The claim of illegality or a violation of public policy is made by one of the parties who seeks to escape an obligation arising out of the contract. It is therefore

important to understand that in adjudicating an issue of illegality or public policy, a court is commonly resolving a dispute between the parties. One of them is trying to enforce the contract (or sometimes trying to obtain restitution for performance under the contract) and the other is resisting. Although balancing the equities between the parties is not as dominant a consideration as the public interest, it does have an influence on the outcome.

The end result of a determination that a contract is illegal or contravenes public policy has some similarity to the remedies for improper bargaining and is in some ways analogous. (A court may decide to refuse enforcement of the improper contract in its entirety, which sounds like the equivalent to avoidance, or it may keep the contract in place and refuse enforcement of only the offending term, which approximates severance.) However, because protection of the public interest is the court's principal goal in dealing with a contract that is illegal or violates public policy, the case is conceptually different from a situation of improper bargaining. This calls for a different approach to the issue of remedy. Society is the principal victim of a contract that is illegal or in violation of public policy. Therefore, where a contract directly violates a rule of law, or its harm to society is serious enough, a court is most unlikely to enforce it under any circumstances. Such a contract is more correctly characterized as void rather than voidable. The same is often true where the parties are joint perpetrators of the offense and it cannot be said that one used the illegal contract to victimize the other. On the other hand, where one of the parties is more to blame for the transaction, the other is a member of a group which the law seeks to protect, and the contract does not involve serious illegality, the contract is more accurately described as voidable. In short, the treatment of a contract that is illegal or contrary to public policy depends on the nature and gravity of the violation, the goals of the law or public policy, and the extent to which the impropriety permeates the contract. Sometimes the best way to protect the public interest is to refuse enforcement of the contract altogether, but in other cases, enforcement of the contract, with or without the adjustment of its terms, may best serve the public good. Sometimes, as we see in section 13.13.3, a contract's illegality or violation of public policy could even affect a restitutionary claim of one of the parties arising from nonenforcement of the contract.

§13.13.2 Illegal Contracts

Some illegal contracts are such a serious violation of the law that performance of the contract (or sometimes even making the contract) is a criminal act. This would be true, for example, of a contract under which one of the parties pays the other to murder someone. Such a contract is not enforceable and its making or performance would lead to criminal prosecution. However, there is a difference between illegality and criminality, and not all illegal contracts are criminal. A statute or the common law could simply forbid a type of contract or a contract term without making the violation of the law a criminal offense. For purposes of contract law, we are not concerned with whether the transaction attracts criminal penalties. (Although the criminal nature of the contract could affect the court's approach to the equities and the public interest when it decides on what remedy is appropriate.)

a. The *In Pari Delicto* Rule

Where the parties share the guilt of having entered an illegal contract, the *in pari delicto* rule holds that the court will keep aloof from the dispute and will not intervene to help either party. The name of the rule is an abbreviation of the maxim *In pari delicto potior est conditio defendentis* (When the parties are in equal guilt, the defendant's position is stronger). The *in pari delicto* rule creates an affirmative defense to a claim based on the illegal contract. That is, the party who is sued on the contract may raise the rule as a defense to the suit.

The rule is not as straightforward as it sounds. First, although it refers to equal guilt, it really means that the guilt of the party seeking relief must be equal to or greater than that of the other party. Second, although it is sometimes possible to assign greater fault to one of the parties, it is not always easy to do this. Third, and less obvious, the rule does not simply depend on an evaluation of the relative guilt of the parties. It also takes into account the seriousness of the illegality, the equities between the parties, and the impact on the public interest in giving or declining relief. This means that weighing the relative guilt of the parties is just one aspect of a broader inquiry into the circumstances of the transaction, the relationship of the parties and their motivations, the protection of the public interest, and the furtherance of the public policy served by the law. In some situations, the court's task in deciding how to apply the *in pari delicto* rule is made easier by

a provision in a statute that prescribes how these considerations should be balanced or at least offers some guidance on how the court should weigh them. For example, a statute may specifically state that a contract that violates it is void or unenforceable, thereby making it clear that the court should not enforce it, even if the equities and balance of guilt would otherwise point in the opposite direction. Or a statute that declares the contract to be unenforceable may specifically allow a party to obtain restitution of any benefit conferred under it, thereby telling the court that avoidance is required but the remedy of restitution is available.[13] Some statutes do not have such a clear prescription, but the provisions or purpose of the statute may indicate that the goal of the law is to protect persons in the position of one of the parties. This signals to the court that a resolution favoring that party is called for.

The *in pari delicto* rule is therefore not an absolute bar to relief, even where the court finds that the party requesting relief bears equal or greater guilt. Rather, it is a starting premise from which the court may depart to the extent that it considers that the equities between the parties, the policy of the law, and the public interest so demand. The weighing of these factors is illustrated by *Parente v. Pirozzoli*, 866 A.2d 629 (Conn. App. 2005), and *Homani v. Iranzadi*, 211 Cal. App. 3d 1104 (1989). In *Parente*, the defendant wished to buy a bar but would have had difficulty in taking transfer of the liquor license because he was a convicted felon. He therefore entered into an agreement with the plaintiff under which the plaintiff would apply for the license as a front man, and the parties would then run the bar as equal partners. The license was granted and the parties went into business. When the partnership was later dissolved, the defendant refused to pay the plaintiff his share of the profits and the plaintiff sued. The court refused to enforce the contract because it was based on the unlawful purpose of evading the liquor control laws. The plaintiff argued that if the court refused to award him his share of the partnership profits, the defendant, who instigated the scheme to evade the liquor control laws, would be rewarded by a windfall. Although the court recognized this, it felt that the public interest was best served by refusing enforcement. Not only should the court not sanction such a contract, but the refusal of enforcement would create a disincentive for people like the plaintiff to act as front men in the future. This decision shows the difficulty of achieving the right balance. It could just as well have been argued that allowing the defendant to keep the plaintiff's share of the profits created an

incentive to use a front man to deceive the liquor control authority.

In *Homani* the court refused to enforce an agreement to pay interest on a loan in a situation in which, for the purpose of evading tax on the interest, the parties had agreed orally to the payment of interest but signed a promissory note showing the loan as interest-free. The court was unpersuaded by the lender's argument that the borrower received a windfall. The court considered that the public interest was best served by removing the lender's incentive to enter such a transaction. This result makes sense. After all, it was the lender who stood to benefit from the tax evasion, and he was most guilty of breaking the law.

b. Restitution Where an Illegal Contract Is Avoided

The effect of applying the *in pari delicto* rule in *Parente* and *Homani* is that the court refused enforcement of the contract and left the parties as it found them. Refusal of enforcement is a natural consequence of illegality because enforcement is an affirmative recognition of the contract, and a court is understandably reluctant to play any role in upholding the improper contract. However, the *in pari delicto* rule also has a less obvious impact. The court may also apply it where a party does not claim enforcement of the contract but concedes it is illegal and asks for restitution of a benefit that he conferred on the other party under the contract. The refusal of restitution is not as easily justified as nonenforcement because the grant of the remedy would not require recognition of the contract. Quite the opposite; it is based on the premise that no contract exists. Also, the equities usually favor the plaintiff more strongly where restitution is claimed because of the defendant's unjust enrichment. Some courts recognize this and are more sympathetic to restitutionary claims. However, the *in pari delicto* rule is broad enough to cover restitutionary claims as well as claims of enforcement and a court may decide that even recognition of a restitutionary claim is not in the public interest.

The following illustrations identify the considerations that a court weighs in deciding whether the *in pari delicto* rule should preclude the restitution of a benefit conferred under an illegal contract. In contravention of a statute forbidding the ownership of casinos by mobsters, Lilly Livered sold her casino to Attila "The Animal" Axehacker, a gangster, for $10 million. Both parties knew about the prohibition. At the time of executing the

agreement, Attila made a down payment of $100,000 to Lilly. A few days later she repudiated the contract. Clearly, the contract is unenforceable, and Attila cannot sue for relief on the contract, whether in the form of specific performance or damages for breach. Can he get the $100,000 back? There is no obvious answer: It could be argued that, as the mobster seeking to acquire the casino, he is more to blame than the seller. But the contrary argument could be made that people like Lilly, by deliberately violating the law, make possible the very harm that the statute seeks to avert. The determination of which of these alternatives best serves the public interest is also difficult to make: Is it better to allow her to keep a windfall profit from her deliberately wrongful transaction, or to allow the court's process to be used by a thug to recover the down payment made in an attempt to violate the law? Unless it is demonstrated that judicial intervention is the more appropriate alternative, the thrust of the *in pari delicto* rule is to leave the parties as they are.

As a second example, a liquor store sells a case of scotch to a 20-year-old minor, violating a statute (known to both parties) that prohibits the sale of alcohol to persons under the age of 21.[14] The buyer paid for the scotch in cash, but the seller now refuses delivery. Again, the buyer clearly cannot enforce the contract, but can he get his money back? One could argue that the buyer had no business trying to purchase the liquor and deserves no help from the court in recovering the payment. However, it seems intolerable to allow the seller to keep his money. If the whole idea of barring the sale of liquor to young people is that they do not have the maturity to use it responsibly, it would seem that this lack of maturity also diminishes the buyer's blame in the transaction. It is also relevant that a central purpose of the law is to protect people like the buyer, and return of the money better serves this goal.

§13.13.3 Contracts Contrary to Public Policy

If a contract is not actually illegal, but it nevertheless offends public policy, the consequence of nonenforcement is not as inevitable. A decision on whether or not to enforce the contract involves a balancing of policy concerns and of the equities between the parties. Assuming that the contract suffers from no deficiencies in assent, the regulation of contracts on the basis of broader public interest creates a tension between the policy of enforcing contracts and the other public policy that would be frustrated by enforcement.

To resolve this dissonance, the countervailing policies must be balanced. If the harm to the public interest outweighs the benefit of enforcement to the public and the parties, enforcement must be refused.

How does the court identify the existence and force of a public policy affected by the contract? In the easiest case, the policy may be expressed by legislation or well-established common law precedent. Of course, if the statute or rule of common law clearly prohibits a contract in violation of a particular policy, we have a case of illegality, as discussed above. But sometimes the law does not actually forbid a particular contract, yet it is apparent that the law's policy goals are incompatible with the recognition and enforcement of a contract of this kind. Because this often amounts to judicial policymaking, most courts are cautious about identifying public policy that does not have a firm base in statute or precedent. A court may try to seek guidance in other governmental policy pronouncements and may entertain policy arguments by the parties. If it should conclude that such a policy exists, it must then weigh it against the policy of upholding contracts.

a. Disclaimers of Liability

Disclaimers of liability for negligent or intentional injury (exculpatory clauses) feature frequently in the caselaw, and provide a good illustration of public policy analysis. A disclaimer of liability for wrongful conduct pits the policy of freedom of contract against the tort policy of holding a tortfeasor accountable for injury caused by his actions and of deterring wrongful conduct. The policy of freedom of contract calls for the enforcement of a freely bargained consensual agreement, but the tort policy of accountability disfavors an agreement that absolves a tortfeasor in advance from liability for future conduct. This means that the public policies of contract and tort pull in opposite directions and must be balanced. It is relatively easy to decide in favor of the tort policy where there is some problem with the way in which the disclaimer was entered into. The policy of freedom of contract is not well served by enforcing the contract unless the disclaimer is voluntary, fairly bargained, and expressed clearly and conspicuously. Therefore, as an initial matter, the court examines the disclaimer itself to decide if its enforcement serves the policies of contract law. Adhesion is a relevant consideration here, and a court is less likely to uphold a disclaimer if it was imposed on the injured party. In addition, courts insist that the language of the disclaimer

must be explicit and must clearly show the intent to exonerate the party from liability. Any unclear language is interpreted restrictively to cut down the scope of or eliminate the disclaimer.

Where the provision is absolutely clear and the victim's agreement to it is not in question, the competing tort and contract policies are in the starkest opposition. To decide which policy should predominate, courts weigh all the circumstances and considerations. Courts have identified several factors that are relevant to this decision. The scope and extent of the disclaimer is important. Although it may be acceptable to exclude liability for negligence, a disclaimer will not be enforced to the extent that it exculpates gross negligence, recklessness, or intentional misconduct. Where only ordinary negligent injury is covered, the court considers the importance or necessity of the service to the public (for example, a disclaimer in a residential lease is potentially much more harmful than one in a skydiving contract); the kinds of people who are likely to execute the disclaimer (for example, whether the service is used by the public at large, or only by a specialized or qualified group); the extent to which the provider of the service has control over the person or property of the victim; and the impact that not permitting the disclaimer will have on the public's ability to obtain the service at all, or at reasonable cost. If factors such as these balance in favor of holding the service provider responsible for negligence, the court will not enforce the disclaimer, even if it is freely executed and not adhesive.

Hanks v. Power Ridge Restaurant Corp., 885 A.2d 734 (Conn. 2005); *Munn v. Hotchkiss School*, 933 F. Supp. 2d 343 (D. Conn. 2013); and *McCune v. Myrtle Beach Indoor Shooting Range, Inc.*, 612 S.E.2d 462 (S.C. App. 2005), show how a court might balance all these considerations. In *Hanks*, the plaintiff was injured while snowtubing and sued the operator of the ski resort for damages, claiming that it had been negligent in the way that it constructed and supervised the snowtube run. Prior to snowtubing, the plaintiff had signed a release that exculpated the operator from liability for negligent injury. The court found that the disclaimer expressed the exclusion of liability in conspicuous and unmistakable language that would alert a reasonable person to its import. The agreement was very clearly written and it unmistakably emphasized that negligent conduct was covered by the disclaimer by capitalizing the word "negligence" several times.[15] Notwithstanding this, the court avoided the disclaimer on grounds of public policy because it found that the contract was adhesive, the snowtube run was

open to all members of the public who had a reasonable expectation of safety, the operator controlled the run and rented the equipment, and it would not be in the public interest to allow the operator to shift risk of liability to the customer.

In *Munn* a student of the Hotchkiss School participated in a school-organized trip to China. Prior to leaving on the trip she had signed a release of liability, in which she released the school from all claims arising during the course of the trip. She contracted a serious tick-borne illness on the trip, which she claimed was a result of the school's negligent failure to take proper precautions against insect-borne diseases. She sued the school for damages caused by its alleged negligence. Unlike *Hanks*, the court held that the language of the release was not broad enough to cover negligence claims. However, adopting the factors identified in *Hanks*, the court said that even had the release covered claims arising out of the school's negligence, it would be unenforceable as against public policy because the release was adhesive, the school had a duty to protect the students that it took overseas, and it had control over the students' exposure to risks of disease.

By contrast, in *McCune*, the plaintiff's eye was injured while she participated in a paintball game because her mask did not fit properly. Before she began the game she signed a release that emphasized the risks of injury, acknowledged that she assumed such risks, and absolved the defendant from all liability for injury, whether caused by negligence or otherwise. The release specifically did not cover injury resulting from gross negligence or wanton misconduct. The exculpatory provisions were printed in capital letters. The court affirmed the trial court's grant of summary judgment in favor of the defendant. The release was explicit and clear, it did not seek to exclude liability for conduct more serious than negligence, and it was a voluntary assumption of risk by the plaintiff. The court pointed out that it would not serve the public good if a business could not exclude liability by a reasonable and explicit disclaimer. The risk of liability would preclude many activities and events.

In *Bagley v. Mt. Bachelor, Inc.*, 340 P.3d 27 (Or. 2014), the court couched its discussion of public policy in terms of unconscionability doctrine, which shows the close connection between public policy analysis and unconscionability. The case involved the validity of a conspicuous and unambiguous provision in a snowboarding season pass that released the operator of the ski area from liability for its own negligence. In deciding that

the release violated public policy, the court examined the factors taken into account to determine procedural and substantive unconscionability. It held that, despite the clarity of the release, its adhesive nature in a consumer transaction was enough to satisfy the element of procedural unconscionability. The court found the release to be substantively unconscionable because it was one-sided, imposed harsh consequences on the user of the ski area, and absolved the operator of its duty to take reasonable care to protect its customers. Although the court acknowledged that skiing and snowboarding are inherently dangerous nonessential recreational activities, and that that there is a reasonable argument that a ski operator should be able to limit its exposure to liability, it found that these considerations were not enough to outweigh the public policy against enforcing the unconscionable release.

b. Noncompetition Agreements

Where a contract offends public policy, the court may decide that the public interest requires avoidance of the contract completely. However, a court may decide that enforcement on adjusted terms is a better solution when the equities favor the party who seeks enforcement and the harm to the public interest can be averted or minimized by eliminating the offensive aspect of the contract. Noncompetition agreements (also called covenants not to compete)[16] may be invalidated completely on public policy grounds, but they are often adjusted by the court to eliminate the violation of public policy.

A covenant not to compete is an undertaking by a person associated with a business that, upon leaving the business, he will not, for a specified period and in a specified area, engage in activity that competes with the business. Such covenants may be found in employment or partnership agreements or in contracts for the sale of a business. Say that a well-established pediatrician takes a newly qualified doctor into her practice as a junior partner. The established doctor is concerned that her new partner may work with her just long enough to get experience and a following among her patients and that he will then terminate the partnership and set up practice on his own. To avoid this, she demands a provision in the partnership agreement in terms of which the junior partner undertakes that upon leaving the partnership, he will not practice medicine within a ten-mile radius of the partnership premises for a period of five years.

There is a long-established public policy against agreements that stifle competition or that restrict a person's freedom to earn a livelihood by full participation in the market. The policy against contracts that curb competition is reflected in the antitrust laws, which prohibit various kinds of anticompetitive behavior. But even in situations not covered by the antitrust legislation (such as the present case) courts apply the policy when a contract unduly hampers competition or improperly restricts the ability of a party to work. Courts are more willing to uphold a noncompetition clause that bars the seller of a business from competing with it for a reasonable period and in a reasonable area. A reasonable restraint is most justifiable in this situation because the seller of the business is in a strong position to poach customers, use trade secrets, and continue trading on the goodwill of the business sold to the buyer. Courts are most resistant to enforcing noncompetition agreements against employees because of the impact of the covenant on the employee's ability to earn a livelihood, and the less likely possibility that the employee takes away from the business anything more than his own skills. In some states, noncompetition agreements in employment contracts are completely invalidated by statute. Noncompetition clauses in partnership agreements, such as the one involving the pediatricians, are usually more justifiable than those in employment agreements because a departing partner is more likely to be analogous to the seller of a business.

For the most part, therefore, a covenant not to compete is not per se invalid, but the court assesses its impact on competition and on the interests of the party who is restrained. The court will consider all the circumstances of the case, taking into account factors including the legitimate interests (such as patient goodwill) of the established doctor, the mores of the medical profession, the hardship on the junior doctor, the patients' right to use a doctor of their choice, and the fairness of the bargaining process leading to agreement on the provision. If, on balance, the deleterious impact of the clause outweighs the interests of the established doctor, the court may refuse to enforce the clause altogether. Alternatively, it may cut down the restraint to a level that goes no further than necessary to protect those interests, reducing the time or geographic limit of the restraint or defining the prohibited activity more narrowly (for example, to cover pediatrics, rather than medical practice generally). In this case, therefore, a violation of public policy may not render the entire contract unenforceable but more likely results in the elimination or adjustment of the offending provision.

§13.14 A TRANSNATIONAL PERSPECTIVE ON POLICING DOCTRINES

Article 4 of the CISG states that the CISG is not concerned with the validity of a contract. Because policing doctrines affect the validity of a contract, the CISG does not provide for them. Therefore, even in a transaction governed by the CISG, the policing doctrines of the governing domestic law apply to the transaction.

Article 3.1 of the UNIDROIT Principles specifically refrains from addressing questions of illegality or immorality. Apart from this, the Principles include doctrines that are equivalent to those discussed in this chapter, even though there are differences in the terminology and elements. Article 3.8 allows for the avoidance of a contract for fraud, including the nondisclosure of circumstances that should have been disclosed under principles of fair dealing. Article 3.9 allows for avoidance for an "unjustified threat" that is "imminent and serious" enough to leave the party with "no reasonable alternative." A threat is unjustified if the act is wrongful in itself or is wrongful as a means of obtaining the contract. Article 3.10 has a doctrine that covers the same ground as undue influence and unconscionability. It allows avoidance of a contract or a term of the contract if the contract or term gave the other party "an excessive advantage." Article 3.16 provides for the avoidance of the specific offending terms of a contract unless it is unreasonable to uphold the contract in the absence of those terms.

Examples

1. Cookie Racha owns a house built in 1915. The house has been plagued with chronic cockroach infestation. Although Cookie fumigated it regularly, roaches reappeared in ever-increasing numbers within a few weeks of treatment. Also, the house was slowly sinking into soft ground on one side. The sinking can only be corrected by an expensive process that requires the side of the house to be jacked up while a firm concrete foundation is laid. The sinking has caused deep cracks in the living room wall. Cookie has replastered the wall a few times, but the continuing movement reopened the cracks soon afterward. Cookie had already become quite sick of the house when she recently read in the newspaper that the neighboring property had been bought by the state for use as a

halfway house for paroled sex offenders. This was the final straw and she decided to sell.

Acting on the advice of her real estate agent, Chic "The Snake" Canery, she fumigated the house, plastered the cracks, and repainted the wall just before the house was placed on the market. Each time that the house was shown, Chic ensured that all the lights were on. Not only did this present the house in a more attractive manner, but the brightness discouraged the regenerating population of roaches from venturing into full view. Chic brought Bugsy Crawley to see the house. On the very next day Bugsy made an offer to buy the house for the full asking price. Cookie accepted immediately. The terms of the contract of sale were set out in Bugsy's offer, made on a standard form provided by the real estate agent. The writing simply set out the basic terms of the transaction and made no representations concerning the property. The transaction closed a short while later, and Bugsy moved into his new home. It did not take very long before the roaches reappeared, the wall cracked, and the sex offenders moved in next door. Does Bugsy have grounds for avoiding the sale?

2. Tutu Tango is a 65-year-old retired tax lawyer. Her life had become quite dull since retirement, and she was looking for excitement. One day she was invited to accompany a friend to a free introductory dance lesson at the Fleece Foot Dance Studios. During the lesson, she fell into the clutches of Jig Aloe, a suave and unctuous dance instructor employed by Fleece Foot. Jig subjected Tutu to all the charm and flattery that he had perfected by taking Fleece Foot's super sales course. After observing Tutu's inept and clumsy cavortings on the dance floor, he pretended to be very impressed. He told her enthusiastically that she had a wonderful natural talent and ageless grace. He said that he was convinced that with proper training, she had the potential of becoming an elegant and alluring dancer. Tutu had been around the block a few times, so she didn't really believe a word of this. But Jig was cute and he would be her instructor, so she agreed to sign up for a month's worth of lessons at a cost of $250. Jig produced a form and asked her to sign it. He cleverly positioned his hand over the top of the form so Tutu could not see the top few lines. This little trick worked, because Tutu did not pay much attention to the form and signed it without trying to read it. Had she been more astute, she would have seen that Jig had given her a

life membership contract form to sign, in which she irrevocably purchased a lifetime of lessons for a fee of $10,000, payable within seven days of signing.

A few days later Tutu went to the studio for her first lesson. She discovered that Jig had been fired and replaced by a decidedly uninteresting instructor—a pot-bellied middle-aged man. Tutu went to the manager to tell him that she wanted to cancel her month's lessons. She was shocked when the manager corrected her, showing her the contract form in which she had signed up, not for a month, but a lifetime. He told her that it was studio policy never to release customers from their commitments, and pointed out that her payment was due within the next few days.

Does the common law give her the right to cancel? (Answer on common law principles only, and disregard any consumer protection legislation of which you may have heard.)

3. Sweaty Shoppe, Inc., is a retailer of sports and fitness clothing. It sells a wide variety of all brands of merchandise. Brute Force, Inc. makes very expensive weightlifting equipment. Sweaty Shoppe considers these products overpriced and has steadfastly refused to carry them despite several requests by Brute Force.

   Through contact with a disloyal employee of Sweaty Shoppe, Brute Force has come into possession of some confidential internal memoranda, written by Sweaty Shoppe's management. These memoranda show that Sweaty Shoppe's buyer routinely engaged in the practice of knowingly buying inventory at bargain prices from a criminal organization that stole it by hijacking manufacturers' delivery trucks. Brute Force told Sweaty Shoppe's president that it would publish the documents unless Sweaty Shoppe agreed to stock and vigorously promote Brute Force products. Sweaty Shoppe's president realized that if the buyer's underhanded means of acquiring inventory became public, Sweaty Shoppe's business would be badly damaged and the company might even be implicated in the buyer's crime of receiving stolen property. He therefore entered into a contract with Brute Force to purchase and promote its weightlifting equipment. The contract is on ordinary market terms, and the quantity of goods, the prices, and other aspects of the contract are fair and commercially reasonable. A week after signing the contract, and before any performance had occurred,

Sweaty Shoppe's board found out about the buyer's improper purchases and the president's attempt at a cover-up. The board fired the president and it decided that it would rather deal with the consequences of exposure than buy any goods from Brute Force. Does Sweaty Shoppe have grounds to avoid the contract?

4. Lunar Tech, Inc. was awarded a contract by the Air Force to manufacture an early warning system for detecting invasions of alien spacecraft. The contract had very precise specifications. Lunar Tech was obliged to give this endeavor absolute priority and to deliver the completed system in one year. The contract provided that if delivery was late, the Air Force would be entitled to claim liquidated damages in a horrendous amount for each day of delay. Also, it was well known in the defense industry that a contractor who has proved unreliable would have great difficulty in obtaining further government contracts in the future. Lunar Tech entered into a written one-year employment contract with Dr. Stella Starburst, a highly respected and brilliant scientist, to supervise the fabrication of the system. Dr. Starburst's contract salary for the year was $750,000. Neither party had the right to terminate the contract before the end of the one-year term, except in the case of material breach by the other.

   About two months after work on the project began, Dr. Starburst approached the president of Lunar Tech and told him that she had received a very attractive job offer from a research institute and would like to resign and accept that offer. The president knew that Lunar Tech could not easily replace Dr. Starburst, and a search for a new supervisor would disrupt and delay the project. The president therefore offered to pay Dr. Starburst a $500,000 bonus at the end of the project if she stayed on until it was complete. Dr. Starburst agreed. The president had his assistant type a short memorandum headed "Contract Modification." The text of the memorandum stated, "In consideration for Dr. Stella Starburst's commitment not to leave the employ of Lunar Tech, Inc., before the end of her contractual employment period, Lunar Tech, Inc., promises to pay Dr. Starburst a bonus of $500,000 at the conclusion of her period of employment." Both parties signed the note. Dr. Starburst did remain in her position until the completion of the project. However, Lunar Tech refuses to pay her the $500,000 bonus. Can Dr. Starburst enforce Lunar Tech's commitment?

5. Add the following fact about the employment contract entered into between Lunar Tech, Inc., and Dr. Stella Starburst: The contract was on a standard form supplied by Lunar Tech. The standard contract was very detailed. It was 20 pages long, single-spaced. It consisted of 130 numbered clauses, printed in 12-point type, without any headings, boldface, or other features that distinguished any of its clauses. Clause 128 read:

   > Any claim made by the employee, arising out of this employment agreement, including claims relating to discrimination, harassment, working conditions, the payment of any amounts claimed to be due under this contract, or termination of employment shall be submitted to final and binding arbitration under the rules of the American Arbitration Association. If any such claim should arise, the employee agrees to deliver a request for arbitration to the employer within six months of the date that the dispute arose. If the employee does not file a written request for arbitration within this time, such claim will be barred.

   Clause 128 was the only term in the agreement relating to arbitration. There was no equivalent requirement of arbitration for any claims brought by Lunar Tech against an employee. The rules of the American Arbitration Association were not appended to the contract. Lunar Tech gave the standard contract to Dr. Starburst when it first offered to hire her, and she had it for about a week before she signed it. However, she was busy and never read beyond the first page. Contrary to the facts stated in Example 4, Dr. Starburst did not seek to resign and there was no modification of the contract. Instead, Lunar Tech fired Dr. Starburst three months after she began work. Dr. Starburst sued Lunar Tech for wrongful dismissal in breach of the contract. Lunar Tech moved to dismiss the suit on the grounds that Dr. Starburst had committed to arbitrate any dispute arising out of the contract. Should the court grant the motion to dismiss?

6. One afternoon, Hardy Ticker developed intense chest pains while digging in his garden. His neighbor, Sam Aritan, noticed his distress and came over to see if he was all right. On being told the problem, Sam put Hardy into his car and rushed him to the nearest hospital, The Sisters of Good Conscience. The receptionist insisted that admission forms be completed before Hardy could be sent to the emergency room. Sam was concerned that Hardy needed urgent attention and begged the receptionist to admit Hardy while he completed the forms. The

receptionist agreed. Sam completed as much of Hardy's biographical information as he knew and handed the form to the receptionist. She told him that he had to sign it, which he did. He noticed that the form had about half a page of printed text above the signature blank, but he did not read it. Had he done so, he would have found that he had signed a standard contract with a provision that obligated the signatory to pay all the hospital's charges for treatment administered to the patient, to the extent that those charges were not covered by medical insurance.

Sadly, Hardy died despite the efforts of the emergency room doctors. It was then discovered that he had no medical insurance and that he was insolvent and there is nothing in his estate. The hospital therefore demands payment of its fees from Sam, based on his signature on the form contract. Must Sam pay?

7. Mary Maker, a resident of California, decided to go on a cruise. After studying the brochures of several cruise lines, she settled on a seven-day package from Los Angeles to Mexico on the ship S.S. Briny Binge, owned and operated by Party Lines, Inc. Party Lines has its headquarters in Miami, Florida, and operates cruises out of Miami and Los Angeles. Mary called her local travel agent and booked. A week later she received her ticket, printed on one side of a single sheet of paper. She checked to make sure that the dates and cabin booking were correct. She did not otherwise read the printed matter on the ticket, despite a warning, printed on the ticket in large red letters, that stated, "PASSENGER: THIS DOCUMENT AFFECTS YOUR LEGAL RIGHTS. READ IT!" Had she read the document, she would have found the following provision:

   > This ticket is issued subject to the following terms and conditions:
   > 1. Party Lines, Inc. shall not be responsible for loss or harm suffered by the passenger while on board the ship, whether or not caused by the negligence of Party Lines, Inc. or any of its employees or agents.
   > 2. In the event of any dispute between Party Lines, Inc. and the passenger arising out of this transaction, the courts of the State of Florida shall have exclusive jurisdiction to hear and resolve such dispute.

   Mary embarked on the ship. Three days into the cruise, she was injured when an inebriated entertainment director mistook her for a piñata. Upon returning home, Mary sued Party Lines in a California court,

alleging that the company was liable for its employee's negligent action. She claimed medical expenses and damages for pain and suffering. Party Lines requests summary judgment on the grounds that the California court has no jurisdiction in terms of the contract and that, in any event, Mary had contractually waived any claim that she may otherwise have had. Should summary judgment be granted?

8. Hi Rate Gems, Inc., operates a retail jewelry store in a less affluent neighborhood and draws most of its customers from the local area. They are typically quite poor and do not have the means to buy jewelry for cash; nor could they qualify for credit under the usual market standards. To make sales, Hi Rate has found it necessary to provide financing to its customers under a lenient credit policy. As a result, its losses from uncollectible debt are much higher than those of more conservative lending institutions. To compensate for this, it prices its jewelry about 20 percent higher than the prevailing market and charges interest 5 percent above the market rate. To obtain credit, a customer is obliged to sign a standard contract under which Hi Rate retains a security interest in the items purchased. This means that if the customer should default in payments, Hi Rate has the right to repossess the jewelry, to credit its value against the balance owing, and to institute collection action against the customer for any remaining deficiency.

   Rock Sparkler bought a diamond nose stud with matching earrings from Hi Rate for $2,000. Rock did not have the $2,000, and his terrible credit record assured that no sensible lender would advance him a penny. He therefore applied for credit from Hi Rate. One of the questions on the form asked if any judgments had been granted against the applicant. Rock knew of at least five such unsatisfied judgments, but he feared that disclosing them would be fatal to the application. He did not wish to lie, so he simply ignored the question and left the space blank. Luckily, the credit clerk did not notice the omission because he did not look at the application very carefully before approving the financing. The sales assistant then filled out the details of the items purchased and the monthly payment rate on the standard purchase agreement, and handed it to Rock for his signature. The assistant made no attempt to explain the form's printed terms to Rock, who did not read it before signing. He then took the jewelry and left.

   A few weeks later, Hi Rate's credit manager was reviewing the

applications and noticed that Rock had not answered the question about judgments. He checked the public record and discovered the unsatisfied judgments. Hi Rate wishes to rescind the contract and get the jewelry back. Has it the right to do so?

9. All the facts regarding the formation of the contract are the same as in Example 8. The only factual difference is as follows: Hi Rate's credit manager did not check the public record after the contract was executed. Hi Rate is happy with the transaction and has no desire to avoid the contract. However, a short time after the purchase, Rock had misgivings about buying the jewelry. He would like to cancel the sale and return the jewelry. May he do so?

10. Rob Graves plundered a 3,000-year-old bronze figurine from the tomb of an ancient king. He smuggled it into the United States for the purpose of selling it. He contacted Ann Teek, a well-known collector of antiquities, to see whether she would be interested in buying the figurine. Ann did not ask Rob how he acquired the figurine, but she suspected that he had stolen it and brought it into the country illegally. She also knew that it is illegal to deal in stolen antiquities. Nevertheless, her desire to own the figurine overpowered her scruples. She entered into a contract with Rob to buy it for $5 million. In terms of the contract, Ann had to pay a deposit of $1 million in cash to Rob on signing the written agreement and would pay the balance in cash on delivery of the figurine a few days later. Ann paid the deposit to Rob, but he never delivered the figurine. What would Ann's prospects of success be if she decided to sue Rob to enforce the contract? What would her prospects of success be if she decided not to sue Rob for enforcement but instead sued him for return of the $1 million?

Explanations

1. There are both acts and silences that could qualify as fraudulent misrepresentations.

   The cockroaches and subsidence. Cookie did not make any statement asserting that the house was free of cockroaches or that it was stable. However, concealment of the truth by conduct is as much an affirmative misrepresentation as a verbal misstatement. Cookie knew the truth and intended by the act of concealment to hide it so as to induce

the contract. Therefore the element of knowledge of falsity and intent to mislead is satisfied. Cookie's fumigating and performing the cosmetic repairs to the wall were not simply acceptable preparations for sale but were deliberate steps to conceal serious problems that would have made the house less marketable.

As noted in section 13.6.5, Restatement, Second, does not require materiality for fraud, but many courts include this as an element. Even where a court follows the Restatement, Second, position, the materiality of the misrepresentation has a bearing on justifiable reliance. Materiality is a question of interpretation, and the test is whether a reasonable person in Bugsy's position would have entered the transaction at all, or on these terms, had he known the truth. It is arguable that an infestation of pests and the sinking of the building would be significant to a reasonable buyer. The misrepresentation must have induced Bugsy to enter the contract on the agreed terms. When fraud is involved, the test for inducement is not purely objective but takes into account the persuasive impact of the falsehood on the victim. Bugsy must show that the misrepresented fact was influential to him and that, given his circumstances and personal attributes, he was justified in relying on the false words or appearance. Of course, it is easier to show inducement where the misrepresentation concerns a fact that would be regarded as material and would have been relied on by a reasonable person. Although we do not know what motivated Bugsy to make the offer, the concealed facts are important even if viewed objectively, so it should not be difficult for him to show that they influenced him to make the offer. Bugsy's justification for relying on appearances is somewhat weakened because he failed to have the house inspected for structural soundness and pests or even to ask questions beyond his inquiry into termite infestation. A court might find that his lack of diligence precludes relief for fraud. But courts do balance the neglect of the victim against the deliberate dishonesty of the perpetrator, and Cookie's purposeful concealment could outweigh Bugsy's failure to make proper inquiry. Finally, prejudice is obvious. Not only does the house have a chronic cockroach problem, but it requires expensive repairs.

The halfway house for sex offenders. Although Cookie knew about the plans to open the halfway house, she did not disclose this to Bugsy. Nondisclosure of known information can be fraud if the duty of fair

dealing imposes an obligation to speak. It can be difficult to decide when disclosure is required, because the law recognizes that fair dealing does not compel a party to bare all information pertinent to the transaction. Furthermore, even if there was a duty to speak, the omission may not be as culpable as a positive act. As a result, the prerequisites for relief are not as heavily weighted against the perpetrator, and the victim is more readily held accountable for failure to make diligent inquiry. As a general guide, a party is only required to disclose information if four conditions are satisfied: She knows that the other is unaware of it; the knowledge would be reasonably likely to influence the other's decision to enter the transaction; the information is not readily accessible to the other by diligent inquiry; and the information is not fairly regarded as the party's own property, having been acquired by special efforts or study.

Given the outcry when a released sex offender takes up residence in a neighborhood, a reasonable person would assume that this information would be material to a homebuyer. The information is not proprietary, so Cookie cannot claim that she had the right to keep it to herself. However, the proposed home is a public project that has already been reported in the press. The information is freely available and for all Cookie knows, Bugsy has also read the paper. If not, it would be easy enough for him to gain access to the information. On balance, if he did not know about the halfway house, his lack of inquiry should preclude relief on this ground despite Cookie's silence.

2. This example is a factual variation of a couple of infamous Arthur Murray cases decided in the 1960s. In *Vokes v. Arthur Murray, Inc.*, 212 So. 2d 906 (Fla. 1968), and *Syester v. Banta*, 133 N.W.2d 666 (Iowa 1965), Arthur Murray franchisees employed the deliberate tactic of ongoing and excessive flattery to induce untalented elderly women to sign up for astoundingly large quantities of dance lessons at grotesque total cost. In both cases the importuning, begun at first contact, was reinforced and accelerated during a long period of continuing lessons. The courts found that the fulsome praise, unremitting sweet talk, undeserved medals and awards, and untrue claims of progress were so extreme as to pass beyond good customer relations and become outright fraud.

The fraud in these cases was not the misrepresentation of an

external objective fact, but of an opinion. By pretending that they believed the victims to have talent and potential, the studio employees lied about what they thought, inducing the victims to buy copious quantities of lessons. Although false opinions do not always qualify as factual misrepresentations, a deliberate misstatement of opinion can be fraud when the party expressing it claims to have the knowledge and expertise to form a judgment and should realize that the victim is relying on an honest assessment. As the brief description of the cases suggests, the behavior of the Arthur Murray studios went far beyond the expression of a dishonest opinion. The transactions were thoroughly unsavory. Lonely and gullible elderly women were cruelly manipulated for a long period and induced to spend substantial amounts of their savings on extended courses of dance lessons that were unlikely to be used up in their lifetimes.

Fleece Foot's conduct was not as egregious as that of the Arthur Murray studios, and Tutu, being a worldly former tax lawyer, is not as sympathetic a victim as the plaintiffs in those cases. Nevertheless, there were two instances of dishonesty by Jig, acting on behalf of Fleece Foot, that could provide an argument for fraud. First, he deliberately misrepresented his opinion. However, this may not be a good basis for establishing fraud because his misrepresentation apparently did not induce Tutu to enter the contract. Tutu was not taken in by his flattery and was motivated by deeper urges. (Although Jig turned out not to be the instructor, there is no indication that he realized that this was an inducing factor or that he knew of and failed to disclose his impending dismissal.)

Second, he concealed the true nature of the form by placing his hands over it. If this is fraud, it would be in the factum, not in the inducement, because it relates to the document being signed rather than to a motivating fact. Note also that the misrepresentation is by concealment, not affirmative assertion. Although his intent is dishonest, Tutu is probably damned by her sophistication and training. While an illiterate or naive person may be able to convince a factfinder of having been bamboozled into unwittingly signing a lifetime contract, Tutu, a trained lawyer, should have known better than to sign something without reading it. The strategically placed hand adds no force to her case. Although the writing was concealed, it was easily discoverable (in fact,

the attempt at concealment should have excited her suspicion). While inducement takes into account the victim's subjective reaction to the misrepresentation, her attributes affect the credibility of any claim that she was actually induced to sign as a result of the clumsy deception. Having said this, it must be acknowledged that an argument of fraud is not entirely inconceivable if Tutu can show an intent to defraud. Even extreme neglect may be outweighed by clear proof of the perpetrator's dishonesty.

Fraud was the basis for relief in both *Vokes* and *Syester*, but the facts make an overwhelming case of unconscionability as well: As a result of the studios' slimy bargaining methods, their victims were induced to enter contracts for lessons well in excess of their needs at a ludicrous cost. Unconscionability doctrine is not needed when the elements of fraud are satisfied, but if there is any doubt about establishing the elements of fraud, unconscionability is an alternative theory for avoidance. Bargaining unfairness short of actual fraud may be sufficient to show procedural unconscionability, and the facts of this Example reveal a deliberate and carefully developed process to manipulate and exploit prospective customers. It is probably safe to say, given the clear procedural unconscionability, that a court would not have too much trouble in finding that it is substantively unconscionable to sell a $10,000 lifetime dance instruction contract to a 65-year-old retiree. Unconscionability is less potent a weapon in the hands of a well-educated and commercially proficient party, but even former tax lawyers can be caught off guard by predators in the marketplace.

3. Sweaty Shoppe should be able to avoid the contract on grounds of duress because it has been induced to enter the contract by Brute Force's wrongful threat. (Although this is a sale of goods, general principles of common law apply because UCC Article 2 has no provisions relating to duress.) The exposure of the criminal conduct of Sweaty Shoppe's buyer would not itself be wrongful. In fact, the revelation of such information is in the public interest. The wrongfulness arises because Brute Force's threat is made for the purpose of blackmailing Sweaty Shoppe's president into entering the contract. Even an otherwise proper act loses its legitimacy if it is used as a threat for the purpose of extorting private advantage. It adds to the wrongfulness of the threat that the information possessed by Brute Force relates to criminal activity and it is using the

information as a bargaining chip to force Sweaty Shoppe's president to enter a contract to buy its products. A person harms the public interest by withholding information of a crime from the authorities in exchange for a commercial reward. For this reason, a threat to expose the crime unless Sweaty Shoppe agrees to a contract is clearly an improper threat for duress purposes.

To show inducement, Sweaty Shoppe must establish that, under all the circumstances, its management had no reasonable alternative but to acquiesce in the contract. Sweaty Shoppe's president did have an alternative—the one that its board ultimately decided to follow. However, Sweaty Shoppe can make the plausible argument that at the time that Brute Force proposed the contract, Sweaty Shoppe's president could reasonably have decided that the threatened exposure and its potentially dire impact on the company was not a reasonable alternative and that the threat undermined the president's volition in making the contract. The terms of the contract were fair and commercially reasonable, but that does not matter. Once the elements of improper threat and inducement are established, Sweaty Shoppe does not have to show that the resulting contract was substantively unfair. Because there is no substantive unfairness in the terms of the contract, duress is a better basis for avoidance than unconscionability.

Note that considerations of public policy are implicated in the determination that the threat was wrongful. If Sweaty Shoppe cannot make a convincing case of duress (say, because it cannot show that it had no reasonable alternative but to agree), it could make the argument that the contract should be avoided as illegal. On the surface, there is nothing objectionable about this contract, which is simply the sale of goods for a price. However, the contract is grounded on blackmail— the underlying purpose of the contract is for the concealment of a crime in return for financial advantage. The *in pari delicto* rule requires a balancing of the relative guilt of the parties, but goes beyond that to consider the impact of enforcement or nonenforcement on the public good. The determination of relative guilt can be difficult. Sweaty Shoppe's buyer committed the crime of buying stolen goods and its president covered up the crime. These acts of its agents are imputed to Sweaty Shoppe. However, when the guilt of the blackmailer and victim are weighed, Brute Force's guilt in extorting the contract is directly

related to its procuring the contract and seems to be weightier. The conclusion that Sweaty Shoppe should be able to raise the *in pari delicto* defense to avoid the contract is reinforced by the equities between the parties and the public interest. The equities favor Sweaty Shoppe because its innocent stakeholders, the board and owners (stockholders), neither knew of nor approved of the illicit activity of the buyer and the president. The public interest is best served by refusing enforcement because to allow enforcement would condone and provide an incentive to extortion.

4. This is an employment contract, not a sale of goods, so the common law applies. The parties expressly state that they intend Lunar Tech's promise of the bonus to be a modification of their existing contract. Under consideration doctrine, the modification is unenforceable unless Dr. Starburst gave new consideration to Lunar Tech. The consideration recited in the memorandum is not a new legal detriment suffered by Dr. Starburst in exchange for Lunar Tech's promise of the bonus. Dr. Starburst had a preexisting duty to work for Lunar Tech until the end of her contract period, and had no right to terminate the contract. (For the same reason, her giving up the other job opportunity is not a detriment for consideration purposes.) Consideration doctrine therefore invalidates the modification. The problem with consideration doctrine is that it is a blunt instrument for dealing with modifications. If there is no new consideration, the modification is invalid, whether or not it was fairly obtained. Conversely, if there is some new consideration, even if slight, consideration doctrine does not invalidate a coerced modification.

   Had Dr. Starburst suffered some new detriment in exchange for the promise, the modification would have been enforceable unless there was some other basis for avoiding it. Lunar Tech might be able to show that the modification should be avoided on grounds of duress. (This was the basis of policing the modification in *Austin Instrument* discussed in section 13.9.) If Dr. Starburst had threatened to breach the employment contract, that threat would be improper. However, it is not clear if she made any threat at all. The Example states merely that she told the president that she wanted to resign. It does not indicate that she made it clear (as did the fishermen in *Alaska Packers*) that she would refuse to perform her contract unless Lunar Tech increased her pay. One could possibly find an implied threat here, but the basis for implication is weak

in the absence of anything more aggressive than her expressing the wish to leave. This could simply be a situation in which Lunar Tech decided that the offer of a bonus was the best way to keep Dr. Starburst happy and engaged. Had Dr. Starburst made an improper threat, Lunar Tech could likely establish that it induced the contract. The stakes of delay and disruption are high, and it does not seem to have an alternative course of action that would be reasonable.[17] If Lunar Tech cannot establish the elements of duress, it is unlikely that unconscionability would be an alternative basis for relief. Unless there was some kind of coercion, there is no suggestion of procedural unconscionability, and we do not know if a $500,000 bonus for a project supervisor exceeds the bounds of substantive fairness in the in the industry.

5. There is a general public policy in favor of arbitration, and Dr. Starburst can avoid the arbitration provision only if she can show grounds for avoidance under general principles of contract law. There is no basis for claiming that the contract is illegal or against public policy, or that Lunar Tech committed fraud or duress. Therefore, the only possible basis for avoidance is unconscionability. *Samaniego v. Empire Today LLC*, discussed in section 13.12.3, found an arbitration provision in an employment contract to be unconscionable where the provision had several features in common with the one in issue here. Like the clause in *Samaniego*, the clause in this contract was in a standard form proffered by the employer. The arbitration clause was near the end of a dense and lengthy contract and was not printed in a way that drew attention to it. The clause incorporated by reference the rules of the American Arbitration Association, but did not provide those rules. The clause imposes arbitration on employees, but not on the employer, and it shortens the limitation period for employees' claims, but not for the employer.

   The complexity of the contract, the inconspicuousness of the clause, and the failure to specify the rules governing the arbitration may suggest procedural unconscionability. However, there is a significant factual difference between this case and *Samaniego*. The employees in *Samaniego* were not proficient in English, and the form was presented to them on a take-it-or-leave-it basis, with little or no opportunity to seek advice. Dr. Starburst is in a very different situation. She has an advanced education, is highly regarded in her field, and was being sought by

Lunar Tech for an important senior position, for which they were offering her an impressive salary. She surely had the bargaining power to negotiate the terms of the contract proffered by Lunar Tech, and there is no apparent basis for thinking that contract was presented to her on a take-it-or-leave-it basis. She was given the standard contract, which she kept for a week before signing it. She had ample opportunity to read it, to consult an attorney and other advisors, and to ascertain the rules of the American Arbitration Association. It is difficult to imagine that a court would find adhesion or any other grounds of procedural unconscionability in this case.

The complete absence of procedural unconscionability will probably dispose of the matter. Even if the court does not require a clear showing of procedural unconscionability where substantive unconscionability is strongly present, a sophisticated party with bargaining power is unlikely to persuade the court that relief is merited. The one-sided nature of the arbitration provision could well qualify as substantively unconscionable. Although mutuality of obligation is not required, where an arbitration provision imposes the obligation to arbitrate on only one of the parties, and additionally limits the rights of that party to pursue the arbitration, the term could be too one-sided to enforce. Notwithstanding, this is probably not enough to outweigh Dr. Starburst's abject failure to read the contract and to take the opportunity to negotiate a less one-sided dispute resolution provision.

Even if the court found the clause to be unconscionable, this does not mean that it would avoid the arbitration term entirely. It could select the intermediate remedy of enforcing the clause and adjusting it to get rid of its unconscionable aspects. However, that works only where the clause can stand without the offending aspects and the severance of those aspects cures the unconscionability. Had the court found unconscionability here, this probably would not have been an appropriate case for adjusting the contract. Although the time limit on suit could be severed, the lack of bilaterally in the obligation to arbitrate cannot really be cured by an adjustment of the provision. In *Zullo v. Superior Court*, 127 Cal. Rptr. 3d 461 (Cal. App. 2011), the court refused to enforce an arbitration agreement in an employee handbook because it was adhesive and also lacked bilaterality—the contract imposed no restrictions on the employer's right to sue an employee, but

the employee was obliged to arbitrate and lost even that means of recourse unless she gave notice of the claim to the employer almost immediately. The court refused to enforce the arbitration clause in its entirety because it found that it was permeated with unconscionability and was drafted not as a neutral means of dispute resolution but merely to maximize the employer's advantage in handling disputes

6. A similar situation occurred in *Phoenix Baptist Hospital v. Aiken*, 877 P.2d 1345 (Ariz. 1994). After rushing his wife to the hospital, a husband signed a standard contract obliging him to pay the hospital's charges. In the absence of this undertaking he would not have been personally liable for his wife's medical expenses. The hospital sued him and applied for summary judgment on the basis of his signature on the form. The court refused summary judgment and held that the husband was entitled to go to trial on the question of whether the contract was unconscionable. The court said that the contract appeared adhesive, signed under traumatic and hurried circumstances in which the husband had little realistic opportunity to know what he was signing. Even if he did know, the emotional stress and the need for the hospital's immediate services would likely leave him without power to bargain and give him no choice but to acquiesce in order to ensure that his wife received medical attention. The court considered that adhesion of this kind could make the contract procedurally unconscionable. In addition, substantive unconscionability could lie in the fact that he assumed liability for which he would not otherwise be responsible and that he could not reasonably have expected to be provided for in the form that he signed.

   As discussed more fully in section 13.12 and Example 7, adhesion and procedural unconscionability are not present merely because the contract is a standard form drafted by the party with greater bargaining power, or because the choices of the weaker party are limited. However, when the services contracted for are desperately and urgently needed, and the party to perform the services presents a form without explanation or a reasonable opportunity to read, in circumstances that make bargaining burdensome or futile, it should not be very difficult to make a case for procedural unconscionability. It is not required that the hospital purposely used unfair bargaining methods to trick or coerce Sam into signing. The procurement of apparent assent under these circumstances should be enough. Sam's emotional stake in the rendition

of the services to Hardy is not as strong as that of a spouse, but the stress and urgency of the situation are patent. Sam would not have to show that the terms were objectively unfair—for example, that the hospital charged an excessive price. The substantive unconscionability lies in the fact that Sam incurred an obligation that he would not otherwise have, for services from which he received no personal gain. In this respect, his case is stronger than that of a spouse. There is thus an adequate showing of substantive unconscionability—but even if a court may question this conclusion, the strong showing of procedural unfairness would seem to place beyond doubt the need to give Sam relief.

Unconscionability is the most appropriate basis for relief in this case. Could it also have been argued under a theory of duress? Duress doctrine has expanded enough to make this a possibility, in that the threat to withhold medical services for Hardy undermined Sam's free will and coerced him into signing. However, this strains the concept of improper threat because the hospital did nothing more than indicate intent not to enter a contract except on its own terms. This cannot be a threat unless the hospital had a duty outside contract law (say, by statute) to render emergency services to any patient brought in.

7. Obviously, Mary is not seeking avoidance of the entire contract. Rather, to assert her tort claim, she must persuade the court that she is not bound by the forum selection clause and liability disclaimer.

   Before dealing with policing doctrines, there are two preliminary questions to settle. The first is whether the disclaimer entered the contract at all. This does not appear to be a rolling contract because there is no indication that the parties intended that Mary would not be bound until she received and had a chance to review the tickets. That is, the contract was formed at the time that she booked, and the transmission of the tickets with the standard terms is not an offer. (*See* sections 5.5. and 13.2.) When the drafting party sends the standard terms to the other party only after the contract is formed, the terms may not be part of the contract at all. However, if the nondrafting party had reason to know that the contract was subject to standard terms and the standard terms are fair and reasonably expected, the court may find them to be part of the contract.

   The second preliminary question involves interpreting the terms. If we find, as a matter of interpretation, that the forum selection clause and

the disclaimer do not cover the claim in this suit, we do not need to consider whether they should be avoided or adjusted under a policing doctrine. The disclaimer's language creates some doubt about its scope. It exonerates Party Lines from "loss or harm." The provision does not expressly mention personal injury, and the juxtaposition of the words "loss" and "harm" could suggest that only economic damage is contemplated. The public policy of reading negligence disclaimers as narrowly as possible, combined with the *contra preferentum* rule, could persuade a court that the clause does not cover personal injury at all. If the court accepts this interpretation, the disclaimer is simply inapplicable and we need not be concerned with avoiding it. The forum selection clause may also be subject to interpretational challenge. Mary could argue that "any dispute…arising out of [the]…transaction" is not broad enough to cover tort claims for personal injury and should be confined to disputes relating to the performance of services promised under the contract. If the court accepts this interpretation, the California suit can proceed without any determination of whether the clause is avoidable.

If the provisions are interpreted to mean what Party Lines says they mean, they are enforceable unless they can be avoided. There is no indication of fraud or duress, so unconscionability doctrine offers Mary the best hope of eliminating the provisions. This is a contract of adhesion with standard terms that Mary did not negotiate or even read. However, that is not enough to make the terms unconscionable. To establish procedural unconscionability, Mary must produce evidence of some form of underhand dealing, which she cannot do on these facts, or must at least show that the terms were imposed on her without any meaningful choice, under circumstances that make the imposition oppressive. The terms were not made available to her at the time of booking, so this is a point in her favor. However, because cruise tickets are routinely subject to standard terms, as a reasonable consumer she should have expected them. She failed in her duty to read by not requesting them before she contracted.

In addition, there is no indication that she tried to shop around to see if better terms were available from a competitor. Her case for procedural unconscionability is weak. She may have a better chance of showing substantive unconscionability, but this is not an easy case either. To establish substantive unconscionability, Mary must do more

than show that the terms served Party Line's interest and were adverse to hers. She must establish that they were not justified by business realities and were so one-sided as to be oppressive. Under circumstances similar to these, *Carnival Cruise Lines*, discussed in section 13.12, found a forum selection clause to be a fair cost-saving measure that selected an appropriate forum and was not designed to suppress suit. The liability disclaimer must be analyzed similarly. It is potentially unfair, but not per se unconscionable to disclaim liability for negligent injury. In evaluating the fairness of a disclaimer the court looks at factors such as the nature of the service, the parties who are likely to avail themselves of it, the degree to which a user of the service places herself under the control of the cruise line, the scope of the disclaimer, the conspicuousness of its disclosure, the business justification for including it, the reasonableness of the clause in light of accepted commercial practice, and whether the price of the cruise would have been higher in the absence of the exclusion of liability. In short, neither procedural nor substantive unconscionability is strongly shown on these facts, and Mary's prospects of avoiding the provisions do not look very promising.

Finally, although public policy considerations have already been raised in the discussion of unconscionability, it is worth noting that even if a provision is fairly bargained, it can still be attacked as violating public policy. Where public policy outside the area of contract is implicated, the court must balance that public policy against the policy of freedom of contract. The forum selection clause affects Mary's right to sue in a court that would otherwise have jurisdiction. It thereby impairs a strong public interest in uninhibited access to justice. The majority in *Carnival Cruise Lines* held that this policy does not absolutely invalidate an agreement restricting this right of access provided that the agreement is genuine and freely made and the selected forum is reasonable. Of course, the strong public policy of access to justice means that the clause must be scrutinized carefully. As noted in section 13.12 the clause withstood the scrutiny of the majority of the Supreme Court, but not the dissent.

As discussed in section 13.13.3, disclaimers of liability are also scrutinized carefully because public policy requires that a person is held accountable for tortious injury. Although a disclaimer of liability for

intentional or reckless conduct is very likely against public policy, courts are more amenable to disclaimers of negligence. In deciding whether a disclaimer for negligence is consonant with public policy, courts consider factors similar to those listed above in relation to the inquiry into substantive unconscionability.

8. Rock's failure to disclose the judgments likely qualifies as a fraudulent misrepresentation. Even though he did not affirmatively lie, he deliberately omitted requested information, knowing that disclosure would imperil his credit application. In some situations it may be difficult to decide if a party has the duty to disclose facts pertinent to the transaction, but this is not such a case. It is generally accepted that a duty of honest response does arise if the other party asks a direct question, particularly when the information sought is not of a proprietary nature.

    It is more difficult to say whether the misrepresentation induced the contract. A debtor's unreliability in other transactions is generally a crucial factor in the decision to grant credit. However, Hi Rate's cursory look at the form suggests that its standard for granting credit is very low indeed. If it really cared about the applicant's credit history or was truly interested in the answers on the application, it would have taken more trouble to read the form. Furthermore, judgments are a matter of public record, easily accessible to the prospective creditor. A creditor who regards this information as crucial would not simply rely on the applicant's disclosure and would check. Normally, when fraud is involved, the serious malfeasance of the perpetrator outweighs any lapse of care by the victim in failing to check the facts. But actual inducement must still be shown, and where the victim is sophisticated enough to know better, careless gullibility may break the chain of justified reliance.

    In addition, there is some suggestion in this case that Hi Rate is not being entirely responsible or socially conscious in selling expensive luxury items to people who cannot afford them, and that it has ameliorated its risk of loss by padding its prices and interest rates. Although this does not excuse Rock's dishonesty, Hi Rate cannot comfortably don the mantle of innocent dupe. It can fairly be expected to take care of its own interests. In short, without condoning Rock's deceitful silence, a court may be indisposed to allow Hi Rate out of the contract. As long as Rock continues to make his payments as promised,

Hi Rate must live with the risk of his lack of creditworthiness.

9. There is nothing to suggest that Hi Rate made any misrepresentation to Rock, or that it applied any threat to make him enter the contract. Therefore, if Rock is to have any right of avoidance, it must be based on unconscionability.[18] Avoidance of the contract, as opposed to enforcement on adjusted terms, is within the range of relief available to Rock at the court's discretion.

   Because Hi Rate seems to have a captive market and it imposes higher prices and adverse terms on its customers under standard contracts, one may jump to the conclusion that Hi Rate is a predatory mass contractor subjecting a whole section of the community to its harsh contracts of adhesion. This conclusion is even more tempting if one perceives it as socially harmful to sell luxury items on credit to people who cannot afford them. However, one cannot conclude as a matter of law that the contract is unconscionable under these circumstances. The transaction must be evaluated to see if it satisfies the two elements of unconscionability.

   Hi Rate did not employ high-pressure selling techniques or deceptive practices that could lead to a clear-cut case of procedural unconscionability. However, *Williams v. Walker Thomas Furniture*, discussed in section 13.11.3, suggests that the contract could be procedurally unconscionable if Rock had no meaningful choice—the contract is adhesive because Hi Rate, the dominant party, had the power to dictate the terms, and Rock, the weaker party had no choice but to accept those terms. Under some circumstances, the mere fact of adhesion, without a demonstration of specific bargaining impropriety, could satisfy the procedural element of unconscionability. (This conclusion could be strengthened slightly if the terms were not conspicuous and drawn to Rock's attention.) However, the claim of lack of meaningful choice is tenuous in relation to a sale of luxury goods. True, this may have been the only means Rock had to acquire the jewelry, but he could have chosen not to buy it at all. In addition, there is no indication that Rock tried to buy the jewelry elsewhere or that he protested over or tried to negotiate the price or other terms. In some cases the weaker party's lack of sophistication can bolster the sense of imposition, but Rock does not appear to be particularly unsophisticated. Remember that he was sly enough to practice his own bit of deception.

Even if the basis for procedural unconscionability is shaky, a court may still find the contract to be unconscionable if the weaker party can show a strong degree of substantive unconscionability. This seems unlikely in this case. The contract terms are adverse to Rock, but the higher price and interest rate could be based on sound business practice and could conform to reasonable commercial practice in a high-risk credit market. Hi Rate's retention of a security interest to secure the price is a widely accepted means of protecting a creditor from default, and the facts do not suggest that the security agreement has unusually harsh terms (for example, such as the cross-collateralization term in *Williams*).

10. The facts indicate that all aspects of this transaction—removing the figurine from the tomb, smuggling it, and selling it—are illegal. (In fact, these actions are surely criminal offenses as well. However, the question of whether the parties face criminal prosecution is not our concern here.) The facts also suggest that both parties were aware that they were entering into an illegal sale. Ann would have no chance of successfully suing Rob for enforcement of the contract. It is inconceivable that a court would abet a seriously illegal transaction by enforcing it, either by an order of specific performance or by the award of expectation damages to compensate for the loss of the bargain.

    The answer is less obvious if Ann does not seek to enforce the contract, but instead claims restitution of the $1 million that she paid to Rob under principles of unjust enrichment. By awarding restitution, the court does not uphold the illegal transaction, so there is a greater possibility that the court may be willing to intervene to remedy Rob's enrichment at Ann's expense. However, this outcome is not guaranteed because Ann's claim of restitution is also subject to the *in pari delicto* rule. The rule does not focus only on enforcement but declares that when the parties are in equal guilt, the court will not intervene to help either of them and will leave them as it finds them. As section 13.13.2 explains, the operation of the maxim is more complicated than its language suggests. It involves a balancing of several considerations—the relative guilt of the parties, the equities between them, and the interests of society. It is difficult to choose which of these parties is more guilty—the thief-smuggler or the buyer who knowingly buys the stolen property. It seems reasonable to conclude that the parties are in equal guilt. If this

was the only consideration, Ann's restitutionary claim would be dismissed. However, the balance shifts in her favor if we consider the other factors to be weighed. As between the parties, the equities favor Ann, who has been cheated of $1 million by Rob. The question of what best serves the public interest is also difficult to answer. Is the public best served by penalizing the buyer of stolen artifacts, thereby creating a disincentive to enter such transactions, or is it best served by forcing the thief to disgorge his ill-gotten gains from the transaction? This question is close, but allowing Rob to keep Ann's money seems to be more damaging to the public interest.

This answer assumes that there is no legislative pronouncement that might assist the court in its decision. However, if transactions are made illegal by statute, the statute may provide rules or guidance on the legal rights of a party to an illegal transaction. For example, a statute that bars the sale of stolen artifacts could state that the buyer has no recourse for recovery of any sums paid. If the legislation pronounces on these matters, the resolution is clearer and obviates the need for the court to perform the balancing itself.

---

1. Remember that, as noted in Chapters 11 and 12, the word "writing" covers both tangible paper documents and retrievable electronic records.

2. There were some strategically placed boxes and a potted plant that covered some holes in the floor, so there was also a possibility of active concealment. In addition, the buyers had noticed rippling in the parquet floor which was consistent with termite damage and had asked the sellers about it. They had replied that it was water damage, which may or may not have been true. Accordingly, the buyers may have been able to establish a fraudulent assertion as well.

3. As explained in section 7.6, a settlement agreement that compromises a doubtful claim is valid for consideration purposes, provided that there is a good faith or reasonable basis for the dispute. Therefore, the fact that Jordan turned out not to be the father would not, in itself, have defeated the settlement agreement if the parties were unsure about the child's paternity. Knafel's problem in this case was that she concealed any doubt on this issue by categorically asserting that Jordan had to be the father, thereby inducing him to enter the settlement.

4. I hope you are not reading this case while eating. Just in case you are, it is also worth mentioning that on one occasion the buyer heard the toilet flushing repeatedly while he was waiting at the front door of the house. The buyer discovered later that the real estate agent (who was also a defendant in the case) was busy scooping up bat droppings and flushing them.

5. Although these facts do not fit comfortably into the elements of duress, if Attila's bargaining strategy is unfair and it results in unfair contract terms, the doctrine of unconscionability, discussed in section 13.11, may provide relief to Lilly.

6. As you will see in section 15.7, there is an affinity between the supervening difficulties doctrine and the defense of impracticability of performance. The difference, however, is that impracticability applies when the party suffering from the changed circumstances has not obtained a modification of the contract, but seeks to be excused from performance.

7. The distinction between law and equity is explained in section 2.5.

8. Walker Thomas sold furniture and appliances on credit to low-income buyers. As security for

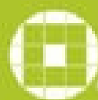
payment of the balance of the price, Walker Thomas structured the transaction to include a “cross-collateralization” provision in the contract. This gave it a security interest in the goods bought under the new transaction as well as in all goods that the customer had ever bought from it in the past. The effect of this was that if the customer defaulted, Walker Thomas could repossess not just the goods sold in that transaction, but all other goods bought in previous transactions. Used furniture and household items do not have much value and were probably not worth enough to settle the debt. Therefore, the real purpose of the clause was to increase the stakes of default and to put pressure on the customer not to miss payments. The trial court had declined to find the cross-collateralization clause unconscionable because the UCC had not yet been enacted in the District of Columbia at that time. The court of appeals held that the doctrine did apply and it remanded the case to the district court to consider whether the contracts satisfied the test that it articulated.
9. Arthur A. Leff, *Unconscionability and the Code: The Emperor’s New Clause*, 115 U. Pa. L. Rev. 485 (1967).
10. Home solicitation sales are legislatively regulated, so the buyer may have statutory grounds of avoidance as well.
11. Adhesion is usually associated with standard contracts, and this is the focus here. However, note that an argument of adhesion could be made in any situation in which one of the parties has no choice but to accept nonnegotiable terms proffered by the other.
12. The deferred communication of contract terms is discussed in section 5.5. In that section, we consider whether standard terms that are not made available to the nondrafting party should be part of the contract. They are part of the contract if it can be interpreted as a rolling contract, in which the offeree is given the opportunity to reject the contract after receiving adequate notice of the terms. However, where the contract is not a rolling contract, standard terms not made available to the nondrafting party at the time of contracting will not be included in the contract unless the nondrafting party had a duty to ascertain what they were, or they were reasonable in content and reasonably should have been expected by the nondrafting party. The discussion in section 5.5 concerns the question of whether contested terms enter the contract and does not address the question of whether those terms are unconscionable. However, recognize that there is a link between these inquiries. Lack of reasonable notice of adhesive terms may satisfy the element of procedural unconscionability, and unexpected or surprising terms may be substantively unconscionable.
13. Restitution upon the avoidance of an illegal contract is discussed below in section 13.13.2b.
14. Although the general rule is that a person must be over 21 to buy liquor, in most states a person acquires contractual capacity at 18. The contract is therefore not avoidable for lack of capacity.
15. The plaintiff testified that although he had read the release, and his 12-year-old son had urged him not to sign it, he did not take it seriously or believe that it would be enforceable. The court pointed out that the plaintiff’s subjective opinion of the effect of the clause was irrelevant under the objective test.
16. You may remember first encountering a noncompetition agreement in Example 10 of Chapter 7, in which the issue was whether an employer had given consideration to an employee in exchange for a post-employment noncompetition agreement.
17. Had this been a sale of goods, the good faith standard of §2.209 would provide a broader basis for evaluating the modification on the good faith standard.
18. As the following discussion shows, the public policy of consumer protection is inherent in the unconscionability analysis and is one of the motivations for unconscionability doctrine. One could therefore say that the right of avoidance is based on public policy, but this is always true because all contract doctrines have a policy basis.

emanuel®
law outlines

Contracts

Eleventh Edition

Steven L. Emanuel


Wolters Kluwer

CONTRACTS

ELEVENTH EDITION

STEVEN L. EMANUEL

Founder & Editor-in-Chief, *Emanuel Law Outlines* and *Emanuel Bar Review*
Harvard Law School, J.D. 1976
Member, NY, CT, MD and VA bars

The *Emanuel*® *Law Outlines* Series

Copyright © 2015 CCH Incorporated.

Published by Wolters Kluwer in New York.

Wolters Kluwer serves customers worldwide with CCH, Aspen Publishers, and Kluwer Law International products. (www.wolterskluwerlb.com)

No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or utilized by any information storage or retrieval system, without written permission from the publisher. For information about permissions or to request permissions online, visit us at www.wolterskluwerlb.com, or a written request may be faxed to our permissions department at 212-771-0803.

To contact Customer Service, e-mail customer.service@wolterskluwer.com, call 1-800-234-1660, fax 1-800-901-9075, or mail correspondence to:

Wolters Kluwer
Attn: Order Department
PO Box 990
Frederick, MD 21705

eISBN 978-1-4548-7369-3

This book is intended as a general review of a legal subject. It is not intended as a source of advice for the solution of legal matters or problems. For advice on legal matters, the reader should consult an attorney.

CHAPTER 3
CONSIDERATION

*ChapterScope*___________________

This chapter describes the next important element to look for after you have identified a valid offer and acceptance: consideration. In brief, consideration is a "bargained-for-exchange for something of legal value."

- **Consideration is required:** If either party to a contract has not given consideration, the agreement is ***unenforceable*** unless it falls under one of the exceptions covered in the next chapter.
- **Definition of consideration:** A promise is supported by consideration if ***two*** requirements are met:
  - [1] The promis*ee* (the party who's receiving the promise being analyzed) ***gave up something of value***, or ***circumscribed her liberty*** in some way. (This is called the ***"legal detriment"*** requirement.)
  - [2] The promisor made his promise as part of a ***"bargain"***; that is, he made his promise ***in exchange*** for the promisee's giving of value or circumscribing of liberty. (This is the ***"bargain"*** requirement.)
- **Mutuality of consideration: *Each party*** is required to furnish consideration to the other. So if *A*'s promise is not supported by consideration from *B*, then not only is *A* not bound, *B* is not bound either. This is the called the requirement of ***"mutuality of consideration."***

I. INTRODUCTION

A. Consideration as a requirement for a contract: It is often said that for there to be a binding contract, there must be not only "mutual assent" (i.e., the offer and acceptance, discussed previously), but also something known as "consideration." This chapter describes what "consideration" is. At the outset, however, you should be aware that consideration is ***not*** required in all contracts. Chapter 4, in fact, describes several sorts of contracts which are enforceable even though there is no consideration; these include contracts made under seal, promises which induce

substantial reliance, and promises to pay for benefits received.

1. **Look for consideration first:** You should, however, first determine whether the contract is supported by consideration. It is only if it is not so supported that the exceptions to the consideration requirement become relevant.

B. Purpose of consideration doctrine: Not all promises are legally enforceable. Promises to make gifts, for example, are not usually enforceable. The function of the consideration doctrine is to distinguish between those promises that are enforceable and those that are not. As a general rule, a court will not enforce a promise unless the promisee has given "consideration" for the promise.

1. **Functions of consideration doctrine:** The requirement that a promise, to be binding, must be supported by consideration serves two primary functions:

   a. **Evidentiary function:** The existence of consideration helps to provide ***objective evidence*** that the parties intended to make a binding agreement. It helps courts distinguish those agreements that were intended by the parties to be legally enforceable from promises which were intended merely as obligations of honor, promises of gifts which neither party expected to be enforceable in court, or any other arrangement as to which the parties did not contemplate legal consequences.

   b. **Cautionary function:** The requirement that promises be supported by consideration serves a ***cautionary function*** as well. If the parties are aware that the providing of consideration by one will make the other's promise enforceable, the parties may ***act more carefully***, and will be less likely to make thoughtless or bad bargains or mistakes. Conversely, parties may take fewer precautions during negotiations because they know that their statements will not be not enforceable in the absence of consideration; fewer precautions during the initial stages of the bargaining process will in turn reduce transaction costs.

C. Definition: A promise is supported by consideration if two things are true:

[1] The promisee ***gives up something of value***, or circumscribes his liberty in some way. (If the promisee does either of these things, he's said to suffer a ***"legal detriment."***)

AND

[2] The promisor makes his promise as part of a ***"bargain"***; that is, he makes his promise ***in exchange*** for the promisee's legal detriment (i.e., in exchange for the promisee's giving of value or circumscription of liberty).

1. **More about "legal detriment":** What qualifies as the ***"legal detriment"*** (the "something of value or circumscription of liberty") that the promisee must exchange for the promisor's promise? The detriment can consist of ***any of the following*** kinds of things:

☐ an ***act*** by the promisee.

> **Example:** Promisor promises to pay $100 if Promisee actually walks across the Brooklyn Bridge. Promisee does the walk. The act of walking is consideration for Promisor's promise to pay $100.

☐ a ***forbearance*** by the promisee.

> **Example:** Promisor promises to pay $100 if Promisee refrains from smoking for the next month. Promisee in fact refrains. Promisee's forbearance from smoking is consideration for Promisor's promise to pay $100.

☐ a ***return promise*** by the promisee.

> **Example:** Promisor promises to pay $100 if Promisee promises now to walk across the Brooklyn Bridge next Saturday. Promisee makes this promise. Promisee's making of the promise to walk is consideration for Promisor's promise to pay $100.

☐ an act, forbearance or return promise by a ***third person*** (someone other than the promisee).

> **Example:** Promisor promises Promisee that if Promisee's sister Sue paints Promisor's house, Promisor will pay Promisee $100. Even though Sue is not the promisee, her act of painting will be consideration for Promisor's promise to pay Promisee the $100.

☐ A promise or act by the promisee, delivered ***to a third person***, rather than to the promisor.

> **Example:** Promisor promises $100 to Merchant, if Merchant delivers $100 in groceries to Son, Promisor's son. Merchant delivers. The fact that the bargained-for performance is rendered to one other than Promisor does *not* prevent Merchant's delivery to Son from being consideration for Promisor's promise to pay $100.

See generally Rest. 2d, § 71.

D. Two kinds of problems: The two aspects of the consideration definition (i.e., the "bargain" aspect and the "legal detriment" aspect) correspond to two very different kinds of cases in which consideration problems arise:

- ☐ The ***"bargain"*** aspect is mainly important in situations that ***do not involve business dealings***, such as a ***promise to make a gift***.
- ☐ The ***"legal detriment"*** aspect is mainly important in business-related contracts where it is not clear that one party has ***really given anything up.*** An example of this would be a deal between a debtor and creditor whereby the creditor promises more time to pay, but the debtor does not promise anything except that he will make the payment he was originally required to make.

We consider the scenarios raising the "bargain" issue first.

II. THE BARGAIN ELEMENT — GIFT PROMISES

A. The bargain element generally: For a promise to be supported by consideration, the promisee's "detriment" must have been ***bargained for*** by the promisor. One of the principal purposes of the "bargain" requirement is to ***prevent the enforcement of promises that are in reality promises to make gifts***.

1. "Bargain" defined: The Second Restatement defines "bargain" this way: "A performance or return promise is bargained for if it is ***sought*** by the promisor ***in exchange*** for his promise and is ***given*** by the promisee ***in exchange*** for that promise." Rest. 2d, § 71(2).

B. Ordinary gift cases: In the ordinary case of a promise to make a gift, the promise fails to be enforceable for lack of consideration not only because the promise is not part of a bargain, but also because no "legal detriment" is suffered by the promisee.

Example: *A* says to *B*, "I promise to pay you $1,000 next year." *A*'s promise fails to be supported by consideration (and is therefore unenforceable) in two respects. First, *A* did not make his promise as part of a bargain; that is, he was not attempting to obtain anything from *B*. Secondly, *B* suffered no "legal detriment."

1. Bargains vs. conditional gifts: In some cases involving promises of gifts, however, the promisee undergoes a detriment, and there is a

lack of consideration for the promise only because of a lack of a bargain. These cases are typically ones in which the promisee must meet certain ***conditions*** in order to receive the gift, but the meeting of these conditions is not really "bargained for" by the promisor, i.e., the meeting of the conditions is not the promisor's motive for making the promise.

> **Example:** *A* promises his widowed sister-in-law *B* a place to live "if you will come down and see me." In response to this promise, *B* travels to see *A*, thereby incurring expenses. *A* then refuses to make good on his promise. *B* has suffered a "legal detriment" (the expenses) sufficient to meet the legal detriment requirement for consideration. But *A* did not promise *B* a place to live because he wanted to see her; that is, he was not "bargaining" for a visit from his sister-in-law by promising her a place to live. Instead, her coming to see him was simply a necessary pre-condition of her accepting the gift. Therefore, *A*'s promise is unenforceable. *Kirksey v. Kirksey*, 8 Ala. 131 (1845).

> **Note:** In situations like that in *Kirksey*, where the promisee suffers substantial detriment preparing to accept a promise which turns out to be unenforceable for lack of consideration, the court may apply the doctrine of ***promissory estoppel***. This doctrine (discussed *infra*, p. 136) provides, in brief, that where a promisor makes an unenforceable promise which induces substantial reliance by the promisee, the promisor may be required to reimburse the promisee's reliance expenses.

2. Test for distinguishing bargains from pre-conditions: To determine whether the condition for accepting a gift is bargained for or not, ask whether the occurrence of the condition is of ***benefit to the promisor***. 1 Williston § 112. In the above example, for instance, you should ask whether the sister-in-law's visit to the promisor was something the promisor actively desired. If so, the promisee's action was probably "bargained for." If not, the promisee's action was merely a necessary pre-condition.

a. Question of fact: This will, of course, often be a difficult question of fact. Thus in the "sister-in-law case" above, the court would have to look at whether the promisor really liked his sister-in-law and wanted her around, or was simply doing her a favor which would bring him no particular pleasure. Had he said to her "I'll give you a place to live if you will come see me and be my housekeeper," the result would obviously have been different, since there would be indications of a bargain. C&P, p. 176.

3. Non-economic benefits: A bargain may be present even though the

promisor does not receive any ***economic benefit*** from the transaction.

Example: A promises his nephew $5,000 if the latter will refrain from smoking, drinking and gambling until he reaches the age of 21. The nephew so abstains.

Held, the uncle's promise was "bargained for," and therefore supported by consideration. While the uncle may have derived no actual economic benefit from his nephew's abstinence, he was clearly attempting to obtain something he regarded as desirable (his nephew's health, morality, etc.), and was therefore bargaining. See *Hamer v. Sidway*, 124 N.Y. 538 (1891). See also C&P, p. 176. Another aspect of this case, involving the "detriment" issue, is discussed *infra*, pp. 94.

a. Altruistic pleasure not sufficient: But the fact that one who promises to make a gift expects to derive ***altruistic pleasure***, or love and affection, from making the gift is ***not*** sufficient to constitute a "bargain."

Example: *A* promises *B* a gift of $1,000, saying to *B*, "I believe that it is more blessed to give than to receive, and it would give me great Christian happiness to have you accept my gift." Because *A*'s intent is clearly donative, the "bargain" element of consideration is lacking, and his promise is unenforceable. A court is highly unlikely to hold that the pleasure *A* receives out of gift-making is something that he is bargaining for.

i. **"Motive" not dispositive:** However, if there are any substantial indications that some kind of bargaining took place, the bargain element is met even though other evidence indicates that the promisor had an overriding, altruistic, motive for doing the bargaining. That is, the court does not look to whether the promisor's deep and ultimate objective was charitable or otherwise, but simply checks to see whether there are ***some aspects of a bargain.***

Example: Testator tells several witnesses that he wants his wife, P, to have the use of his house for the rest of her life; he then dies, and his will contains no such bequest. His executors, the Ds, sign an agreement with P whereby she is given a life estate in the house, in return for her promise that she will pay to the estate $100 per year in rent, and that she will keep the house in good repair. Courts will likely find the agreement is supported by consideration, even though the actual motive of the Ds may have been an altruistic desire to respect Testator's wishes.

ii. **Mixture of bargain and gift:** The fact that only "some aspects of a bargain" are required means that where a transaction is a ***mixture of a bargain and a gift,*** the consideration requirement is ***satisfied***. See Rest. 2d, § 71, Comment c. For instance, if one party promises to sell the other an item at a price that both

parties recognize is a ***large discount*** to its market value, that promise is supported by consideration (in the form of the buyer's promise to pay, or actual payment of, the discounted price).

Example: *A* is a close friend of *B*. *B* has long admired *A*'s painting "Irises" by Picasso, which as both parties know has a market value of $200,000. *A* promises to sell "Irises" to *B* for $20,000, and *B* promises to buy it for that price. The contract is enforceable because each promise is supported by consideration, notwithstanding the presence of a significant "gift" element to the exchange. Cf. Rest. 2d, § 71, Illustr. 6.

4. **Business context does not negate donative intent:** Even in a business context, a promise may occasionally be unenforceable because of lack of the requisite "bargaining."

Example: Landlord gives Tenant an "option" to renew tenant's lease. Relying on this promise to allow renewal, Tenant employs an architect to draw up plans to alter the premises, and pays the architect. Landlord's promise to allow renewal will be unenforceable for lack of consideration. Although Tenant has suffered a detriment (payment of the architect), Landlord did not "bargain" for this detriment. (Note, however, that a court might apply the doctrine of promissory estoppel [*infra*, p. 327] to allow Tenant to recover her expenditures.)

5. **Absence of overt bargaining not fatal:** Suppose the defendant can show that the plaintiff ***never overtly bargained*** for the defendant's promise to do something. Does that help the defendant establish that his performance was a gift, and was thus unsupported by consideration? The answer is ***"not necessarily,"*** especially in a business context. As long as the court concludes that D's promise ***induced*** P's promise or performance, the fact that D didn't expressly bargain in return for that promise won't matter.

Example: D gives P free recycled ash for use in a construction project. The ash turns out to be defective, so P sues D for breach of contract. D replies that it has no contractual obligations to P, because any promise it may have made (such as a warranty of non-defectiveness) was not supported by consideration from P. D says it merely made a gift of the ash on the condition that P come pick it up; D didn't explain why it wanted P to take away the ash, and didn't "bargain" for P's performance.

Held, there *was* consideration if the reason D offered the ash for "free" was because it wanted someone else to come remove it, and thus save D the cost of disposing of the ash itself. The "bargain" theory of consideration does not mean the parties must *actually bargain* over the terms of the agreement—it just means the promise made by D and the detriment to P must *induce* each other. Here, P has alleged that D *wanted* P to come take the ash and benefited when P did so, and that

that was why D made the offer. If P's allegation is true, consideration was present. *Pennsy Supply, Inc. v. American Ash Recycling Corp.*, 895 A.2d 595 (Pa. Sup. 2006).

C. Sham and nominal consideration: The parties to agreements that are essentially promises of gifts frequently recite that the agreement is made "in consideration of $1 paid," or some other small sum. While it is true that the law does not normally concern itself with the ***adequacy*** of consideration, provided that that consideration was truly bargained for (see *infra*, p. 95), the recital of purely nominal consideration is usually an ***indication that there was no bargain at all***, but rather, a gift.

> **Example:** *A* says to *B*, "Because you are my friend, I promise to give you $1,000." *B*, aware that such promises are not binding without consideration, suggests to *A* that they draw up an agreement containing the promise, and also containing a statement that *B* has paid $1 "in consideration for *A*'s promise."
>
> Whether or not *B* has actually paid *A* the $1, it is clear from the facts that *A* did not really give his promise "in exchange" for *B*'s dollar. Therefore, *A*'s promise is unenforceable. It is unenforceable not because *B* has failed to suffer a detriment (even the payment of $1, or the promise to pay $1, could be sufficient detriment) but because the facts indicate that there was no bargain, just an attempt to make a gratuitous promise enforceable by cloaking it in the form of a bargain. Rest. 2d, § 71, Comment d and Illustr. 5.

D. Importance of whether recited consideration was actually paid: Where the agreement recites that a particular form of consideration has been given, that recital may of course be ***false***. Under what circumstances may the party resisting enforcement show the falsity of the consideration? And if she is permitted to make such a showing, what effect will the showing have? These issues usually arise in the context of a recital that a particular sum of money has been paid; it is on this typical fact setting that we focus.

1. **Right to make showing:** Most courts will ***allow*** the party resisting enforcement to show that the recited consideration was never paid. A few courts, however, hold that such a showing may not be made, either on the theory that the parties are "estopped from contradicting the writing" or on the theory that the recital of consideration gives rise to an implied promise by the promisee to pay it. See C&P, p. 177.

2. **Significance of showing:** But even in courts following the majority rule, and thus allowing a showing that the consideration was not paid, such a showing will ***not necessarily mean that there is no***

consideration. The underlying issue is always ***was there a bargain***? — the truth or falsity of a recital that consideration was paid is merely ***nondispositive evidence*** on this issue. Thus if other evidence shows that there was in reality a bargain, the fact that the recited sum was never paid will not generally render the contract unenforceable.

Example: D signs an agreement stating that P has lent D $2,000. But the actual loan is approximately $25. *Held*, P may recover the full $2,000, because there was in reality a bargain despite the falsity of the recital of consideration. *Batsakis v. Demotsis*, 226 S.W.2d 673 (Tex. Civ. App. 1949). (The case is discussed more extensively *infra*, p. 96.)

a. Close cases: In close cases, the recital may make a difference. This is especially likely to happen where it is ***unclear whether there was a bargain or not.*** For instance, suppose that in *Kirksey v. Kirksey, supra*, p. 88, the brother-in-law had promised in writing, "In consideration of your coming down and seeing me, I will give you a place to live." This recital might well have been enough to induce the court to find that the brother-in-law was bargaining for the visit, rather than merely setting a condition whose fulfillment he did not actively desire. See Farnsworth, p. 89.

E. Promisee must be aware of promise: If the promisee is ***not aware*** of the promise, any act she performs is obviously not ***bargained for***. For this reason, most courts hold that where a ***reward*** is promised for a certain act, and the act is performed without the actor being aware of the reward, she cannot recover.

Example: D offers a reward of $500 to anyone who captures escaped prisoner. P captures the prisoner and returns him to jail, without having been aware of the existence of the reward.

Held, D's promise of a reward was not supported by consideration. (Apparently this was because P and D could not be said to have "bargained" together.) *Broadnax v. Ledbetter,* 99 S.W. 1111 (Tex. 1907).

Note: The holding in *Broadnax* was also based on the law of offer and acceptance, i.e., that since P never knew of the offer, he could not be said to have accepted it, and therefore no contract ever existed. See the discussion of the requirements for a valid acceptance, *supra*, p. 18.

F. Consideration doctrine not applicable to executed gifts: It is only the ***promise*** to make a gift, not the making of the gift, that is unenforceable for lack of consideration. That is, ***once the promisor makes the gift***, she

cannot rescind it for lack of consideration. Thus it is critical to distinguish between "executed" gifts (which cannot be undone, and as to which the consideration doctrine is irrelevant) and "executory" gifts (i.e., promises to make a gift), which are unenforceable for lack of consideration. See Emanuel on *Property* for the elements required to complete a gift.

III. THE BARGAIN ELEMENT — "PAST CONSIDERATION"

A. "Past consideration" not sufficient: Another kind of situation in which the "bargain" is missing (and where there is therefore no consideration) is that in which the promise is made in return for detriment ***previously*** suffered by the promisee. Where the detriment has been suffered before the promise is made, it is obviously not "bargained for" by the promisor.

1. "Past consideration" a misnomer: In such situations, the detriment occurring before the promise is frequently called ***"past consideration,"*** and the court then often makes a statement such as ***" 'past consideration' is not valid consideration."*** Such a statement is ***true***. That is, the term "past consideration" is a misnomer, since it is not consideration at all.

Example: P, a middle-age woman, has worked for D Corp. for 37 years. The corporation passes a resolution that P be given the right to retire at any time with a $200 per month lifetime pension. P continues to work for a few more years, then retires and receives the pension for a number of years. After the founder of D dies, the pension is cut off, and P sues.

Held, the services performed by P prior to the awarding of the pension rights were not the consideration for those rights, since "past services are not a valid consideration for a promise." Furthermore, the fact that P worked for a couple of years between the time she had the right to receive the pension and the time she actually retired was not consideration for the pension rights; it was clear that she had had the right to retire and draw the pension as soon as the promise of it was made. (In other words, her additional years of work were not bargained for.)

But because P ***relied*** to her detriment on the promise (by choosing to retire when she could have gone on working), the promise will be enforced under the doctrine of ***promissory estoppel***. This doctrine, and a further discussion of this case, are presented *infra*, pp. 136 and 141. *Feinberg v. Pfeiffer Co.*, 322 S.W.2d 163 (St. L. Ct. App., Mo. 1959).

B. Pre-existing debt: A sub-category of the rule that "'past consideration' does not constitute consideration" relates to situations in which the promisor promises to pay a ***pre-existing debt***. Suppose, for instance, that

A once owed *B* $1,000, but the running of the statute of limitations now prevents *B* from collecting this debt. *A* then promises to pay the debt. Most courts hold that there is ***no consideration*** for *A*'s promise, since he has not bargained for anything (he obviously received the original loan before making the promise). Variations on this "promise to pay a pre-existing debt" problem are discussed as part of our treatment of the "pre-existing duty rule," *infra*, p. 101.

1. **Possibly binding without consideration:** By the way, many courts hold that this sort of "promise to pay a pre-existing debt" is enforceable ***even without consideration***. See *infra*, p. 127.

C. **Promise to pay for past services received:** Similarly, a promise to pay for ***services received in the past*** is usually held not to be supported by consideration.

> **Example:** D's son, a 25-year-old, becomes ill while traveling, and is nursed by P. D writes to P, promising to pay P's expenses.
>
> *Held*, D's promise was not supported by consideration, since P's services were not given at D's request. (Also, since the son had long since left home, his own request for assistance should not be imputed to his father.) *Mills v. Wyman*, 3 Pick. 207 (Mass. 1825).

1. **Possibly binding without consideration:** Again, however, certain types of promises to pay for past services or benefits received may be binding without consideration. For instance, if the son in *Mills* had been a minor (for whom the father was still responsible), the court would probably have held the promise binding. Situations in which such promises to pay for past benefits are enforceable without consideration are discussed *infra*, p. 129. See particularly *Webb v. McGowin*, *infra*, p. 130 and Rest. 2d, § 86.

Quiz Yourself on
THE BARGAIN ELEMENT

20. George Washington's friend Benny Arnold tells him, "If you walk across the street with me now and go into the hardware store, I'll buy you an axe." Washington crosses the street and enters the store. Arnold reneges. Has Arnold breached a contract?

21. Lion Hart is walking through the woods when he steps on a thorn. He languishes in pain for hours, screaming. Furdley Naturelover walks by and sees Lion's predicament. Acting as a good samaritan, without any expectation of payment, Furdley removes the thorn. Lion, immensely relieved, says, "Boy, am I grateful. I'm going to send you $1,000 a month as long as I live." Is Lion's promise supported by consideration?

22. Alexander the Great throws a birthday party for his mom, Mrs. the Great. In between mouthfuls of cake and ice cream, washed down with cheap champagne, Alexander writes on a sheet of his stationery, "In consideration of today being Mom's birthday, I promise to give her Italy." Mrs. the Great's eyes light up. Is Alex's promise enforceable?

Answers

20. No, because there was no consideration, and promises without consideration are generally unenforceable. These facts highlight the difference between: (a) consideration, and (b) a condition on a gift. In these kinds of cases, you have to look at whether the detriment in question is something the promisor *bargained* for (a requirement for consideration). In other words, did the promisee's detriment *motivate* the promisor to make the promise? Here, Arnold wasn't really motivated by a desire to have Washington cross the street and enter the store; instead, these acts were merely a condition to facilitate Arnold's making of the purchase. Since Arnold didn't bargain for Washington's crossing the street, there was no consideration for Arnold's promise. Therefore, that promise was an unenforceable promise to make a gift.

21. No. Consideration requires a bargained-for exchange. If the promisee's detriment occurred *before* the promise was made, then the promisor could not have bargained for that detriment. Here, Furdley has already performed by pulling out the thorn, so his performance wasn't bargained for in exchange for Lion's promise to pay him $1,000 a month. As such, Lion's promise is not supported by consideration. (But the promise might be enforceable without consideration, especially if Furdley somehow relied on the promise; see the next chapter.)

22. No, unfortunately for Mrs. the Great. Promises are generally not

enforceable without consideration. In order for consideration to exist, the promisor, Alex, has to bargain for a benefit to him (or detriment to the promisee) in exchange for his promise. Although he uses the word "consideration" here, his words are a statement of sentiment, not a recital of legal consideration — he's not bargaining for anything from his mother in return for his promise. Since there's no bargain, there's no consideration to back up Alex's promise, and it's unenforceable.

IV. THE "DETRIMENT" ELEMENT GENERALLY

A. The "detriment" aspect of consideration: We turn now to the other aspect of the consideration requirement, i.e., that not only must there be a bargain, but that the promisee must undergo a "detriment" of a sort that the law recognizes as adequate. Some courts say that this detriment must be "legal detriment," but this label is merely conclusory; the courts have developed rules, outlined below, concerning what sort of value given by the promisee constitutes the requisite detriment.

B. "Detriment" idea summarized: The "detriment" idea is, broadly, that the promisee must ***do something he does not have to do***, or ***refrain from doing something that he had a right to do***.

1. Non-economic "detriments": A detriment may be sufficient to constitute consideration even though it involves no economic disadvantage to the person involved, and even if, indeed, it aids him morally, physically, or spiritually. ***As long as the party has circumscribed his freedom of action***, she has incurred sufficient detriment, regardless of whether there is "harm" to him in the commonly-accepted sense.

> **Example:** Recall *Hamer v. Sidway*, *supra*, p. 88, in which Uncle promised Nephew $5,000 if the latter would refrain from drinking, gambling, etc. Nephew, by so refraining, did not suffer any economic harm, and probably even benefited morally and physically. However, because he circumscribed his freedom of action, his forbearance was the kind of "detriment" that was sufficient to constitute consideration for Uncle's promise. Therefore, Uncle's promise was enforceable. Another way of looking at it is that Uncle "benefited" by Nephew's forbearance, and this benefit was sufficient to satisfy the "detriment" requirement.

C. Consideration may be either promise or performance: The "detriment" given or suffered by the promisee may be either a promise or a performance. If the detriment is a performance, the contract is of the

kind traditionally called “unilateral.” If the detriment is a promise, the contract is “bilateral.”

> **Example:** *A* says to *B*, “I promise to pay you $10 if you’ll sell me that book.” By the language of his offer, *B* has a choice between accepting by a promise and accepting by performance. (See *supra*, p. 21; see also UCC § 2-206(1)(a).) If *B* says “All right, I promise to sell you the book,” he has furnished consideration for *A*’s promise by his own promise to deliver the book. If, on the other hand, he simply takes the book and hands it to *A* saying “It’s yours for $10,” he has furnished consideration by performance.
>
> > **Note:** As a general rule, a promise can be a sufficient detriment if and only if the performance that has been promised would be a sufficient detriment. See Rest. 2d, § 75.

D. Where issue arises: Among situations in which the adequacy of the detriment arises are the following, all of which are discussed in this chapter:

- **[1]** Where the promisee ***forbears from suing on a claim***, in return for the promisor’s counter-promise to pay a ***settlement***;
- **[2]** Where a creditor promises to accept a ***smaller sum than is actually owed***, in discharge of the debtor’s debt;
- **[3]** Where the promisee performs or promises to perform a thing which she was ***already legally obligated to do***;
- **[4]** Where the promisee reserves power to ***determine the extent of his own performance*** (as in requirements and output contracts); and
- **[5]** Where the promisee makes a promise that is ***conditional upon the happening of some future event.***

E. Court will not inquire into “adequacy” of the detriment: There are some situations in which the parties exchange things that do not have roughly equivalent value. This may be due to the donative intent of the parties, to the fact that one party is more ignorant than the other, to the fact that the parties are mistaken, etc. In such situations, as long as the promisee suffers ***some detriment***, no matter how small, the court will not find consideration lacking merely because what the promisee gave up was of ***much less value*** than what he received. As Rest. 2d, § 79, puts it, “If the requirement of consideration is met, there is no additional requirement of…(b) equivalence in the values exchanged.” Or as the idea is often stated, ***“the court will not inquire into the adequacy of the consideration.”***[1]

Example: During World War II, P, a Greek resident, lends D, also a Greek resident, 500,000 drachmae, at the time worth $25. In return for the loan, P requires D to sign a promissory note for $2,000, payable at the end of the War. After the War, P sues to collect the $2,000; D defends on the grounds that there was a failure of consideration for the note.

Held, P is entitled to recover the $2,000 recited in the note. The transaction amounted to a sale by P to D of the 500,000 drachmae in return for signing of the instrument. D got exactly what she bargained for. "Mere inadequacy of consideration will not void a contract." *Batsakis v. Demotsis*, 226 S.W.2d 673 (Tex. Civ. App. 1949), *supra*, p. 91.

Note: The promissory note in *Batsakis* actually contained a recital that D had received from P the $2,000 which she was promising to repay. Observe that the *Batsakis* court followed the majority rule, allowing D to present evidence that she never in fact received the $2,000. That is, the court permitted demonstration of the falsity of the recital of consideration. But the court also followed the majority path in another respect, in that it found that despite the falsity of the recital of consideration, there was an actual bargain. See *supra*, p. 90, for a more complete discussion of the general rule that the falsity of a recital of consideration will not prevent consideration from being found as long as the bargain and detriment elements are satisfied by the actual (as opposed to the recited) deal.

1. **Minor effort or other thing of non-monetary value:** The principle that courts will not acquire into the adequacy of the consideration means that consideration can consist of the promisee's doing something that requires ***only a tiny bit of effort and has no financial value.*** For instance, the promisee's effort in ***clipping a coupon*** or ***filling out a contest entry form*** — even though this effort is minimal and has no monetary value — will typically be ***enough*** to constitute consideration for the other side's promise.

Example: Suppose D, an auto manufacturer, displays an online contest-entry form that says, "Fill out this form, and if your entry is drawn, you'll get a brand new D-mobile plug-in electric Model T worth $40,000." P sees the form, spends 30 seconds filling it out online, and is lucky enough to have his entry selected. D then refuses to deliver the car, defending on the grounds that its promise is not binding because P did not furnish consideration for that promise. P sues to enforce the award.

P would almost certainly win. A court would almost certainly hold that P's act of spending even 30 seconds filling out the form — and identifying himself to D for, say, marketing purposes — constituted consideration sufficient to support D's promise of a car to the winner.

2. **Equity courts have different rule:** Courts of ***equity***, as opposed to courts of law, have traditionally been much more ***willing to examine the adequacy of consideration*** for a contract. Equity courts have traditionally been in charge of actions for ***specific performance*** (see

infra, p. 311), ***injunctions***, etc. Therefore, when the action is for equitable relief, the court will often deny relief to a party whom they believe to have ***thrust an unfair bargain*** on his adversary.

> **Example:** P is a wealthy and sophisticated land owner. He helps the Ds, a couple with limited financial means and business know-how, to buy 80 acres of resort land near P's property. P promises the Ds some help in getting business for the resort they plan to establish, and also makes them a loan of $5,000, which they use in buying the property. In return, the Ds promise that they will not cut down trees on the property, or build any new buildings closer to P's property than the present buildings. These restrictions are to last for 25 years. The resort is not successful, and the Ds wish to add a trailer park and tent camp; to do this, they invest $9,000 in putting in utilities and buying bulldozing equipment. P then sues to enjoin them from making these improvements, arguing that this would violate their promise.
>
> *Held*, imposition of these restrictions would be extremely burdensome to the Ds, a burden which far outweighs the value of the $5,000 loan (which was repaid), and the small amount of business which P helped the Ds get. Furthermore, P would not be able to see the camp from his home. Therefore, the agreement is "unfair and based upon inadequate consideration," and the injunction will be denied. *McKinnon v. Benedict*, 157 N.W.2d 665 (Wis. 1968).

a. **Separate equity courts abolished:** The vast majority of states no longer maintain a separate system of equity courts apart from their law courts. Instead, a single trial system administers *both* legal claims (e.g., a claim for damages based on breach of contract) as well as equitable claims (specific performance, injunction, etc.) Nonetheless, courts are still somewhat more likely to inquire into the "adequacy" of the consideration where the claim is one that historically would have been considered equitable rather than legal.

3. **Inadequacy of consideration as evidence of fraud, duress, unconscionability, etc.:** While a law court will not take into account whether the things exchanged by the parties are roughly equivalent for purposes of determining whether consideration is present, a gross inequality between the two things exchanged may be evidence of *fraud, duress*, *unconscionability*, or *mistake.* See Rest. 2d, § 79, Comment c.

   a. **Duress:** For instance, in *Batsakis v. Demotsis, supra*, p. 91, D might have made a quite plausible argument that whether or not there was consideration, her promise was void for ***duress***. In support of this argument, she could have contended that there was widespread starvation and other suffering in Greece during the War

(see Dawson and Harvey, pp. 167-68), and that P took unfair advantage of D's utter desperation.

i. **Probably fails:** However, this argument probably would ***fail*** in today's courts, because P was not in any way responsible for D's predicament. As the Second Restatement's materials on duress put it, "Parties are generally held to the resulting agreement, even though one has taken advantage of the other's adversity, as long as the contract has been dictated by ***general economic forces***." Rest. 2d, § 176, Comment f.

b. Unconscionability: Similarly, where the value of the things exchanged by the parties is grossly unequal, the court may, although it will not inquire into "the adequacy of the consideration," hold that the agreement is void because it is ***"unconscionable."*** The notion of unconscionability, which originated with the courts of equity, is now embodied in UCC § 2-302. § 2-302(1) provides that "if the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract.…" Unconscionability will be discussed in a subsequent chapter (see *infra*, p. 478). It is important to note, however, that the voiding of a contract for unconscionability has nothing to do with the consideration doctrine.

III. THE PRE-EXISTING DUTY RULE

A. The pre-existing duty rule generally: If a party does or promises to do what she is ***already legally obligated*** to do, or if she forbears or promises to forbear from doing something which she is not legally entitled to do, she has not incurred the kind of "detriment" necessary for her performance or forbearance to constitute consideration. This is the so-called ***"pre-existing duty"*** rule.

1. Exceptions: The courts have, however, shown much ingenuity in creating exceptions and limitations to the pre-existing duty rule, many of which we will be discussing below. The UCC has gone even further — it has essentially abolished the rule.

2. Two party and three party cases: The courts distinguish between

those cases in which the promise to perform a pre-existing duty is made to the person to whom the duty is owed (the so-called ***"two party"*** cases) and those in which the promise to do the duty is made to some third person, not the person to whom the duty was owed (the ***"three party"*** cases). We shall first consider the "two party" cases. (The three party case are discussed *infra*, p. 105.)

B. General pre-existing duty rule in two party cases: Most courts hold that where one person promises another that he will do what he is ***already legally obligated to do*** for that other person, this promise is ***not a "detriment" sufficient to satisfy the consideration requirement***.

1. **Promise to modify:** The pre-existing duty rule means that if parties to an existing contract agree to ***modify*** the contract ***for the sole benefit for one of them,*** the modification will usually be unenforceable at common law, for lack of consideration.

2. **Deterring hold-up behavior:** A key reason for the pre-existing duty rule as applied to contract modifications is that courts want to ***deter "hold-up"*** behavior, by which one party attempts to ***take unfair advantage*** of the other by threatening not to live up to his obligations.

> **Example:** The Ps, a group of workmen, sign contracts at a fixed rate to work on D's ship during the salmon canning season, as the ship goes from San Francisco to Alaska and back. When the ship arrives in Alaska, the men tell D that they will not do any more work unless D gives them a very substantial increase in salary. Since D has nowhere to get replacement men, it agrees; the Ps work on the way back to San Francisco. D then refuses to pay the extra money, and the Ps sue.
>
> *Held*, for D. The agreement to pay the extra money was without consideration, since by agreeing to work on the way back to San Francisco, the Ps were simply agreeing to do what they were already bound to do under the contract. Furthermore, the Ps' conduct was coercive. *Alaska Packers Ass'n v. Domenico,* 117 F. 99 (9th Cir. 1902).

3. **Construction contracts:** One situation in which the pre-existing duty rule often arises is the case of ***construction contracts***.

> **Example:** Contractor agrees to pave Owner's driveway for $5,000, the job to be completed by May 1. Halfway through the project, Contractor tells Owner, "I've gotten very busy. Increase the price to $6,000, or I'll have to finish 6 weeks late." Owner says, "OK, I agree to pay you $6,000, now just finish on time." Contractor finishes on time, but Owner refuses to pay more than $5,000. Contractor sues for the extra $1,000.
>
> Owner's promise to pay the extra $1,000 (a modification of the contract) will

not be enforceable — the contract was modified to the sole benefit of Contractor, who was merely promising to do what he was already legally obligated to do. Therefore, he did not furnish consideration to support Owner's promise of the extra $1,000.

4. **Restatement view:** The Second Restatement is in accord with the majority of courts, in holding that an agreement to do what one is already legally obligated to do is not consideration. ***"Performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration...."*** (Rest. 2d, § 73).

5. **The "unforeseen circumstances" exception:** Most courts, and the Second Restatement, recognize an important ***exception*** to the pre-existing duty rule as applied in cases of modification: the rule does not bar a modification that's ***fair*** in light of an ***unexpected change in circumstances.*** Thus Rest. 2d, § 89(a) ***makes a modification binding*** if it is "fair and equitable in view of circumstances ***not anticipated*** by the parties when the contract was made."

   Example: Maher contracts with the city of Newport to collect garbage. Although the contract entitles Maher to $137,000 per year for five years, Maher twice requests an additional $10,000 per year from the city council, because his operating costs have substantially increased due to an unanticipated spurt of new dwelling units. After the additional payments are made, a citizen sues to have the additional payments refunded to the city.

   Held, the modification is enforceable. The modification was fair and equitable, voluntarily entered into, and motivated by events which were not anticipated at the time the original contract was created. *Angel v. Murray*, 332 A.2d 630 (R.I. 1974).

6. **Promissory estoppel:** If the party who benefits from the modification ***changes position in reliance*** on it, then the doctrine of ***promissory estoppel*** may apply, to make the modification binding even if it was not motivated by a major change in circumstances.

   a. **Restatement:** Thus Rest. 2d, § 89(c) allows the use of promissory estoppel to make a modification binding "to the extent that justice requires enforcement in view of ***material change of position*** in reliance on the [modification]."

   Example: An apartment lease calls for rent of $10,000 per year. Because of war conditions, many vacancies occur, and the landlord, L, agrees to reduce the rent of the tenant, T, to $5,000. This reduced rent is paid and accepted for five years. L then sues for back rent of $5,000 per year for the five years.

   A court will likely hold that T does not owe the back rent — by staying in the

apartment for five years in reliance on the promise of lower rent (rather than moving out to cheaper premises), T has qualified for promissory estoppel: justice requires enforcement of the modification, even though T did nothing in return for it that he wasn't already required to do. Cf. Rest. § 89, Illustr. 7. (But if the lease had more time to run, L would have the right to *prospectively* raise the rent back up to $10,000 per year, i.e., to withdraw the modification.)

7. **Where extra duties assumed:** Another very important exception to the pre-existing duty rule in modification cases is this: if the party who promises to do what she is already bound to do assumes the ***slightest additional duties*** (or even ***different*** duties, with the new duties substituted for the old), her undertaking of these new duties ***does*** constitute the required "detriment." This may be the case even though the new performance promised is less burdensome than the old one.

    Example: Contractor agrees to build a house for Owner for $30,000. Midway through the job, Contractor realizes he's losing money, and threatens to walk off the job if Owner does not increase the price to $40,000. In return for this price increase, Contractor is willing to change the kind of fittings in the windows, as requested by Owner; this change will actually save Contractor money. Most courts would probably hold that the change of specifications, even though actually less burdensome to Contractor, constituted consideration for Owner's promise to pay more for the house.

    a. **Where change is mere pretense:** The "additional" or "different" duties promised by the person already legally bound must not, however, be merely a ***pretense*** for avoiding the pre-existing duty rule. As the Restatement Second puts it, "A performance [similar to that previously due] is consideration if it differs from what was required by the duty in a way which reflects more than a pretense of bargain." Rest. 2d, § 73.

8. **Duty owed to third person rather than to promisor:** Another exception recognized by most modern courts is that the pre-existing duty rule does not apply where the promisee owes the pre-existing contractual duty ***to a third person*** rather than to the promisor. Rest. 2d, § 73, Comment d.

    Example: Parent's daughter Dee attends School, a private school. Parent makes the following promise to Teacher, Dee's teacher at School: "If Dee gets a 4 or 5 on the AP calculus exam at the end of the year, I will interpret this as being due in major part to your fine teaching, and I will pay you $1,000." School's policy allows teachers to collect such rewards from parents. Dee gets a 4, and Parent refuses to pay. Teacher sues, and Parent defends on the grounds that all Teacher did was the

teaching she was already contractually required to do, so that Parent's promise was not supported by consideration on account of the pre-existing duty rule.

In a court applying the prevailing modern approach, Parent will lose with this argument — because Teacher's pre-existing duty was owed to a third person (School) rather than to the promisor (Parent), the pre-existing duty rule does not apply, and Teacher's doing the teaching that produced the 4 was therefore "fresh" consideration for Parent's promise. Consequently, the promise was binding.

9. **Some states have rejected rule:** Some states have simply ***repudiated the pre-existing duty rule***, and allow promises to modify contracts without any consideration at all. See, e.g., N.Y.G.O.L. § 5-1103, making a modification enforceable if it is in writing and is signed by the party against whom enforcement is sought.

    a. **UCC changes the rule:** In the case of contracts to sell goods, the UCC has in effect ***abolished the pre-existing duty rule***. It has done so by § 2-209(1), which provides that "an agreement modifying a contract within this article needs no consideration to be binding." There are some qualifications to this rule, including a duty of good faith and a requirement that if there is a no-oral-modification clause in the original written agreement, the modification must also be written. The UCC approach to modification is discussed more extensively *infra*, p. 131-132.

10. **Rewards and bonuses:** Outside of the modification context, a promise to pay a ***reward*** or ***bonus*** will be unenforceable under the pre-existing duty rule, if the promisee is already under a legal obligation to perform the act being rewarded.

Example: Officer, employed by City, has the duty to investigate crimes and arrest the guilty. He learns of a reward offered by City for "information leading to the arrest and conviction of..." the person responsible for a particular robbery. Officer arrests a suspect, who is convicted. Officer won't be entitled to the reward, because there is no consideration for his act of making the arrest — he was only doing what his job already required him to co.

C. **Agreements to accept part payment of debt in satisfaction of whole:** A common application of the pre-existing duty rule involves a creditor's agreement to accept a payment by his debtor of ***a lesser sum in satisfaction of the full debt***. Since the debtor owes the full amount, he is not by paying a partial amount doing anything that he was not already legally obligated to do. Therefore, most courts hold that ***the creditor's promise not to require payment of the full amount is not binding, for***

lack of consideration.

1. **Extra time to pay:** These courts also hold that a creditor's promise to allow the debtor ***extra time to pay*** is, similarly, not binding for lack of consideration.

2. **Rule of *Foakes v. Beer*:** These two rules (barring the enforceability of promises to take a lesser sum, and of promises to give more time to pay) follow what is often called the "rule of ***Foakes v. Beer,***" after the case set forth in the following example.

   Example: P obtains a judgment for £2,000 against D. The parties agree that P will accept in full satisfaction of this judgment £500 in cash and the rest in installments. D fully complies with this agreement, and the amount of the judgment is eventually completely paid off. P then brings suit for interest on the part of the judgment that was paid off in installments. D claims that the "installment payment plan" agreed to by P constituted a discharge of any obligation by D to pay the interest.

   Held, such an extended payment plan cannot constitute consideration for a promise of discharge, since D only promised what he was already obligated to do. *Foakes v. Beer*, 9 App. Cas. 605 (Eng. 1884).

3. **Inroads on the rule of *Foakes v. Beer:*** Most courts and commentators feel that the rule of *Foakes v. Beer* serves no useful function, since it discourages what is frequently a useful commercial transaction, and breeds litigation. Therefore, in most jurisdictions the rule of *Foakes v. Beer*, although still followed, has been stripped to its barest bone: it applies only when the debtor makes part payment of an amount that is indisputably due, and due on the date that the part payment is made. If, in addition to making part payment, the debtor does any of the following things, he ***has given consideration*** for the discharge of the larger amount:

   [a] the debtor ***gives security*** in addition to the part payment;

   [b] she ***refrains from bankruptcy*** or insolvency proceedings which she would otherwise employ;

   [c] she arranges for a ***"composition agreement"*** in which several creditors agree to take less than the full amount due them;

   [d] she pays part of a claim the full amount of which is in *bona fide* ***dispute*** (see *infra*).

   See C&P, pp. 212-13.

4. **Overruling of the *Foakes v. Beer* rule:** A few jurisdictions have

simply ceased to follow the rule of *Foakes v. Beer*, and allow a creditor's promise to forgive part of a debt to be enforced where the debtor makes payment of the remainder, even if the debtor suffers no other kind of detriment.

5. **UCC also overrules:** UCC § 2-209(1), providing that "an agreement modifying a contract within this article needs no consideration to be binding," essentially ***overrules the Foakes v. Beer doctrine.*** That is, when the creditor agrees to take a partial payment in discharge of the full debt, he presumably has "modified" the contract. However, there are some potential "strings attached" to the use of this UCC modification provision; see *infra*, p. 132.

6. **Unliquidated or disputed debts:** The rule of *Foakes v. Beer* applies only to those debts as to which the parties are in agreement as to amount and liability (often called ***liquidated*** debts). If the debtor in good faith and not unreasonably disputes his ***liability*** on the debt, or if he reasonably and in good faith disputes the ***amount of the debt*** (an ***"unliquidated"*** debt), then a settlement by which the creditor agrees to take less than ***he*** thinks is due is enforceable.

   Example: Creditor asserts that Debtor owes him $1,000. Debtor claims, reasonably and in good faith, that he owes Creditor only $500. Creditor agrees to accept a $750 check in settlement of the debt. Debtor's payment of the $750, since it is payment on a claim whose amount is legitimately in dispute (i.e., an "unliquidated" debt), is a "detriment," and is consideration for Creditor's promise to discharge any part of the debt which might still be remaining. Therefore, Creditor cannot later sue for what he asserts is the balance due on his claim.

   The same result would be reached if Debtor denied that he had any liability to Creditor at all, but agreed to pay a certain sum in settlement. See Rest. 2d, § 73, Comment c.

7. **Detrimental reliance:** If the debtor can show that he has clearly ***relied to his detriment*** on the creditor's promise to discharge part of the debt, the court may decide to dispense with the requirement of consideration.

8. **Cashing of check tendered as settlement:** The above example assumes that the creditor agrees to a settlement of the debt disputed in good faith by the debtor. What frequently happens, however, is that the debtor simply ***sends the creditor a check*** for an amount less than the creditor believes is due, and marks it ***"payment in full"*** or similar

words. If the creditor then cashes the check, has she in effect made a promise to discharge the debtor from any additional obligation? Can the creditor prevent such a discharge by crossing out the words "payment in full" and writing something like "under protest"?

a. **Common-law view:** The common-law view was that even if the creditor writes the words "under protest" or "reservation of rights" on the check, her act of cashing it constitutes an enforceable discharge of the debtor. However, this rule was subject to several important exceptions, which we will not go into.

b. **UCC in accord:** Under modern law, the check-cashing problem is dealt with in the UCC, even in non-goods cases. This is done by a detailed provision, § 3-311. (Article 3 is the article dealing with negotiable instruments.) Most of the time, the creditor who cashes a check marked "in full settlement" or the like ***will lose*** under § 3-311, no matter what the creditor writes on the check.

§ 3-311 provides that the claim will be ***discharged*** by the cashing of the check (i.e., the ***debtor will win***), if these three conditions are met:

- □ the check or accompanying written communication contained a "***conspicuous statement*** to the effect that the instrument was tendered as full satisfaction of the claim," and
- □ the claim was either ***"unliquidated"*** or was "subjected to a ***bona fide dispute***," and
- □ the debtor acted in ***good faith.***

i. **Right to return payment:** There's an important exception that can hurt the debtor, though: the creditor has the right, within 90 days after cashing the check, to reverse the transaction by ***paying the debtor back*** the amount of the check; the creditor is thereby restored to the rights it had before cashing the check. § 3-311(c)(2).

ii. **If creditor is an "organization":** If the creditor is an ***"organization"*** (as opposed to an individual), the debtor must make an additional showing before getting the benefit of the "cashing the check discharges the claim" rule of § 3-311: she must show that "an ***agent*** of the [creditor] having direct responsibility with respect to the disputed obligation ***knew*** that

the instrument was tendered in full satisfaction of the claim, or received the instrument and any accompanying communication."

(1) **Rationale:** The basic idea behind this "organization" clause is to make sure that the creditor will be found to have waived its rights only when an employee of the creditor with knowledge of the underlying transaction ***knew*** that the debtor was proposing an accord and satisfaction. This rule ensures that the debtor can't slip a fast one past a large creditor by sending the check to the creditor's accounts receivable department, where the overworked clerks will not notice the "in full settlement" language.

iii. **Summary:** So in cases of unliquidated or disputed claims, as long as the debtor follows the above simple rules, he will be ***discharged*** when the check is cashed, ***no matter what the creditor writes on the check.***

iv. Check from insurance company: By the way, there is one context in which § 3-311 will work in favor of the large organization at the expense of the consumer (in contrast to the usual situation where the new rule favors the consumer/debtor): when an ***insurance company*** sends a check to an insured in settlement of a claim, and the insured cashes the check after writing "under protest" on it, the insured will be found to have accepted an accord and satisfaction.

v. **Enacted nearly everywhere:** Virtually all states and the District of Columbia have adopted § 3-311.

D. Extension agreements: Suppose a creditor agrees to give his debtor ***extra time*** in which to pay off a debt which both agree the debtor owes. Is the creditor's promise to forbear from bringing immediate suit on the debt supported by consideration? *Foakes v. Beer*, *supra*, p. 101, implies that such an extension agreement is not supported by consideration. But as in the part-payment situation discussed above, most modern courts try to avoid this result.

1. **Promise to pay interest:** If the debtor promises to pay ***interest*** for the period of forbearance, most courts agree that the creditor's promise of extra time to pay is supported by consideration:
   - □ If the debtor agrees not only to pay interest, but also agrees that he does not have the right to ***pay off the debt before the end of the extension period*** (and thus does not have the right to terminate the running of interest), *all* courts agree that the creditor's promise of an extension is binding. See Rest. 2d, § 73, Illustr. 8.
   - □ If no interest is promised (a relatively rare situation), many courts would probably still follow *Foakes v. Beer* and hold the agreement unenforceable for lack of consideration.

   See C&P, p. 201, n. 6.

E. **Settlement of other kinds of suits:** As we saw earlier, if the existence or amount of a monetary claim is in reasonable and *bona fide* dispute, a settlement will not be invalid for lack of consideration. A similar rule is usually applied to the settlement of other kinds of potential or pending litigation, such as ***tort suits***.

1. **Valid claim surrendered:** If a plaintiff promises to waive a ***valid claim***, all courts are in agreement that this promise is "detriment" to the plaintiff, and constitutes consideration for the defendant's promise to pay a settlement. See C&P, p. 180.

2. **Surrender of invalid claim:** If, on the other hand, the claim that the plaintiff promises to forbear from suing on is ***invalid*** (or of uncertain validity), things are trickier. But most of the time, even here the promise to forbear will be consideration for the return promise to pay.

   a. **Modern/Restatement view:** The modern view (represented by the Second Restatement) is that the forbearing plaintiff gives consideration if ***either:***
      - □ the plaintiff's forborne claim is one ***whose validity is uncertain***, ***or***
      - □ the plaintiff ***subjectively believes*** that the forborne claim has possible merit (even if it doesn't in fact have any possible merit).

   See Rest. 2d, §§ 74(1)(a) and (b).

Example: Mary becomes pregnant. She honestly believes that Dave is the father. Before the baby is born, she orally promises not to sue Dave for child support if Dave will promise to pay her pre-birth medical expenses. Dave orally so agrees. The child is born, and a DNA test shows that Dave is not the father. Dave refuses to pay the medical expenses.

A court applying the modern/Restatement view would find that Dave's promise to pay the expenses was supported by consideration, because the child support claim that Mary was promising not to assert was one that she honestly — even though incorrectly — thought was valid. Therefore, Mary's promise to forbear from bringing the invalid claim was consideration for Dave's return promise to pay the medical expenses, and Dave's promise will be enforceable.

i. **Execution of release:** Even if the would-be plaintiff who is forbearing from asserting her claim ***does not subjectively believe*** that the claim is valid, if the plaintiff ***executes a written instrument settling the claim,*** and the prospective defendant ***bargained*** for that instrument, in most states the instrument itself will be sufficient consideration for the defendant's counter-promise. Rest. 2d, § 74(2).

Example: Same basic facts as above Example, except that Mary never believes that Dave is the father. Dave, worried about a possible bad-faith paternity suit down the road from Mary, says to her while she's still pregnant, "If you will sign a document agreeing that I am not the father and promising never to sue me for child support, I will agree to pay your medical maternity expenses." Mary signs the agreement, but after a post-birth test shows that Dave could not be the father, he refuses to pay the medical expenses.

Even though the child-support claim that Mary was agreeing not to assert was invalid, and even though she did not believe it was valid, her execution of a written settlement agreement was by itself enough to constitute consideration for Dave's promise to pay expenses, and his promise will therefore be enforceable.

F. The "three party" pre-existing duty cases: The pre-existing duty cases discussed above involve promises made between the two parties to the original contract. Where the promise to do what one is already obligated to do is made to a ***stranger to the original contract***, however, the courts have been ***more willing*** to hold that the promise constitutes consideration. ???

Example: Contractor contracts with Sub-contractor to have the latter install heating units in a house being built by Contractor for Owner. Contractor becomes insolvent and discontinues work. Owner promises to pay Sub-contractor the price Sub-contractor would have received from Contractor, if Sub-contractor will complete the units.

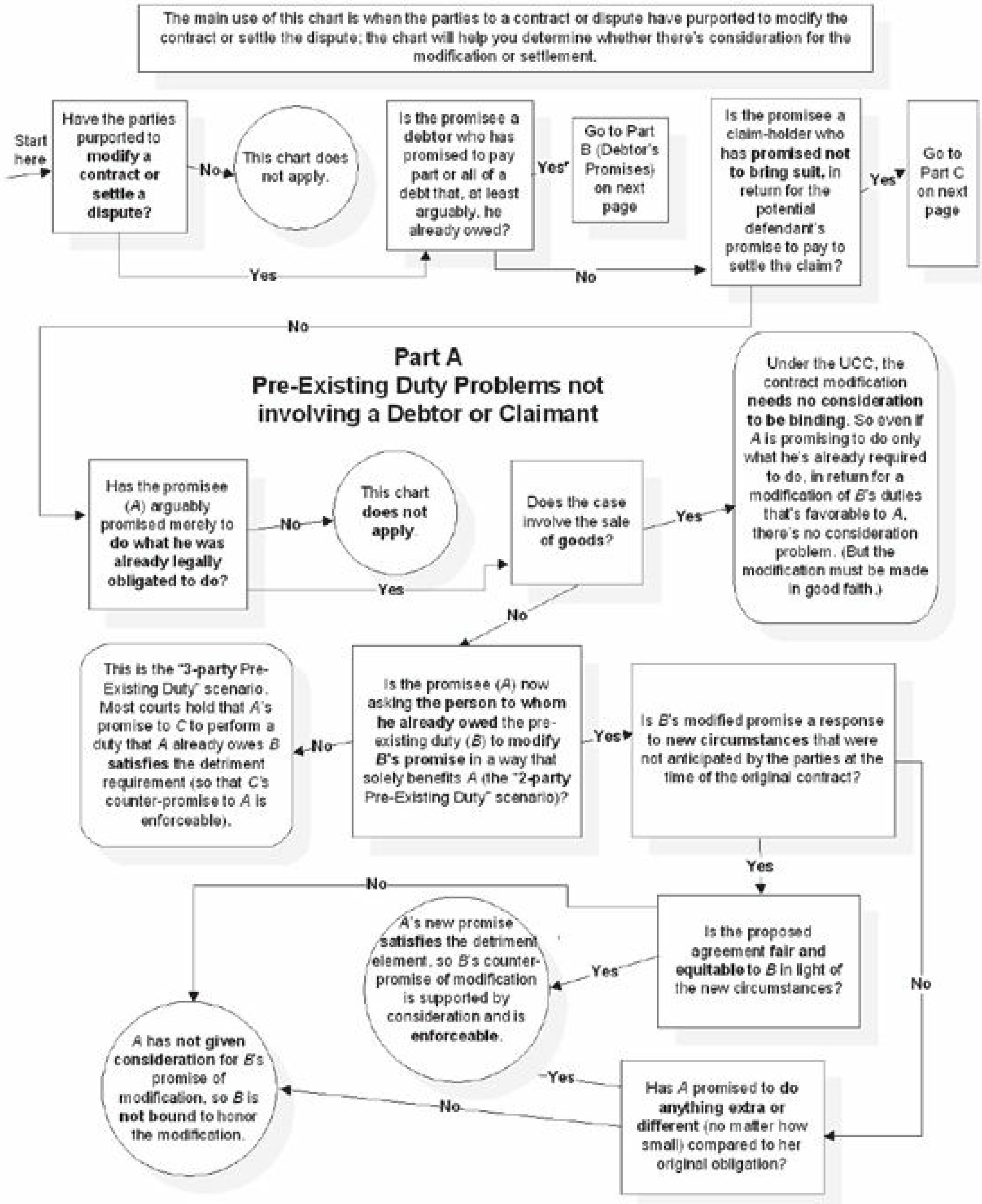
Sub-contractor's completion of the units (or his promise to complete the units)

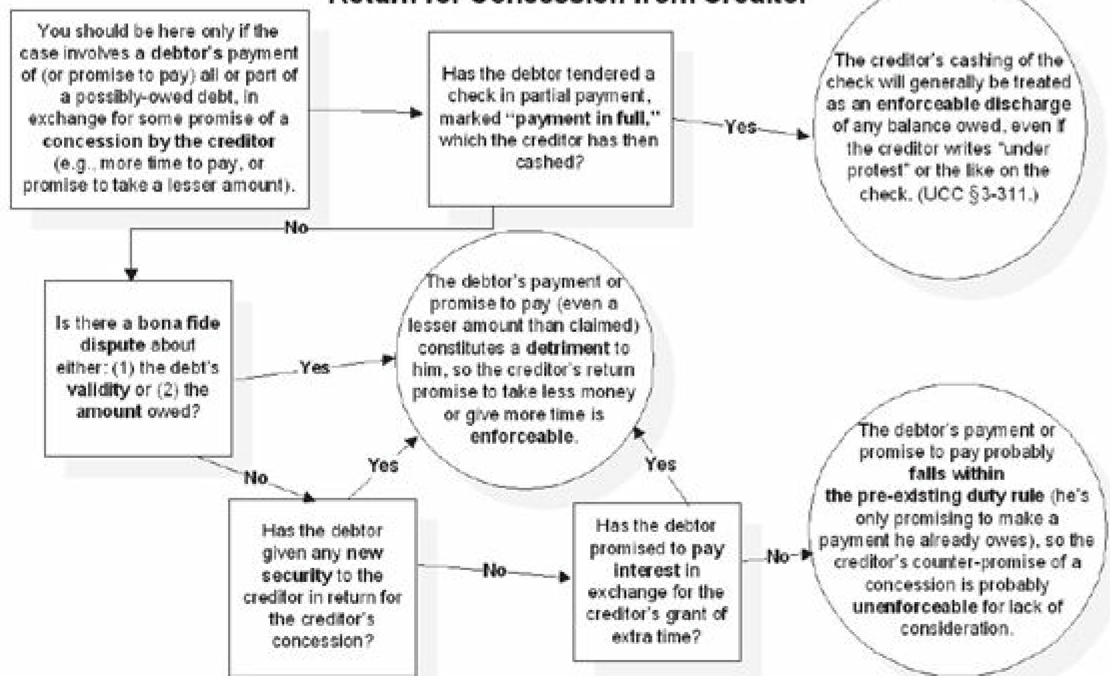
is consideration for Owner's promise to pay Sub-contractor. This is so even though Sub-contractor was already contractually obligated (albeit to a now-insolvent party) to complete the units. There is consideration regardless of whether Owner's promise is to pay the same amount, or an increased amount. See Rest. 2d, § 73, Illustr. 11.

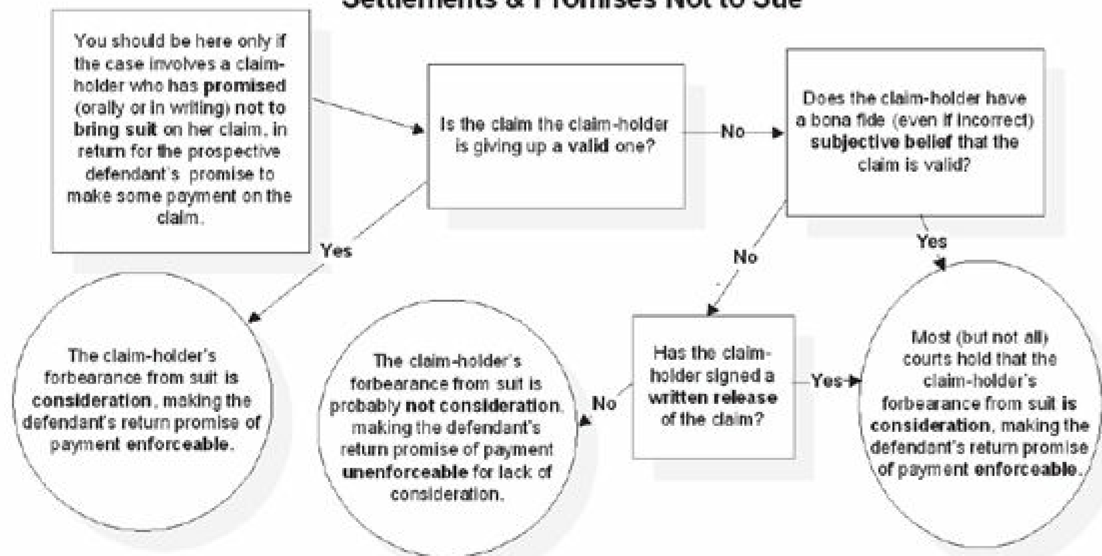
1. **Rationale:** The reason that some courts and the Second Restatement give for abandoning the pre-existing duty rule where the promise to do one's duty is made to a stranger to the original contract, is that "there is less likelihood of economic coercion or other unfair pressure than there is if the duty is owed to the promisee." (Rest. 2d, § 73, Comment d.)

Figure 3-1

Contract Modifications and Settlements, and the Pre-Existing Duty Rule







Quiz Yourself on

DETRIMENT, AND THE PRE-EXISTING DUTY RULE

23. The Trianon Bakery has a contract with Marie Antoinette to deliver 1,000 cakes for a Bastille Day Party Antoinette is conducting. Trianon fails to deliver, and Antoinette threatens to sue. Trianon says, "If you agree not to sue, I'll give you a strand of priceless black pearls." Antoinette agrees, and accepts the pearls. Both parties reasonably believe that Antoinette's claim may be valid.

(A) Assume that Antoinette's claim is in fact valid. Is Antoinette's promise not to pursue her claim enforceable?

(B) Now assume that Antoinette's claim is invalid, because the jurisdiction just shortened the statute of limitation for food-related contracts to five days, and that period has already lapsed. Assume further that neither Antoinette nor Trianon knows about this change, and that their lack of knowledge is reasonable. Is Antoinette's promise not to pursue her claim enforceable?

24. The New World Cruise Company hires Christopher Columbus to perform a publicity stunt for them — Columbus promises to sail due West to discover America, in return for which New World promises to pay $5,000 on completion, plus a lifetime supply of dramamine.

(A) Just before Columbus is set to sail, he decides that the payment isn't big enough, and refuses to go unless New World ups the ante. New World says, "OK, we'll also name the capital of Ohio after you if you're successful." Columbus agrees, sails, discovers America, and collects his $5,000 + dramamine. New World refuses to name the capital after him. Under common-law principles, can Columbus enforce this capital-naming promise?

(B) Same facts, but assume that the original agreement called for Columbus to leave Genoa on April 1. Assume further that when Columbus balked at starting the trip, New World said that it would name the Ohio capital after Columbus if he left on March 30 instead of April 1, and successfully completed his mission. Columbus leaves on March 30, completes the mission, and now wants to compel New World to honor the capital-naming promise. Is that promise enforceable?

25. Charlie Tuna's Fish Shack contracts to buy 100 pounds of fresh salmon over the next month at $3 a pound from Chicken of the Sea, a fresh fish

wholesaler. After the contract is entered into, an unexpected freeze affects the salmon migration and makes it more difficult (and more expensive) for Chicken of the Sea to obtain the fish. Melissa Mermaid, president of Chicken of the Sea, calls Charlie and says, “We’ve got to talk. I’m going to lose money if I sell you the salmon at $3 a pound. Let’s make it $4 and we’ll still both come out ahead under the present market conditions. Agreed?” “Agreed.” One day later (at a time when Melissa hasn’t yet relied on the higher price in any way), Charlie says, “Sorry, I won’t pay the $4. We’ve got a contract at $3 a pound; I’ll expect you to deliver.”

(A) Can Melissa enforce the modification to the contract?

(B) If the contract was governed by the Restatement and not by the UCC, could Melissa enforce the modification?

26. E.T. signs up for a long distance calling service with MCI (Make Calls Intergalactically). The calling plan says that calls made “between 7 and 11” will be 10 cents a minute, and calls made at all other times will be 15 cents a minute. E.T. gets a bill for $187 for one month’s calls, properly computed based on MCI’s assumption that “between 7 and 11” means between 7 and 11 p.m. E.T. thinks that “between 7 and 11” should also apply to the 7-11 a.m. period. (Assume that a court would probably find for MCI on this issue, but that E.T.’s reasoning is not crazy, and is done in good faith.) E.T. decides to pay only what he thinks he owes, and sends in a check for this lesser amount ($125). At the bottom of the check he writes, in neon green ink, “Paid in Full.” He sends the check, along with a note explaining why he believes this is all he owes, to MCI. MCI cashes the check but writes next to its endorsement, “Under Protest, and With Reservation of Rights.” MCI then sues E.T. for the $62 difference. Can MCI recover?

Answers

23. (A) Yes. The agreement is supported by consideration in the form of Antoinette’s promise not to assert her claim. When a party promises to waive a valid claim, that is sufficient “detriment” to constitute consideration for the other party’s promise to pay a settlement (here, the

pearl necklace).

(B) According to most courts, yes. Even though Antoinette's claim is not valid — and she is therefore actually giving up nothing (i.e. suffering no "detriment") — the majority rule is that her promise not to sue will be sufficient consideration if (1) she had a *bona fide* subjective belief that her claim was valid, and (2) that belief was reasonable. Both appear to be the case under these facts. (Some courts, and the Restatement, go further: they'll enforce the settlement if it's the case that *either* the promisor had a subjective believe that her claim was valid, *or* such a belief would have been reasonable.)

24. (A) No, because New World's promise to do so was not supported by consideration. Consideration requires a bargained-for exchange, and either detriment to the promisee or benefit to the promisor. At the moment New World made its capital-naming promise, Columbus was already obligated to sail West and discover America. Therefore, he was promising merely to do exactly what he was already obligated to do. A promise to perform a ***pre-existing duty*** does not involve a detriment to the promisor.

(B) Yes, because he did something beyond what he was originally obligated to do. Even in courts following the majority/common-law rule that a promise to do what one is already obligated to do cannot be consideration, the promisor's promise to undertake different or additional duties (no matter how slight the difference) is consideration for the return promise. So Columbus' agreement to leave 2 days earlier was consideration for the capital-naming promise, making that promise enforceable.

25. (A) Yes. Under the common-law "pre-existing duty rule," contract modifications generally require independent consideration to be enforceable. However, the UCC abolishes this rule with respect to contracts for the sale of goods. Under § 2-209(1), sales contracts can be modified without any additional consideration, even if the other party merely promises to do exactly what it had previously promised to do. So even though Melissa is merely promising to supply the same quantity of fish she was already required to supply, Charlie's agreement to raise the price was binding. Once he made that agreement, he couldn't retract it,

even though Melissa hadn't relied on the modification yet.

(B) Yes. Under Rest. 2d § 89, a modification of a contract that has not yet been fully performed on either side is binding, if the modification is "fair and equitable in view of circumstances not anticipated by the parties when the contract was made." The freeze and consequent price run-up certainly qualify as such an unanticipated circumstance.

26. No. Under UCC § 3-311, a creditor who cashes a check thereby surrenders his underlying claim, provided that: (a) the check or accompanying written communication contains a "conspicuous statement" that the check is being tendered in full satisfaction of the claim; (b) the claim is either unliquidated, or subjected to a bona fide dispute; and (c) the debtor acted in good faith. (a) is clearly satisfied by the "Paid in Full" notation and the accompanying letter. (b) is probably satisfied, since we're told that E.T.'s reasoning is plausible, though not necessarily likely to prevail. (c) is also satisfied, since we're told in the facts that E.T. is acting in good faith. So when MCI cashed the check, this act released E.T. (it acted as an accord and satisfaction), and nothing MCI wrote on the check could change this result.

VI. MUTUALITY OF CONSIDERATION

A. Requirement that each side furnish consideration: For a contract to be binding, there must be what is often called ***"mutuality of consideration."*** That is, ***each party must furnish consideration to the other***, or the entire agreement fails to be enforceable by either. To put it another way, each of the contracting parties must undergo a "detriment" which was bargained for by the other.

1. **Capsule summary of argument:** As we'll see in much more detail below, the essence of a mutuality-of-consideration defense is that the defendant is saying, ***"Because you never bound yourself to do anything, I shouldn't be bound, either."***

B. Consideration in bilateral contracts: The problem of mutuality really only arises with respect to ***bilateral*** contracts, i.e., contracts where each party makes a promise to the other.[2]

1. **Determining when a promise is consideration:** In the case of bilateral contracts, the mutuality problem consists of determining

whether a given ***promise*** constitutes consideration for another promise. We start with a simple rule: A promise in a bilateral agreement is consideration ***only if the performance which is promised would be sufficient consideration.***

2. **How the problem arises:** The mutuality problem arises because it is it is frequently more difficult to tell whether a promise constitutes consideration than it is to determine whether an act constitutes consideration. This is so because some promises don't really bind the promisor to do any act that would constitute consideration.

   a. **Choice of acts:** For instance, a promise may give the promisor a ***choice*** of acts, only one of which would be a sufficient "detriment."

      Example: Suppose *P* says to *D*, "In return for your promise not to sue me right now for the $100 I owe you, I promise either to buy your car or to pay you the $100 immediately." In this situation, *P* is not really bound, because she can elect the "branch" that does not constitute a legal detriment (here, paying money she already owes). Therefore, *D* can argue that she is not bound to forebear from suit — she can say, "You, *P*, did not bind yourself to do anything you weren't already obligated to do, so my return-promise can't be binding on me."

   b. **Analyzing promises:** Therefore, the remainder of this chapter addresses some of the problems encountered in determining whether particular kinds of promises constitute consideration for counter-promises.

C. **"Mutuality of obligation":** In the standard case of a bilateral contract, the requirement that both parties give consideration means that ***both parties must make promises that somehow bind them.*** This requirement that in bilateral contracts both parties be bound is usually called the requirement of ***"mutuality of obligation."***

   1. **How the issue arises:** In these bilateral contract situations, it is obviously always the defendant who alleges that there was no consideration. Since there will rarely be any doubt as to whether the defendant's promise constituted "detriment" (the very fact that the plaintiff is asking her to do something she doesn't want to do virtually assures that the defendant's promise is a "detriment"), the defendant will typically assert that the *plaintiff's* promise was not a "detriment," and that it therefore did not constitute consideration for the defendant's counter-promise.

In other words, the defendant says in effect: "It is true that my promise was consideration to support your promise, but ***your promise was not consideration for mine.*** Therefore, there is no mutuality of consideration, and no contract." (The P-D example earlier on this page is an illustration.) The rest of this chapter thus examines whether various ***promises made by plaintiffs*** constitute consideration for the defendant's counter-promise.

VII. ILLUSORY, ALTERNATIVE, AND IMPLIED PROMISES

A. Introduction: We now examine two situations in which the plaintiff's promise may fail to constitute consideration because the plaintiff is not really bound:

- promises that are ***"illusory,"*** which means that they appear to promise a performance that would constitute consideration, but don't really do so; and
- sets of ***alternative*** promised performances, where the plaintiff gets her choice of which performance to render, and one of those alternatives would not be consideration. An alternative that allows the plaintiff to ***terminate*** the contract may fall into this category, depending on its precise terms.

B. Illusory promises: One kind of "promise" that is not sufficient consideration to support a counter-promise is called an ***"illusory"*** promise. An illusory promise is a statement which appears to be promising something, but which in fact does not ***commit*** the promisor to anything at all.

> **Example:** *A* offers to deliver to *B* at $2 a bushel as many bushels of wheat as *B* may choose to order within the next thirty days. *B* replies, "OK, you've got a deal." *B* then gives *A* an order, and *A* refuses to sell at the $2 a bushel price (perhaps because the market price has gone up). *B* sues for breach of contract. *B*'s promise is illusory, since she has not clearly committed herself to do anything. All she has said to *A* is, in effect, "I promise to buy from you whatever I choose to buy from you." Therefore, her "promise" does not constitute consideration for *A*'s counter-promise, and *A* is not bound to sell the wheat. See Rest. 2d, § 77, Illustr. 1.
>
> **Note:** If, however, in the above example, *B* had promised that if she bought any wheat during the 30-day period, she would buy it from *A*, her promise *would* be consideration for *A*'s counter-promise to sell. See the discussion of requirements and output contracts *infra*, p.115.

1. Reservation of right to change mind: One common kind of "illusory" promise occurs when the promisor reserves the right to ***change his mind***.

Example: D's husband owes money to P, as evidenced by a promissory note. When the note becomes due, D signs the back of it, thereby agreeing to pay the note if her husband does not. She does this in return for P's promise that he will not put the note in his bank for immediate collection, but will instead "hold it until such time as I want my money." P refrains from collecting on the note for two years, and then sues D on her endorsement. D argues that since P did not really bind himself to refrain from collecting, there was no consideration for D's endorsement.

Held, for D. P did not really promise to forbear, since he could have sued immediately, and this would have been evidence that he had decided that he wanted his money. Therefore, there was no consideration for D's endorsement. The fact that P actually refrained from suing for two years is irrelevant, since he did not promise to do so. (But if D or her husband had asked for forbearance, and P had said ***nothing at all***, and had then refrained from suing, this would have been consideration. It was the fact that P explicitly denied that he was promising to forbear that prevented consideration from existing.) *Strong v. Sheffield*, 39 N.E. 330 (N.Y. 1895).

a. **Promissory estoppel theory:** A promise to guarantee someone else's obligation might be binding, even without consideration, on a ***promissory estoppel*** theory. Under Rest. 2d, § 89, a guarantee is binding if "…(c) the promisor should reasonably expect the promise to induce action or forbearance of a substantial character on the part of the promisee or a third person, and the promise does induce such action or forbearance."

   i. ***Strong***: Thus on the facts of *Strong*, *supra*, a court today might find that D's guarantee of her husband's repayment should reasonably have been expected to induce P to refrain for a while from suing, that it did in fact have this effect, and that his forbearance was of a "substantial character." In that event, D would have been bound, even though there would have been no formal consideration. See the discussion of other aspects of promissory estoppel *infra*, pp. 136-149.

b. **Objective standards:** Also, if the promisor's right to change her mind is ***limited*** by some ***objective standard***, consideration is likely to be found present. For instance, if the promise of forbearance in *Strong* had provided some ***objective standards*** for determining when P could or could not ask for his money, rather than leaving this to P's uncontrolled discretion, P would probably have been found to have been sufficiently bound for his promise to be consideration for D's counter-promise. Thus had P promised that he would not ask for his money unless he had a "real financial

need” for it, this modification would probably have been sufficient.

C. Alternative promises: A promise which reserves to the promisor several ***alternative*** performances is generally consideration only if ***each of the alternative performances would have been consideration if it had been bargained for alone***. See Rest. 2d, § 77(a). (Alternatively, there is consideration if one of the alternative performances would be consideration and there is a “substantial possibility” that before the promisor makes his choice, events will eliminate the other alternatives. Rest. 2d, § 77(b).)

> **Example:** *A* offers to sell *B* a book if *B* will promise either to give *A* a different book, or to pay *A* $5 which *B* has previously owed *A*. *B* accepts. *B* decides he wants to make the exchange of books, but *A* changes his mind. Because one of the alternative performances open to *B* under the offer would not have constituted consideration (i.e., the paying of the $5 *B* already owed *A*; see *supra*, p. 93), *B*’s promise is not consideration for *A*’s counter-promise, even though *B* is willing to give the books.

> **Note:** If, in the above example, *B* had actually tendered to *A* the book that *A* wanted, and *A* had taken it, *A* would probably be bound to give the other book in exchange. A court would probably reach this result by treating *B*’s tender of the book, and *A*’s taking it, as having transformed the contract from a bilateral contract into a unilateral one. *B*’s tender was the act requested by *A*, and would be valid consideration for *A*’s counter-promise to give *B* the other book. The process of converting a bilateral contract invalid for lack of consideration into a valid unilateral contract is sometimes called “forging a good unilateral contract out of a bad bilateral contract.” See C&P, p. 210.

D. Right to terminate agreement: Some contracts provide that one of the parties may ***terminate*** the agreement at his option. The courts are split as to whether and when a party has furnished consideration if he may escape the contract by exercising his power of termination.

1. Where termination possible only after partial performance: If one party to a contract has the right to terminate only ***after he has done an act*** which ***by itself would constitute consideration,*** his promise is ***not illusory***, and constitutes consideration.

> **Example:** *A* promises *B* that *A* will act as *B*’s agent for three years, starting immediately. *B* agrees that *A* may act as agent, but reserves the power to cancel the agreement on 30 days notice. *B*’s agreement is consideration for *A*’s promise, since *B* can exercise his cancellation right only after the agency relationship has run for 30 days. (The granting of a 30-day agency relationship would by itself be consideration.) See Rest. 2d, § 77, Illustr. 5.

a. **Employer's give-up of right to immediately terminate employee:** This principle — that a party who gives up the right to terminate until after he's done some act that would itself be consideration — is sometimes applied to an employer who ***agrees not to fire an "at will" employee*** for at least a short period of time, in exchange for that employee's return promise of some sort (say, a non-compete). The employer's curtailment of what would otherwise be its right of immediate termination will be consideration for the employee's promise.

2. **Termination based upon party's inability to perform:** Similarly, if the contract provides that a party may terminate if he is ***unable to perform*** in a certain respect (as opposed to merely unwilling), this right of termination will ***not*** render the contract void for lack of consideration.

3. **Unfettered right to terminate with notice:** Where the agreement provides that one party may terminate simply by giving ***notice at any time***, the older cases hold that the party with the termination right has not furnished consideration. These courts reason that this party has not promised anything at all, since he has reserved an unfettered right to change his mind.

   a. **Modern view:** The more modern cases, however, generally take the view that even where one party has the right to terminate an agreement by giving notice, that party's termination power does ***not*** prevent him from having given consideration. The rationale is that the ***duty to give reasonable notice*** of termination itself constitutes consideration. (Furthermore, if no notice requirement is expressly stated in the contract, some courts will imply it.)

   b. **Duty to notify under UCC:** A court that wishes to uphold an agreement in which one party has what appears to be an unfettered right of cancellation can obtain assistance from the UCC in cases falling under the Code. UCC § 2-309(3) provides that "Termination of a contract by one party except on the happening of an agreed event requires that ***reasonable notification*** be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable." This section can enable a

court to find an ***implied duty to give notice*** of cancellation even when the contract is silent as to any notification obligation. See C&P, p. 206.

c. Other statutory limits on termination: Other statutes, both state and federal, may similarly limit a party's right to terminate a contract. For instance, the Automobile Dealers Day in Court Act, 15 U.S.C.A. § 1221 *et seq.*, allows an automobile dealer to sue the manufacturer with whom he has a franchise agreement if the latter has failed to act in good faith in performing or terminating the franchise contract.

E. Other kinds of implied promises: Just as an implied promise to give reasonable notice of cancellation is often implied by the courts, and constitutes consideration, so other sorts of promises have been implied. The most famous case finding consideration through an ***implied promise*** is ***Wood v. Lucy, Lady Duff Gordon***, a Cardozo opinion set forth in the following example.

Example: Defendant, Lucy, Lady Duff Gordon, is a fashion designer. She makes an agreement with the plaintiff, a businessman, whereby the latter is to have the right to place the Lucy, Lady Duff Gordon endorsement on fashion designs. Lucy agrees that the plaintiff shall be the only person to have this right, and the plaintiff agrees to give Lucy one-half of any profits derived from the sales of such endorsed designs. Lucy then puts her endorsement on the designs of third persons (without sharing the profits with plaintiff) and plaintiff sues for breach of the agreement. Lucy asserts that the contract failed for lack of consideration, on the grounds that the plaintiff did not bind himself to do anything, since he was not obligated under the contract to sell any endorsed designs at all.

Held, the plaintiff can be impliedly found to have promised to use "reasonable efforts" to market Lucy's designs. This implied promise is a sufficient "detriment" to the plaintiff to constitute consideration for Lucy's counter-promise that she would not place her endorsement upon anyone else's designs. Therefore, the contract is binding, and Lucy has breached it. See *Wood v. Lucy, Lady Duff Gordon*, 222 N.Y. 88 (Ct. App. 1917).

VIII. REQUIREMENTS AND OUTPUT CONTRACTS

A. Requirements and output contracts: Suppose Buyer agrees with Seller that Buyer will buy all of his requirements for a particular good from Seller at an agreed-upon price. Has Buyer given consideration sufficient to support such a contract (called a ***"requirements"*** contract)? Similarly, if Seller agrees to sell all of his output of a particular product to Buyer, has Seller given sufficient consideration for this contract

(called an ***"output"*** contract)?

1. **Earlier approach held no consideration to be present:** Earlier cases, especially ones decided before the advent of the UCC, frequently held that such output and requirements contracts were ***invalid*** for lack of consideration (as well as for indefiniteness).

2. **Contracts usually valid today:** But such requirements and output contracts are very likely to be ***enforced*** today, at least if it can be found that the buyer has ***implicitly promised to use his best efforts to sell the goods*** (or that the seller in an output contract has implicitly promised to attempt to maintain his production at a reasonable level), and the bargain is not otherwise unduly one-sided.

B. **UCC approach:** The ***UCC explicitly validates requirements and output contracts.*** UCC § 2-306(2) provides that "A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in ***good faith***, except that no quantity ***unreasonably disproportionate*** to any ***stated estimate*** or in the absence of a stated estimate to any ***normal or otherwise comparable*** prior output or requirements may be tendered or demanded."

1. **Rationale:** Comment 2 to § 2-306 explains that requirements and output contracts ***do not "lack mutuality of obligation*** since under this section, the party who will determine quantity is ***required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade*** so that his output or requirements will ***approximate a reasonably foreseeable figure.***"

2. **Exclusivity implied in requirements contracts:** § 2-306 contemplates that the buyer in a requirements contract will deal ***exclusively*** with the seller with whom he has contracted. In other words, the buyer must promise that he will buy ***all*** of his requirements from that particular seller. This promise, coupled with the buyer's good faith obligation to order quantities that are not "unreasonably disproportionate to any stated estimate…or to any normal or otherwise comparable prior…requirements," ***constitutes consideration*** for the seller's counter-promise to meet the buyer's needs.

Example: P **(**Eastern Airlines) agrees to buy all of its jet fuel requirements in specified cities from D, a jet-fuel supplier, and D commits to supply those requirements at a price pegged to the industry-wide posted price for crude oil. The price then increases dramatically due to actions by the OPEC cartel, and D reneges on the agreement. When P sues, D asserts that the contract is void for lack of mutuality, since P wasn't bound to buy any specific quantities.

Held, for P. P bound itself to act reasonably and in good faith in estimating the quantities of fuel it required in each city. Since P was bound, D's return promise was not void for lack of mutuality of obligation. *Eastern Airlines Inc. v. Gulf Oil Corp.*, 415 F.Supp. 429 (S.D.Fla. 1975).

3. **Best efforts imposed on buyers and sellers:** There is a special type of good-faith obligation imposed by § 2-306 on buyers and sellers under requirements contracts. § 2-306(2) says that "A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned ***imposes*** unless otherwise agreed an obligation by the ***seller to use best efforts to supply the goods*** and by the ***buyer to use best efforts to promote their sale.***"

   a. **Significance:** Therefore, under a requirements contract the buyer must make best efforts to promote the sale of the goods, and ***cannot simply decide that the entire product line is not worth carrying***. Conversely, under an output contract the seller cannot simply decide to ***stop selling or manufacturing*** the item, and must instead make best efforts to supply the goods.

Example: Donut Co. and Retailer agree that Retailer will buy all of Seller's output of honey-glazed donuts for the coming year, at a particular price. Both parties anticipate that Donut will produce 2,000 dozen such donuts over the course of the year, but the contract does not oblige Donut to produce any particular number. Shortly after the contract has started, and when Donut has supplied only 20 dozen donuts, Donut gets a new contract from Wal-Mart to supply hundreds of thousands of cinnamon donuts. Donut decides that it will not make any more honey-glazed donuts at all, and will instead shift the machine on which it had intended to make these donuts to making cinnamon donuts for Wal-Mart. Retailer sues for breach, and Donut responds, "It's not that we're selling our output of honey-glazed to someone other than you, we simply don't have any output of this product at all anymore, so we're not breaching."

A court would probably conclude that Donut has breached the implied obligation that § 2-306(2), in all cases involving requirements or output contracts, places on the seller to "use best efforts to supply the goods."

4. **No speculation allowed under requirements contracts:** When a change in market conditions makes it highly advantageous for a requirements buyer to ***increase his requirements sharply***, the UCC

probably does not permit such abuse of the contract. This is especially true where the buyer uses the extra purchases to ***speculate***, rather than using them in the ordinary course of his business.

a. **Rationale:** Such sharply increased requirements should be invalid either under the buyer's duty to purchase in "good faith," or as being "***unreasonably disproportionate***…to any normal or otherwise comparable prior…requirements." § 2-306(1). (These code restrictions would also prevent the ***seller*** under a fixed-price output contract from taking advantage of a sharp ***drop*** in market price by greatly increasing his production.)

5. **Sale of the business:** What if the business that's subject to the requirements or output contract is ***sold*** — can the contract be assigned as part of the sale? That's not clear — the assignment might be invalid on the grounds that it ***materially increases the risk*** on the other party, something that will be determined based on the non-UCC law of assignment (see *infra*, p. 391). But even if the assignment *is* valid, § 2-306 makes it clear that the benchmark for the requirements or output is the requirements or output of the ***old*** owner, not the new one. See Official Comment 4 to § 2-306: "Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the ***actual good faith output or requirements under the normal operation of the enterprise prior to sale.*** The sale itself is not grounds for sudden expansion or decrease."

C. **Requirements and output contracts distinguished from continuing offers:** You must distinguish requirements and output contracts from ***continuing offers***. If a seller says to a buyer, "I will sell you all the widgets you order at $2 per widget," and the buyer says "OK," there is no consideration for the seller's promise, since the buyer has not bound himself at all. If, however, a return promise by the buyer (such as a promise not to order from anyone else) can be implied, the contract is then enforceable. Otherwise, the seller must be treated as having made an ***offer looking to a series of contracts;*** this offer is ***revocable at will,*** and each order given by the buyer would constitute a separate contract.

Quiz Yourself on

MUTUALITY PROBLEMS: ILLUSORY, ALTERNATIVE AND IMPLIED PROMISES, AND REQUIREMENTS AND OUTPUT CONTRACTS

27. Princess promises to sell her golden ball to Frog for $200 "unless I change my mind." Can Frog enforce Princess's promise?

28. Medusa is a magician. Her best trick is to turn her assistant to stone. Medusa hires an agent, Farley Mythical. The contract between them provides that for one year, Medusa will use Farley and no one else as her agent, and that Farley will receive in return 10% of Medusa's earnings. The contract says nothing about how hard Farley must try to get engagements, and does not set any minimum number of engagements which, if Farley fails to procure them, will entitle Medusa to terminate. Before Farley has gotten Medusa any engagements, Medusa repudiates. Is there a binding contract on which Farley may recover?

29. Hercules Manufacturing agrees to buy "all the thing-a-ma-bobs we need to produce our what-cha-ma-callits for the next year" from Zeus Metalworks. Zeus declines to deliver.

(A) Is Zeus bound?

(B) Assume instead that the agreement was for Hercules to buy "all the thing-a-ma-bobs we order for the next year." Is Zeus bound?

Answers

27. No, because Princess's promise is illusory. An illusory promise is one unsupported by consideration due to one party's completely unrestricted right to renege on her promise. Here, there is no restriction whatsoever on Princess's freedom of action — she can change her mind at will. Therefore, her promise is illusory and unenforceable.

28. Yes. Medusa's argument would presumably be, "You weren't bound to do anything, so I'm not bound either." (This is an argument based on the mutuality-of-consideration doctrine, which says that if one party has not furnished consideration, the other party is not bound.) However, in an exclusive-dealing contract such as this one (remember, Medusa's given up her right to use any other agent), a court would imply a duty on

Farley's part to use his best reasonable efforts to get engagements for Medusa. By making this promise, he has restricted his freedom and thereby incurred a "detriment" sufficient to constitute consideration, and that detriment is sufficient to support Medusa's return promise.

29. **(A) Yes.** This is a typical "requirements" contract. Both requirements and output contracts are enforceable under the UCC, because they are deemed to be supported on both sides by consideration. This is so because the UCC imposes an implied obligation of good faith upon the parties, as well as one of exclusivity, in such output and requirements contracts. That is, Hercules has implicitly agreed to run his business in a good-faith way, so that he will continue to have a need for thing-a-ma-bobs. This (together with his agreement that he will not buy any thing-a-ma-bobs from anyone but Zeus), provides sufficient consideration to make the contract enforceable. Since Hercules has bound himself, Zeus' return promise is supported by consideration, making Zeus also bound.

    (B) No. Under these facts, Hercules has not restricted his freedom in any way — he can choose to buy one unit, 100 or none. His promise is therefore illusory, and does not constitute consideration. Consequently, that promise cannot serve as consideration for Zeus' return promise, and Zeus is therefore not bound.

IX. MISCELLANEOUS CONSIDERATION PROBLEMS

A. Conditional promises: If the performance of a promise is made ***conditional*** upon the happening of some future event, is the promise "illusory," and thus not consideration for a counter-promise? In most cases, the existence of such a condition will ***not*** prevent the conditional promise from constituting consideration.

1. **Conditions outside of the promisor's control:** If the condition is ***outside of the promisor's control***, that condition will almost never prevent his promise from being consideration, even though it turns out that he does not have to perform.

    Example: *A* and *B* are brothers-in-law. They agree that regardless of what amount is left to each by their father-in-law, the two will share equally in the total bequest. *A* is left $10,000, and *B* is left nothing. *B* sues *A* for $5,000, and *A* defends on the ground that there was no consideration for his own promise; he argues that *B* has in fact not promised anything at all (since he has not received anything under the bequest to share). However, since the happening of the event upon which *B*'s

promise is conditioned (i.e., the leaving to *B* of some money) was outside of *B*'s control, his promise constitutes consideration for *A*'s counter-promise, and the contract is enforceable. Murray, p. 148.

Note: There would be consideration in the above example even though the father-in-law's will had already been drawn before the brothers-in-law made their agreement. In other words, as long as the brothers-in-law *thought* that there was a possibility that either would have to perform his promise (i.e., share some of the money left to him), their promises were consideration for each other, even though in reality, it was already the case that *B* would not have to perform anything. See Murray, p. 154.

a. **Conditions that cannot occur:** But even if the condition is outside of the promisor's control, a conditional promise is not consideration if the promisor ***knows*** at the time the promise is made that the condition ***cannot occur.*** See Rest. 2d, § 76(1). For instance, suppose that in the above example, *B* had ***known*** that his father-in-law had already drawn a will leaving *B* nothing, and that the father-in-law would not change his will. In that event, *B*'s promise would not be consideration for *A*'s, and *B* would not be able to recover.

2. **Where condition is within partial control of the promisor:** If the performance of a promise is contingent upon the occurrence of an event ***within the control of the promisor***, or partially within his control, most modern decisions ***imply*** a promise to ***attempt to make the condition occur***. This promise will therefore constitute consideration for a counter-promise.

Example: Owner, who owns Blackacre, agrees to sell it to Buyer. The agreement is contingent upon Buyer's obtaining the necessary financing. Buyer obtains the financing, but Seller refuses to sell, claiming that Buyer's promise was illusory since it left to Buyer the option of not obtaining financing. Since, however, Buyer could be said to have impliedly promised to use "best efforts" to obtain the necessary financing, his promise was not illusory, even though conditional, and it constituted consideration for Seller's counter-promise to sell. See C&P, p. 208.

Note: A similar result is usually reached where one party to a contract can make the contract conditional upon her obtaining a particular ***license*** necessary to conduct the business which she plans to conduct, or any other event which that party wishes to make a condition in order to protect herself. See C&P, p. 208.

3. **Promisee's discretion:** But if one party's performance is left completely to his ***discretion***, so that he may choose not to perform at all, he ***has not furnished consideration*** for the other party's promise.

Example: *A* offers to sell *B* as many widgets at $2.75 as *B* wishes to order. *B* says "OK, you've got a deal; I'll probably need some next week." *B* has not really promised anything, since his performance is solely within his discretion. Therefore, he has given no consideration, there is no contract, and if *B* sues *A* to get damages for *A*'s refusal to accept his order, *A* will win. See, e.g., *Strong v. Sheffield, supra,* p. 112.

B. Voidable and unenforceable promises: Suppose two parties exchange promises, but one party's promise is ***voidable*** at his option, or is ***unenforceable***. This might, for example, be the case if that party is a minor, is senile, is the victim of fraud, or his promise is an oral one that violates the Statute of Frauds. Since the promisor with the option of avoiding the contract has not definitely bound himself, can the other party also avoid the contract, on the grounds that his own promise is not supported by consideration? This argument will ***not succeed***. "The fact that a rule of law renders a promise voidable or unenforceable does not prevent it from being consideration." Rest. 2d, § 78.

1. Rationale: Some courts reach this result simply by saying that voidable promises are an exception to the requirement of "mutuality of obligation." Other courts reason that since the party who has the power to avoid the contract must act affirmatively to do so, he has incurred a detriment by putting himself in a position where he must either perform the contract or make an affirmative act of avoidance. See C&P, p. 202. In any case, all courts agree that a voidable promise may constitute consideration, and most agree that this is also true of an unenforceable one.

Example 1: Car Dealer makes a contract to sell a car to Minor. Minor, by virtue of his youth, is given the legal power to avoid the contract if he so wishes. Nonetheless, he decides he wants to buy the car, but Dealer refuses to sell. Minor sues, and Dealer defends on the grounds that because Minor had the power to avoid the contract, Minor never really bound himself, and thus furnished no consideration for Dealer's promise to sell the car.

Dealer's defense will be ***unsuccessful***. A voidable or unenforceable promise constitutes consideration, if the promised performance meets all other requirements for consideration (e.g., it is not the performance of a pre-existing legal duty).

Example 2: *A* makes an oral promise in exchange for *B*'s return promise. Although *A*'s promise is unenforceable under the state's version of the Statute of Frauds, this fact does not prevent *A*'s promise from being consideration for *B*'s promise. Rest. 2d, § 78, Illustr. 2.

C. Forging a good unilateral contract out of a bad bilateral one: A

bilateral agreement that is unenforceable for lack of mutuality of obligation may be transformed into an enforceable unilateral contract or series of contracts if one party ***relies*** on the bilateral agreement. You can think of this as ***"forging a good unilateral contract out of a bad bilateral one."***

1. Non-competition clause: One situation in which courts will often forge a good unilateral contract from a bad bilateral one is one where an employee under an ***at-will employment arrangement*** signs a ***non-competition*** agreement. Even though the employer is not really promising to do anything (since he can fire the employee at any time, because of the at-will nature of the arrangement), the non-compete clause will ***become*** enforceable, according to many courts, if the employer does in fact keep the employee on the job for a substantial time. (Non-competition agreements are discussed in more detail *infra*, p. 461.)

Quiz Yourself on
MISCELLANEOUS CONSIDERATION PROBLEMS

30. Papa Bear agrees to sell, and Goldilocks to buy, four bushels of oats from the next season's harvest. The agreement further provides that Papa Bear's duty will be conditional on Papa's planting of one more acre of oats than he planted the prior season. (Papa's decision on whether to plant the extra acre will be based solely on his decision about how hard he wants to work.) Papa Bear in fact plants the extra acre, and tenders the resulting four bushels to Goldilocks. Is Goldilocks bound to accept and pay for them?

31. Nero is a big fan of gladiatorial bouts. His favorite gladiator is Spartacus. Nero finds out that his friend, Romulus, has title bout tickets; if Spartacus wins his next two bouts, he'll be in the title bout. Nero tells Romulus, "If Spartacus makes it to the final round, I'll buy your tickets for $50." Romulus accepts. Spartacus makes it to the finals. Nero wants the tickets for $50; Romulus refuses to sell them at that price. Is their oral agreement enforceable?

Answers

30. **No, because Goldilocks' promise was not supported by consideration, in that Papa Bear's return promise was illusory.** An illusory promise is one that does not constitute consideration because the promisor has an unrestricted right to renege on his promise. One type of illusory promise is a promise that is conditional upon an event, which event is solely within the promisor's control. That's what we have here: Papa's duty to sell was subject to a condition (his planting of the extra acre), but Papa was solely in control of whether that condition was satisfied. Now, the doctrine of "mutuality of consideration" says that one party's illusory promise (here, Papa Bear's) cannot serve as consideration for the other party's return promise (here, Goldilocks' promise to buy). So Goldilocks' promise was not supported by consideration, and she's therefore not bound.

31. **Yes.** As in the prior question, the issue here is conditional promises, and the circumstances under which they fail for lack of consideration. It's true that Nero would not have been bound to anything if Spartacus had not made it to the finals. But we judge consideration as of the moment of contract's making, and at that moment Nero was conditionally bound. If the satisfaction of the condition had been solely within Nero's control (see the prior question for an example of this), Nero would not have furnished consideration, and neither party would have been bound. But satisfaction of the condition here was not solely within Nero's control, so the fact that there was a condition did not prevent Nero's promise from constituting consideration. Since Nero gave consideration, Romulus' return promise did not fail for lack of consideration, and he's bound as well.

EXAM TIPS ON CONSIDERATION

<u>Consideration</u>

☛ Always check whether or not a contract is supported by consideration.

Consideration is a ***legal detriment suffered by the promisee in exchange for the promisor's promise***.

Example where there is a legal detriment: X, the owner of a chain of dry cleaning stores, promises to give to *Y*, her cousin, a franchise if *Y* promises to move from a distant state to where *X* lives. *Y* promises to do so. It is irrelevant whether *X* gains any benefit from *Y*'s move. What matters is that *Y* has promised to suffer a detriment in exchange for *X*'s promise. Therefore, there's consideration for *X*'s promise.

Example where there isn't a legal detriment: University receives a pledge from *X*, an alumnus, for a donation of $50,000. *X* later withdraws the pledge. The promise lacks consideration because University hasn't suffered a legal detriment. (But the promise may still be enforceable without consideration, through promissory estoppel.)

☞ Remember that something can be consideration even though it is done by (or for) a ***third person***, one who is ***not a party*** to the contract.

Example 1: A promises *B* that *A* will pay *B* $100 if *B*'s son drives *A* to the airport. Even though B's son is not the promisee (*B* is), the son's act of driving will be consideration for *A*'s promise to pay *B*.

Example 2: A promises *B* $100 if *B* promises to drive *A*'s daughter to the airport. The fact that the performance being given in exchange for *A*'s promise is to be rendered to someone other than *A* (the promisor) doesn't matter.

☛ Where the issue of consideration is prominent in an essay, it usually manifests itself in one of the following four situations:

(1) Promises to make gift: D promises to make a ***gift***, usually to a relative or charity. There's no consideration supporting D's promise, so it's not enforceable (unless it falls under one of the exceptions to the consideration requirement, covered in the next chapter).

☞ **Mixture of bargain and gift:** But a transaction that's a ***mixture of bargain and gift satisfies*** the consideration requirement, making the generous party's promise enforceable.

Example: D promises to sell P D's antique car at a 90% discount to its market value, in return for P's promise to buy it at this low price. As long as there is some sort of a "bargain," the fact that there's a gift element doesn't prevent D's promise from being supported by consideration (P's promise of payment).

(2) Promises to pay for past services: D promises to pay for ***past***

services which P rendered to him. Most commonly, P is a ***Good Samaritan*** who saves D, an unconscious person, who later promises compensation and then reneges.

- ☞ **No compensation reasonably expected:** A promise to pay for past services isn't supported by consideration where the services were performed with ***no reasonable expectation of compensation.*** Fact patterns may trick you into thinking that under certain circumstances consideration has in fact been offered. Don't be fooled if:
  - □ The unconscious person regains consciousness ***immediately after*** the rescue and then promises to pay the savior.
  - □ The savior happens to be someone with medical expertise, such as a ***retired doctor.***
  - □ A ***relative*** of the party who was saved promises after the fact to pay the savior (still no "bargained for" exchange).
  - □ The promise to pay is made ***in writing*** and/or is promised "in consideration" for services rendered.

In all four of the above scenarios, there is no consideration for the promise to pay for the past services. (But the promises might be binding without consideration, to the extent necessary to avoid injustice — see the next chapter.)

These examples should be distinguished from emergency medical services provided by parties who *would* reasonably expect compensation, such as an ambulance service or hospital emergency room. Here, there would be consideration for the patient's (or patient's relative's) subsequent promise to pay.

(3) Pre-existing duty. P promises to pay (or perform services) that P is already legally obligated to pay/perform — D's return promise is not supported by consideration.

- ☞ **Contract modifications:** The most common scenario is a ***contract modification.*** Here, you must distinguish between the UCC and non-UCC situation.
  - ☞ **Non-UCC:** If P merely promises to do what P already promised to do under the contract, and there are no unanticipated circumstances, D's new promise (e.g., more money) given in return is not supported by

consideration.

Example: D promises to pay $5,000 if P paints D's house by June 14. After the house is halfway painted, P threatens to walk off the job unless D raises the price to $7,500. D agrees. D's promise to pay the extra $2,500 is not supported by consideration, because P merely promised to do what he was already contractually required to do.

- ☞ **Substitute performance by P:** But if P ***changes his own duty,*** however slightly, in response to D's promised modification, then D's counter-promise *is* supported by consideration. (*Example:* In the above example, if P promised to finish the job one day earlier [or to use a different color of paint] than previously promised in return for the extra $2,500, D's counter-promise of the extra $2,500 would be supported by consideration.)

  Common scenario: A party who is owed money due on a later date agrees to accept a lesser amount in exchange for a promise of immediate tender of payment. The creditor has received consideration for the promise to take less.

- ☞ **Unanticipated circumstances:** Also, if the modification is a response to ***new circumstances unanticipated by the parties*** when they made their original deal (e.g., a well-driller hits rock, and asks for a higher price to finish the job), remember that most modern courts will find that the modification is binding.

☞ **UCC:** Under the UCC, the pre-existing duty rule simply doesn't apply to the contract-modification scenario — under Article 2, "An agreement modifying a contract within [Article 2] needs no consideration to be binding."

Example: On the above house-painting example, if P had promised to sell paint to D rather than perform painting services, the lack of consideration for D's promise to pay more would not prevent D's new promise from being binding.

(4) Settlement of claim: Similarly, if a party who has a contractual claim for money agrees to take less in a ***"settlement,"*** the promise to take less is supported by consideration, so long as the other party ***disputed*** in good faith the ***amount*** or ***validity*** of the claim.

Example: P, a painting contractor, agrees to paint O's house for $5,000. The contract provides that P will deliver a satisfactory result. When the job is completed O tells P that he doesn't find the work satisfactory, but he's willing to call it "square" if P will accept $4,500. P agrees to take the less amount in payment. P's promise to take the lesser amount is supported by consideration (O's willingness not to dispute whether P performed), so that promise is binding, and P can't change his mind and demand full payment.

☞ **Invalid claims:** This is true ***even if the claim is not valid,*** so long as the holder of the claim ***believes in good faith*** that the claim is valid.

Example: *B,* acting as a Good Samaritan without expectation of payment, saves *A*'s life. *A* promises in writing to pay *B* $1,000. *B* honestly believes that *A*'s promise is binding. *A* then reneges. *B* threatens to sue, then agrees to forebear from suing if *A* will sign a new writing promising to pay $750. *A* signs the new writing. *A* will be bound — even though *A*'s original promise to pay was not binding (it was a promise to pay for past services, rendered without expectation of payment), the new promise is supported by consideration, since it was in settlement of *B*'s good-faith claim for breach of the prior promise.

Illusory Promises

☛ **Total discretion by one party:** When you spot a contract that gives one party ***total discretion on whether to perform***, that party's promise is illusory, because the party hasn't committed to anything. Therefore, the other party isn't bound, either.

Example: Seller offers Buyer an annual contract for the sale of widgets at a stated price, with the quantity to be "whatever quantities you choose to order, up to a maximum of 10,000." Notice that Buyer isn't obligated to purchase *anything* under these terms. Therefore, Seller's promise isn't supported by consideration, and Buyer can't sue Seller for refusing to fill the orders Buyer places.

But keep in mind that contracts with apparently-illusory promises may nonetheless be wholly or partly enforceable. Some situations to watch for:

☞ **A divisible contract:** If there is a long-term agreement in which the seller's promise is illusory, but the buyer places individual orders, the seller's promise will be interpreted as an offer for a ***series of unilateral contracts***, and each order will be an ***acceptance of a unilateral contract*** (which the seller is then bound to fill).

Example: Buyer requests an annual price quote for fuel oil from Seller. On Dec. 24, Seller writes to Buyer, "I offer to supply you with any no. 2 fuel oil ordered by you during the next year beginning January 1 under the following terms: 14 cents a

gallon to be ordered only in 3,000 gallon tank cars." On Dec. 30, Buyer writes, "I accept your offer." Since there isn't any language indicating a quantity (e.g., Buyer's requirements) or exclusivity of source, the contract is illusory at this point (and either party could cancel it completely).

But now, suppose that on the following Jan. 20, Buyer writes, "My first order is for 6,000 gallons." This would probably be interpreted as an acceptance of Seller's outstanding offer to enter into a series of unilateral contracts. Therefore, Seller would have to fulfill the order. (But Seller could cancel at any time, and not have to fill any orders placed after the cancellation date.)

- ☞ **An implied promise by a party:** In certain circumstances a promise may be ***implied***, thus making that party's duty not illusory.
  - ☞ **Exclusive distributorships:** Where Buyer has exclusive rights to distribute (resell) Seller's product, Buyer has an implied duty to ***use her reasonable efforts*** to sell the product. This implied duty will furnish consideration for Seller's return duty to sell to Buyer.
  - ☞ **Requirements contracts:** Similarly, in a ***requirements*** contract, Buyer's promise of exclusivity supplies consideration for Seller's return promise to supply Buyer.
    - ☞ **Good-faith quantities:** Remember that the ***quantity*** in both requirements and output contracts is measured by the actual quantity that occurs ***in good faith.*** However, the quantity can't be an amount which is unreasonably disproportionate to any stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements.

    Example: *S* and *B* have an exclusive five-year contract whereby *S*, a chair manufacturer, supplies a certain type of chairs to *B*, a chair distributor. (*S* is to sell this type of chair only to *B*, and *B* is to buy this chair only from *S*.) Orders for the first three years are 330, 100 and 250 chairs, respectively. *B* orders 1,000 chairs in the fourth year and *S* cannot produce that amount. *S* will probably not be liable for breach, because the amount requested is disproportionate to the prior requirements.

  - ☞ **Personal satisfaction of party.** Look for a contract where a party's duty to pay arises only if he's personally satisfied with the work done by the other party. His promise to pay isn't illusory because of the requirement that dissatisfaction, if it occurs, be in ***good faith.***

- *Notice of cancellation:* Lastly, if a party can ***cancel*** the contract at any time, but only on some period of notice, the obligation to give the notice (and to perform or be bound til them) supplies consideration for the other party's promise.

- Two further points to remember:
  - Courts seldom care about the "***adequacy"*** of consideration. So a big imbalance between the "value" of what *A* got and what *B* got won't mean a lack of consideration.
  - A promise to make a gift is unenforceable, as noted. However, a gift, ***once it has been completed***, can't be rescinded by the donor.

---

1. Remember, we're talking here only about the "detriment" requirement; recall that extreme lack of equivalent value may indicate that the ***bargain*** element is not satisfied; see *supra*, p. 90.

2. In a unilateral contract, the mutuality problem doesn't arise for the following reason: "Lack of consideration" only becomes an issue if raised by the defendant. The defendant in a unilateral contract situation is always the promisor (rather than the offeree, who accepted by performing the requested act.) The essence of any defendant's "no mutuality of consideration" argument is, "You weren't bound [i.e., you didn't give consideration], so I can't be bound." But in the unilateral situation, the defendant can't make this argument, because the offeree furnished consideration by performing the requested act.

CHAPTER 4
PROMISES BINDING WITHOUT CONSIDERATION

ChapterScope

This chapter covers the exceptions to the rule requiring consideration. Here are the key exceptions, situations in which a promise can be enforceable even though there is no consideration for it:

- **Promises to pay past debt:** Most courts hold that a promise to pay a ***past debt*** that is no longer legally enforceable is binding without consideration, if it is ***in writing.***
- **Promise to pay for benefits received:** Similarly, a promise to ***pay for services already received*** is enforceable in many situations.
- **Modification:** The UCC provides that a ***modification*** of a contract for the sale of goods does not have to be supported by consideration.
- **Option contract:** An ***option*** contract (i.e., a promise to ***hold an offer open*** for a set amount of time) usually does not need consideration, if the option is in a writing signed by the offeror, and recites that consideration has been paid for the option.
- **Guaranty contract:** A ***guaranty*** (i.e., a promise to pay the already-existing debt of another person) is usually enforceable if it is in a writing that (1) is signed by the guarantor, and (2) states that consideration has been paid for the guarantee.
- **Promissory estoppel:** Under the "promissory estoppel" doctrine, a promise will be enforceable without consideration if: (1) the promisee ***acts or forbears in reliance on the promise*** and (2) this action or forbearance was ***reasonably foreseeable*** by the promisor. The doctrine is often applied in a situation where there has been a ***promise to make a gift.***

I. INTRODUCTION

A. Types of promises that may not need consideration: This chapter covers the circumstances in which a contract may be enforceable even though it is not supported by consideration. It also discusses the situations in which the doctrine of promissory estoppel can serve as a

substitute for consideration.

1. **Listing of situations:** The above ChapterScope lists the most important types of promises that may be enforceable without consideration.

II. PROMISES TO PAY PAST DEBTS

A. Promises to pay past debts that are no longer legally enforceable: Suppose the debt owed by a debtor to a creditor has been ***legally discharged.*** This discharge may have occurred, for instance, because the debtor became ***bankrupt***, or because the ***statute of limitations has run*** on the creditor's claim. If the debtor then makes a gratuitous promise (i.e., a promise for which he receives nothing in return) to ***pay the now-barred debt***, is this promise enforceable? Most courts agree that it is ***enforceable***, ***even though there is no consideration***.

B. "Moral consideration": Some courts justify making such a promise enforceable by stating that there is ***"moral consideration"*** for the promise to pay the now-barred debt. But this "moral consideration" label is simply conclusory, since there is no "bargain" present, and therefore there is nothing resembling the traditional consideration idea. A better explanation is that courts simply feel that the enforcement of such promises to pay pre-existing obligations is socially beneficial.

1. **Restatement view:** The Second Restatement takes the position that promises to pay debts that are barred by the ***statute of limitations***, or that have been discharged in ***bankruptcy***, are ***binding without consideration***. See Rest. 2d, §§ 82 and 83.

2. **Requirement of a writing:** Statutes in most states require that for a promise to pay a debt barred by the statute of limitations to be enforceable, it must be in a ***signed writing***. A few states similarly require a signed writing where the debt has been discharged in bankruptcy. See C&P, p. 233; Rest. 2d, § 82, Comment a and § 83, Comment a.

3. **Promises to pay inferable from acts or statements:** Sometimes the promise to pay the discharged debt will be explicit. In many situations, however, the debtor will take actions which the creditor claims constitute an ***implied*** promise to pay the now-discharged debt.

a. **Bankruptcy discharges:** Where the promise is to pay a debt that has been discharged in ***bankruptcy***, most courts probably share the view of the Second Restatement (§ 83), which will enforce only an ***express*** promise and will not infer such a promise from the debtor's actions.

b. **Statute of limitations:** Where the debt has been discharged by the running of the ***statute of limitations***, on the other hand, most courts (and the Second Restatement) recognize several situations in which a promise to pay the debt may be ***implied*** from the debtor's actions. The Second Restatement (§ 82) lists the following acts or statements as giving rise to a promise to pay a time-barred debt:

   i. "A voluntary ***acknowledgment*** to the obligee, ***admitting the present existence*** of the antecedent indebtedness";

   ii. "A voluntary ***transfer*** of money, a negotiable instrument, or other thing by the obligor to the obligee, made as ***interest on or payment of or collateral security for*** the antecedent indebtedness";

   iii. "A statement to the obligee that the statute of limitations ***will not be pleaded as a defense***."

C. **Scope of promisor's duty:** If the promise to pay a previous debt is held enforceable, it is only enforceable ***under the precise terms of the promise***, and the promisor ***cannot be held for more than that.***

> **Examples:** If the debtor promises only to pay a portion of the pre-existing debt, only that portion may be collected. Similarly, if she promises to pay it "if I am able," the promise is only enforceable if the debtor does achieve an objective ability to make the payment. And if the debtor acknowledges that the debt still exists, but states that she does *not* intend to pay it, her acknowledgment does not operate as a promise, in view of the opposite intention she has manifested.

III. PROMISE TO PAY FOR BENEFITS RECEIVED

A. **Promise to pay for benefits received generally:** Suppose *A* has rendered a service to *B*, without having come to an express contractual agreement for the service (e.g., *A* has saved *B*'s life in an emergency). If, after the service has been rendered, *B* promises to pay a specified amount for it, is that promise enforceable? It is clearly not supported by consideration, since it was not even made until the services had already

been rendered, and cannot therefore be said to have been bargained for by *A*. The question is therefore whether such a ***promise to pay for past service***s is enforceable without consideration. The enforceability of such a promise is likely to depend on several factors, including whether the recipient initially requested the services, and whether the donor rendered them in expectation that he would receive payment.

1. **Where services were requested, and rendered with an expectation of payment:** Where the services were initially ***requested*** by the recipient, the enforceability of the later promise to pay ***doesn't matter*** very much, because the initial request probably created an implied-in-fact contract to pay for them. (This assumes that the person who performed the services ***expected to be paid for them***.)

   a. **Requested act performed as favor:** Now, suppose that the services were requested, but the person performing them intended that they be a ***gift***. If the recipient later promises to pay for the services, most courts (and Rest. 2d, § 86(2)(a)) will ***not*** enforce the promise. See C&P, p. 227.

2. **Benefits previously received but not requested:** The most interesting case is where *A* renders services to *B* ***without*** *B*'s having expressly requested the services, and *B* then promises to pay. We assume that at the time A renders the services, he is ***not intending a gift.***[1]

   a. **Split of authority:** Here, the cases are ***split***. The older cases generally hold that *B*'s promise is ***unenforceable***. But "the trend is clearly in favor of ***increased enforceability***" of such promises. Farnsworth, § 2.8.

      Example: Recall the facts of *Mills v. Wyman* (*supra*, p. 93): D's son, a 25-year-old, becomes ill while traveling, and is nursed by P. D later writes to P, promising to pay P's expenses.

      The court hearing the case (in 1825) held that D's promise was not supported by consideration, since P's services were not given at D's request. But a modern court might well hold that such a promise made on account of "moral obligation" should be enforced.

   b. **Where benefit and cost are substantial:** Even in courts that would not automatically hold that a promise to pay for unrequested past services should be automatically enforced, the court may

choose to enforce the promise where the benefit to the recipient of the services (and/or the cost to the provider) was ***substantial***. The case set forth in the following example is the classic illustration.

> **Example:** *A* saves *B*'s life in an emergency, and is totally disabled in so doing. *B* then promises to pay *A* $15 every two weeks for the rest of *A*'s life, and makes these payments regularly for over eight years until he dies. The estate then refuses to continue the payments and *A* sues on the promise.
>
> *Held*, *B*'s promise is enforceable, even without consideration, because *B* incurred a substantial material benefit from *A*'s act, even though *B* did not request the act. See *Webb v. McGowin*, 168 So. 196 (Ala. Ct. App. 1935). See also, Rest. 2d, § 86, Illustr. 7 (drawn from *Webb*).

c. Restatement view: The Second Restatement more or less follows the more modern, liberal, view. Receipt of an unrequested material benefit, followed by the receiver's promise to pay for the benefit, is ***enforceable without consideration***, but only ***"to the extent necessary to prevent injustice."*** Rest. 2d, § 86(1).

i. **Intent to make gift of services:** The Restatement gives one illustration of a situation in which enforcement will definitely ***not*** be necessary to prevent injustice (and thus not enforceable): where the promisee "conferred the benefit as a ***gift.***" Rest. 2d, § 86(2)(a).

ii. **Request irrelevant:** The Restatement does not distinguish at all between benefits that are ***requested*** by the promisor and those that are not. (In *both* situations, the promise is not binding if the promisee conferred the benefit as a gift; nor will the promise be enforced if its "value is disproportionate to the benefit." *Id.*)

d. State statutes: Some states have enacted ***statutes*** to make enforceable promises to pay for services previously received. See, e.g., N.Y. Gen. Oblig. L. § 5-1105 and Cal. Civ. Code § 1606.

e. Restitution possibility: Also, in certain situations (e.g., emergencies and mistakes), the law of ***quasi-contract***, or "restitution," allows the person rendering the services to recover their reasonable value. See *infra*, p. 335. Where such a restitutionary recovery is possible, a subsequent promise by the recipient of the services to pay a particular sum for them may at

least constitute ***evidence*** of the value of the services, even though the promise is not directly enforceable.

Quiz Yourself on
PROMISES TO PAY PAST DEBTS AND PROMISES TO PAY FOR BENEFITS RECEIVED

32. Donald owed Mickey $100 and gave him a promissory note to that effect. Mickey has never enforced the note and the statute of limitations has now passed. Donald now sends a letter to Mickey that says, "Dear Mickey, I know I still owe you some money under my promissory note. I'll pay you $75 next month." Donald does not pay the $75 the next month. How much, if anything, may Mickey collect?

33. Opie became extremely ill one day while visiting his Aunt Bee. Aunt Bee, a retired nurse, ended up nursing him back to health for several days and spent $200 on medications for him. When Opie recovered, he said, "Aunt Bee, I know you devoted several days of your time to caring for me, and I appreciate it greatly. I promise to repay you by giving you $500 for your services, plus an additional $200 to reimburse you for the medications." Opie never pays up. According to the modern view, can Aunt Bee enforce the promise? If so, to what extent?

Answers

32. $75. Under the Second Restatement (and according to most courts), a promise to pay a debt that is barred by the statute of limitations or that has been discharged in bankruptcy is binding *without consideration*. Most states require that the new promise be made in writing, but that requirement is satisfied here. However, states enforcing promises to pay limitations-barred debts almost always limit enforcement to the precise terms of the promise. Since Donald promised only $75, that's all Mickey can collect. (But if Donald, in addition to promising an immediate $75, had specifically acknowledged that the full $100 was presently owing, this acknowledgment of present-indebtedness would have been enough, at least under the Restatement's view, to bind Donald to pay that full $100, even though Donald didn't expressly promise to pay the entire

$100.)

33. Yes, but probably only for the $200 spent on drugs. Under the modern and Restatement view, a promise to pay someone for benefits received is enforceable without consideration — but only to the extent necessary to ***prevent injustice.*** Here, Aunt Bee would likely be able to enforce the promise to reimburse her for the medicines, since it's probably unjust that she be left with this out-of-pocket expense after Opie promised otherwise. However, she would probably *not* be able to enforce the promise for the additional $500 for the value of her services: since Aunt Bee is not only a *retired* nurse but also a relative of the recipient, it's highly likely that a court would conclude that Bee intended the services as a gift, not as something for which she expected to be paid. If she intended a gift, prevention of injustice would not require that she be paid.

IV. OTHER CONTRACTS BINDING WITHOUT CONSIDERATION

A. Promise to perform a voidable duty: Suppose that *A* owes a duty to *B*, but *A*'s duty is ***voidable*** at her option. This might, for example, be the case if *A* had been induced to make her promise through fraud or duress, or at a time when *A* was an infant. If, after *A* has discovered her option to avoid her promise, she reaffirms the promise, the ***subsequent promise is enforceable,*** even though made without consideration. See Rest. 2d, § 85.

> **Example:** *B*, in order to induce *A* to promise to lend her $10,000, misrepresents his ability to repay *A*. *A* agrees to make the loan. Before he actually makes the loan, *A* discovers *B*'s fraudulent representation of ability to repay, and has the right to avoid the loan on grounds of fraud. However, he says to *B*, "I'll lend you the money anyway." *A*'s second promise is enforceable, even without consideration. See C&P, p. 234.

B. Modification of contracts: In the chapter on Consideration, we saw that most courts in a non-goods situation hold that a modification of a contract which benefits only one party is unenforceable for lack of consideration. (See *supra*, p. 98.) The ***UCC***, however, explicitly ***removes the consideration requirement for modifications of existing contracts:*** "An agreement modifying a contract within this article needs no consideration to be binding." § 2-209(1).

> **Example:** Seller sells an airplane to Buyer on credit, with Buyer to make payments

of $10,000 per month over five years, at 0% interest. After one year, Buyer develops money problems, and tells Seller that he can no longer afford to pay more than $7,000 per month. Seller agrees to let Buyer pay this lesser monthly amount (still at 0% interest) until the plane is paid off. One year later, Seller becomes dissatisfied with the arrangement, and demands that Buyer start paying at the original $10,000 per month or the plane will be repossessed. When Buyer threatens to sue for breach of the modified agreement, Seller retorts that Buyer gave no consideration for the original modification, since Buyer was merely agreeing to do what he was already required to do.

Under the UCC, the modification is binding on Seller, even though Buyer gave no consideration for it.

1. **Contracts containing a "no oral modification" clause:** However, UCC § 2-209 does have a limitation. § 2-209(2) provides that "a signed agreement which ***excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded***, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party."

   a. **Meaning of § 2-209(2):** § 2-209(2) thus provides that if the original written agreement states something to the effect of "this contract may not be subsequently modified except in writing," that clause will be ***enforced***, and any subsequent oral modification (even if proved beyond a doubt, and even if benefiting both sides) is not binding. A clause falling under § 2-209(2) is usually called a ***"no oral modification"*** clause.

   b. **"No oral modification" clause must be separately signed:** However, such a "no oral modification" clause in the original agreement is ***ineffective*** if it is contained on a form supplied by a merchant (essentially, a business person — see § 2-104(1)) unless either (1) the other party is ***also a merchant***; *or* (2) the other party has ***separately signed*** the n.o.m. clause.

Example: Consumer buys a washing machine from Dealer. The machine is to be paid for under the contract, at the rate of $20 a month for 36 months. The written contract states that "this contract may not be modified except in writing." The machine develops problems and to placate Consumer, Dealer says to Consumer "I'll let you reduce the payments from $20 a month to $15 a month." Consumer agrees with this reduction, then fails to make the payments. Dealer sues. He seeks the full $20 per month price, claiming that the "no oral modification" clause in the contract rendered the subsequent oral modification ineffective.

Because of § 2-209(2), the "no oral modification" clause is ineffective to bar the subsequent modification unless it was separately signed by Consumer. Thus if

Consumer merely signed the overall sales agreement, and did not place his signature next to the "no oral modification" clause, Dealer is bound by the subsequent oral modification.

c. May be overridden by waiver: Also, a no-oral-modification clause is not completely ironclad, because the party who later tries to enforce the clause may be found to have ***waived the benefit*** of the clause. For instance, UCC § 2-209(4) provides that "[a]lthough an attempt at modification … does not satisfy the requirements of [a valid no-oral-modification clause] it can operate as a ***waiver***." (Courts in non-UCC cases similarly apply waiver principles.)

Example: Buyer and Seller sign a contract containing a no-oral-modification clause, and also setting a firm delivery date. Buyer later orally says to Seller, "I won't insist on firm adherence to the delivery date — you can take an extra three weeks." If Seller *relies* materially on this statement, Buyer will probably be held to have *waived* the benefit of the no-oral-modification clause, and will thus be held to have effectively modified the contract to provide for a later delivery date. See W&S, pp. 33-34.

2. Good faith and unconscionability in modifications: The traditional non-UCC requirement that there be consideration to support a modification was designed in part to prevent one party from extorting concessions from the other by threatening to breach. (See *supra*, p. 98.) The Code, although it removes the consideration requirement for modifications, nonetheless guards against such extortion. It does this through two provisions: (1) the requirement that "every contract or duty within this act imposes an obligation of ***good faith*** in its performance or enforcement" (§ 1-304); and (2) the court's right to refuse to enforce any contract which it finds to be "unconscionable" (§ 2-302).

C. Option contracts: Many courts do ***not*** require consideration for an ***offer to be irrevocable***. That is, in many courts an ***option contract*** will sometimes be binding without consideration.

1. Restatement: Thus the Second Restatement states that an option contract is binding if it satisfies four requirements:

[1] it is ***in writing;***

[2] it is ***signed by the offeror;***

[3] it "***recites a purported consideration*** for the making of the offer," and

[4] it proposes "an exchange on ***fair terms within a reasonable time***. …"

Rest. 2d § 87(1)(a).

a. No consideration really required: This Restatement provision, although it applies only where the offer "recites a purported consideration," does not require true consideration. As long as the terms of the proposed agreement are fair, it does not matter that the consideration recited in the document was ***never in fact paid***, or that it was not bargained for. See Rest. 2d, § 87, Comment c.

b. Fairness of exchange: Notice requirement [4] above: Under the Restatement (and in many states), the court will inquire into the ***fairness*** of the proposed terms under the option, even though it will not inquire as to whether the recited consideration was actually paid. If these terms are unfair, the option will not be binding.

Example: In consideration of $1 paid by *B*, *A*, an ignorant widow, gives *B* a 10-year option to mine phosphate from her farm for a royalty of 25¢ per ton. As *B* knows, but *A* does not, the prevailing royalty for phosphate is more than $1 per ton. The option is unenforceable, not for lack of consideration, but because of the gross unfairness of the option price. See Rest. 2d, § 87, Illustr. 2.

2. Offers which induce reliance: An offer which induces foreseeable detrimental reliance by the offeree may be treated by the court as an option, pursuant to Rest. 2d, § 87(2). See *supra*, p. 53. In this sort of unintentional option, there is no consideration requirement; the offeree by hypothesis has undergone a "detriment," but usually not one which has been "bargained for" by the offeror.

3. Firm offers under the UCC: The UCC's ***"firm offer"*** provision (§ 2-205) similarly allows the creation of an option contract without consideration. That section (discussed *supra*, p. 53) provides that a written and signed offer by a merchant to buy or sell goods which states that the offer is irrevocable is indeed irrevocable, even though no consideration is given for it. The provision is limited, however, to a maximum of three months of irrevocability. (If consideration is given by the offeree, of course, the option can be indefinite.)

D. Guaranties: A ***guaranty*** is a promise by one person (the guarantor) to pay the debts incurred by another person (the debtor) owed to a third

person (the creditor).

1. **Guaranty given simultaneously with creation of debt:** If the guarantor gives his guaranty ***at the same time*** that the debt he is guaranteeing is created, there is no problem of consideration, since the guarantor is bargaining for a detriment to be incurred by the creditor, i.e., the loan to the debtor. (The consideration doctrine does not require that any benefit flow directly to the person doing the bargaining; thus the fact that the loan proceeds go to the debtor, and not the guarantor, does not negate the existence of consideration.)

    Example: Son wants to buy a car from Dealer. Dealer will allow Son to buy the car on credit only if Son's Father will guarantee repayment. If Father makes such a guaranty as part of the sale of the car to Son, Father's guaranty is supported by consideration. This is so because Father's guaranty is given in exchange for (i.e., "bargained for") Dealer's agreement to sell the car to Son on credit.

2. **Guaranty given after underlying debt has arisen:** Where the guaranty is not given until ***after*** the underlying debt has been created, however, consideration will not necessarily be present for the promise of guaranty. In the above example, for instance, if Dealer went to Father after the sale to Son, and simply said "Would you guarantee your Son's repayment?", Father's guaranty would not be supported by consideration. (There might, of course, be new consideration given for the guaranty, such as a promise by Dealer not to repossess the car if Son falls behind on his payment, or any other meaningful change in the terms of the debt.)

    a. **Guaranty without consideration is invalid in some jurisdictions:** In many jurisdictions, a guaranty that is not supported by consideration is ***unenforceable***.

    b. **Recitals of consideration under modern decisions:** Most modern decisions, however, take the view that if the guaranty is ***in writing***, and ***states*** that a consideration (even a nominal one) has been paid by the creditor to the guarantor for his guaranty, the guaranty is ***enforceable*** even if the purported consideration was never in fact paid or is in fact merely a sham.

        i. **Restatement in accord:** This is also the view of the Second Restatement, which in § 88(a) provides that a guaranty is binding if "the promise is in ***writing*** and ***signed by the***

***promisor and recites a purported consideration*....” The Restatement’s treatment of guaranties is thus similar to its treatment of options (see *supra*, p. 133), in that both are binding without consideration as long as a signed document reciting the payment of consideration exists.

ii. **UCC view is similar:** The UCC similarly takes the view that a written guaranty is not unenforceable for lack of consideration. § 3-408 states that “[N]o consideration is necessary for an instrument given in payment of or as security for an antecedent obligation of any kind.” Comment 2 to § 3-408 explains that this rule is intended to make a written guaranty of another’s obligation binding without consideration. Observe that this section goes even further than the Second Restatement, in that it does not even require the “recital” of a purported consideration.

c. **Promissory estoppel:** Alternatively, the guaranty might be binding under the theory of ***promissory estoppel***, if the guarantor should reasonably have expected the person to whom the guaranty is made to rely on him (e.g., by not suing on the underlying obligation that has been guaranteed), and this reliance actually occurs. See Rest. 2d, § 88(c).

E. **Contracts under seal:** Under the common law, an agreement made ***under seal*** was enforceable, even though not supported by consideration. The “seal” was a mark of wax, an impression, a notary’s mark, or any other insignia denoting the fact that the parties intended their promise or agreement to be binding. See C&P, pp. 270-271.

1. **Rationale:** The theory for making promises made under seal enforceable without consideration was that the seal made it clear that the parties intended to be bound, and thus served the same evidentiary and cautionary functions as the giving of consideration (see *supra*, p. 85).

2. **Statutory abolition of modification:** Most states have enacted statutes which ***modify or abolish*** the effect of the seal. See Rest. 2d, Chap. 4, Topic 3, Statutory Note (“Rest. Note”).

a. **Abolition:** At least 34 states have enacted statutes that either explicitly abolish the seal or that give sealed and unsealed contracts the same effect. (Rest. Note.)

b. **UCC abolition of seal:** Where an agreement involves sale of goods, the seal is ineffective in all jurisdictions which have enacted the UCC (i.e., all states except Louisiana). UCC § 2-203 states that "the law with respect to sealed instruments does not apply to…a contract [for goods]."

c. **Presumption of consideration:** Even among states which have not completely abolished the seal, most have statutes providing that a seal imports only a ***rebuttable presumption*** of consideration. (Rest. Note.)

Quiz Yourself on
OTHER CONTRACTS BINDING WITHOUT CONSIDERATION

34. The Great Philosophers Mint offers to consumers a collection of commemorative plates, each with the likeness of a great philosopher on it. Plato, an amateur collector of plates, signs a contract with Great Philosophers to purchase the entire 12-plate set for $300, payment to be at the rate of $10 a month for 30 months, no interest. The contract contains a clause in the boilerplate (which Plato never noticed) saying that no modification will be effective unless it's in a writing signed by both parties. Plato gets the plates, makes the first 2 months' payments, then loses his job writing philosophy tracts. He and Great Philosophers orally agree that he can pay just $5/month til the debt is paid off, still no interest. After one month of this arrangement, Great Philosophers says, "We want the original $10/month." Is Plato obligated to resume paying $10/month?

35. Jerry Seinfeld is a part-owner of a soup store called The Soup Nazi. On Aug. 1, Jerry and his friend George Costanza sign an option agreement that reads as follows: "In consideration of $10 paid this day by Costanza to Seinfeld, Seinfeld hereby grants to Costanza an option to purchase Seinfeld's interest in The Soup Nazi for $10,000 cash, this option to be exercised no later than Sept. 1." ($10,000 would be a fair price for

Jerry’s interest.) George never in fact paid Jerry the $10 for the option, as Jerry knew when he signed the option agreement. On August 15, Jerry tells George that the option is terminated, because he has decided his interest is worth more than $10,000. Will a court enforce the option?

Answers

34. No. First, the fact that Plato is not giving consideration in return for Great Philosophers’ concession is irrelevant: under UCC § 2-209(1), “an agreement modifying a contract within [Article 2] needs no consideration to be binding.” Next, § 2-209(2) generally enforces No Oral Modification clauses, such as the one here. However, where the deal is between a merchant and a consumer, an N.O.M. clause on a form supplied by the merchant is not enforceable against the consumer unless the clause has been separately signed by the consumer. Since the facts tell us that Plato didn’t even notice the clause, he clearly didn’t “separately sign” it. Therefore, the clause isn’t enforceable, and the modification was effective, under the general rule that oral modifications are enforceable.

35. Yes. Under the Restatement and prevailing modern view, an option does not need consideration to be binding, provided that the option is in writing, recites a purported consideration (whether actually paid or not), and proposes an exchange on fair terms within a reasonable time. Rest. 2d, § 87(1)(a). All of these conditions are satisfied here, so the option is enforceable. The significance of the option’s enforceability, of course, is that Jerry cannot revoke the option (in contrast to the usual rule making offers that are not supported by consideration revocable even where the offer recites that it’s irrevocable).

V. PROMISSORY ESTOPPEL

A. Introduction: The consideration doctrine is designed to enforce promises which are “bargained for.” There are some promises which, although the promisor makes them without bargaining for anything in return, nonetheless induce the promisee to ***rely to his detriment***. The doctrine of ***“promissory estoppel”*** is being used by an increasing number of courts to enforce such promises which, although not

supported by consideration, induce detrimental reliance by the promisee. See C&P, p. 250.

1. **Other applications:** The promissory estoppel doctrine's scope has also been broadened by some courts to bind promisors even where the promisee has ***not*** relied detrimentally (e.g., promises to make charitable donations). The following material, after setting forth the Restatement definition of promissory estoppel, considers several of the contexts in which the doctrine is most frequently applied.

B. Restatement definition: The First and Second Restatements have been instrumental in shaping the doctrine of promissory estoppel. (In fact, § 90 of each Restatement, dealing with this subject, is probably the most important single section of each.) Rest. 2d, § 90(1) sets forth the doctrine of promissory estoppel as follows:

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

Example: P owns a tract of land on which he desires to construct a commercial building or shopping center. P and D sign a document in which D promises to obtain a $70,000 construction loan for P, or to supply the loan himself if he cannot find anyone else to do so. The document does not specify the amount of monthly installments on the loan to be provided, the amount of interest to be charged, or when interest is to be paid. Following the signing, D urges P to demolish buildings presently on the tract (having a value of about $58,000), so that the new construction can take place quickly once the loan comes through. P does the demolition. D is unable to find a lender, and refuses to lend the money himself; P sues. D defends on the grounds that the document is not an enforceable contract, because it is indefinite with respect to basic terms.

Held, P may recover on a promissory estoppel theory; he shall be compensated for his "foreseeable, definite and substantial reliance." However, he is entitled to recover only his reliance damages (i.e., the money required to "put [him] in the position he would have been in had he not acted in reliance upon the promise"), not his expectation damages (the profits he would have made had the loan been given). *Wheeler v. White*, 398 S.W.2d 93 (Tex. 1965).

C. Unbargained-for reliance: The essence of the promissory estoppel idea is that the maker of a promise may be bound by that promise, even though it is not supported by consideration, if the promisee ***relies upon the promise to her detriment***, and the promisor should have foreseen this reliance.

1. **Use:** The promissory estoppel doctrine was originally applied chiefly to ***gratuitous promises*** (i.e., promises to make gifts) which were relied on by the promisee, and then retracted by the promisor. But the doctrine has been expanded to cover certain commercial situations, such as where the parties engage in preliminary negotiations, one party gives assurance to the other that they will be able to reach a binding agreement, the other relies on this assurance to his detriment, and then the contract falls through. (See, e.g., *Hoffman v. Red Owl Stores*, *infra*, p. 144.)

2. **Not necessarily contractual:** There is a dispute about the precise function of the promissory estoppel doctrine.

   a. **Contract action:** Some courts (and the Second Restatement) view the doctrine as simply ***supplying consideration*** which would otherwise be lacking. If this is the theory, then an action based on promissory estoppel is an action ***on the contract*** (though courts following this approach will nonetheless often apply reliance damages rather than the usual contract "expectation" measure; see *infra*, p. 148).

   b. **Tort action:** Other authorities, however, view promissory estoppel as having a large component of ***tort law***. As the idea has been expressed, "One person has caused harm to another by making a promise that he should reasonably have expected would cause such harm, and he is therefore held liable for the harm caused." Farnsworth, p. 100. Under this view, the appropriate measure of damages will almost ***always*** be reliance, rather than expectation.

3. **Actual reliance:** The promisee must ***actually rely*** on the promise. So if the claimed reliance is an affirmative act, the promisee must show that he would not have taken the act except for the promise, i.e., that there was a cause and effect relationship between the promise and the act. And if the claimed reliance is a ***forbearance*** from doing something, the promisee must show that he could have and would have done the act but for the promise.

   Example: P, a travelling salesman, is 65 and has worked for D for 25 years. D suggests that P retire, and tells P that if P does so, D will pay P a $20,000 per-year pension for the rest of P's life. P retires. The day after he does so, for reasons having nothing to do with the retirement, P suffers a stroke that completely and

permanently paralyzes him. D pays the pension for one year, then stops.

On these facts, P will probably not be able to use the promissory estoppel doctrine to recover on the promise of the pension. The reason is that P ***has not significantly relied on the promise*** to his detriment — even without the promise, he still would have been forced to stop working.

4. Foreseeability of reliance: The promisee's reliance must also have been ***reasonably foreseeable*** to the promisor. This requirement probably means not only that it must have been reasonably foreseeable to the promisor that the promisee would rely, but also foreseeable that the promisee would rely ***in the particular way*** that he did in fact rely. Farnsworth, p. 96.

Example: Suppose that the plaintiff in *Wheeler v. White*, *supra*, p. 137, had relied on the promise of a loan not by demolishing structures on the land, but by buying a new house in anticipation of the profits he would make from the forthcoming construction. A court would almost certainly say that this *type* of reliance was not reasonably foreseeable by the defendant. (Alternatively, promissory estoppel might fail in this situation because the plaintiff's reliance would probably be held to have been "unreasonable.")

D. Promises to make gifts: The promissory estoppel doctrine is often applied to enforce promises to ***make gifts*** that induce detrimental reliance.

1. Intra-family promises: Promissory estoppel may be used to enforce certain promises made by one member of a family to another, if the latter reasonably and detrimentally relies on the promise. See C&P, p. 251.

Example: Grandfather, distressed because his Granddaughter has to work in a store, gives her a promissory note, telling her that he has done this so that she will not have to work anymore. She quits her job. He then dies, and his estate refuses to pay the note.

Held, Granddaughter justifiably and foreseeably relied on Grandfather's promise of payment, by giving up her job. This reliance made the note enforceable, and operated to "estop" the executor from denying that the note was given for valid consideration. See *Ricketts v. Scothorn*, 57 Neb. 51 (1898).

a. Utility of doctrine: Ordinarily, promises made by one family member to another are unenforceable, either because the parties lack an intent to contract (see *supra*, p. 7) and/or because there is no consideration since the promise is not bargained-for (see *supra*, p. 87). The promissory estoppel doctrine thus fills an important function in the intra-family promise situation, since it at least

allows the promisee some legal remedy if he ***relies*** on the promise to his detriment. However, most courts do not give a full contractual measure of damages (i.e., "lost profits") in this situation, but merely recompense the promisee for his ***out-of-pocket losses.***

2. **Oral promises to convey land:** A promise to make a gift of ***land***, like any other gratuitous promise, is unenforceable for lack of consideration. If the recipient of such a promise, acting in reasonable reliance on the promise and with the continuing assent of the promisor, incurs detriment with respect to the land, the promise may be enforced under the promissory estoppel doctrine.

    Example: *A* orally promises to make a gift of Blackacre to his son *B*, who takes possession of the land. *B* builds a house on the land and lives in it for twenty years until *A* dies. *B* may obtain, from *A*'s estate, a decree ordering specific performance of *A*'s promise to convey the land. See *Seavey v. Drake*, 62 N.H. 393 (1882). See also Rest. 2d, § 90, Illustr. 16 (using fairly similar facts).

    Note: The Statute of Frauds requires that a contract to convey land, to be enforceable, must be in writing. If one party to an oral contract to convey land relies to her detriment on the contract, she may be able to use the promissory estoppel doctrine to recover her reliance interest. In other words, promissory estoppel may be used as a ***substitute for compliance with the Statute of Frauds***, just as it may be used to substitute for consideration. See C&P, p. 252.

E. **Charitable subscriptions:** Suppose a person promises to give a specified sum of money to a particular ***charity***. Such a promise would not ordinarily be enforceable, since a charitable donor usually does not "bargain for" anything in return for his promise, and therefore there is no consideration. The doctrine of promissory estoppel is being used with increasing frequency to ***enforce such promises of charitable subscription.***

1. **Pre-promissory estoppel theories of consideration:** Before the use of the promissory estoppel doctrine became widespread, courts enforced such promises of charitable contributions by finding consideration to be present. Some courts found an ***implied promise by the donee*** to use the gift for charitable purposes. Other courts found that the promises of other prospective donors to make donations were consideration for the particular donor's promise. In any case, these "consideration" theories were tenuous at best, since the prospective

donor almost never truly “bargained” for his promise. In a few cases, the finding of consideration for a promise of charitable contribution was reasonable, as in the following example.

> **Example:** D promises to give $5,000 to P, a charitable organization. The parties agree that the $5,000 will be used to establish a scholarship fund to be named after D. D gives $1,000, which is put aside by P for the fund, and then D repudiates her promise. She dies, and P sues her estate for the remaining $4,000.
>
> *Held* (by the New York Court of Appeals, in an opinion by Judge Cardozo), there was an enforceable bilateral contract. The consideration for D’s promise was P’s promise to name the scholarship fund after her. (The opinion also mentioned the possibility of using promissory estoppel to enforce the promise, although the case was in fact decided on a contractual basis.) See *Allegheny College v. National Chautauqua County Bank of Jamestown*, 246 N.Y. 369 (1927).

2. **No reliance necessary in charitable subscription case:** Although in most contexts promissory estoppel will apply only when the promisee relies to his detriment, the courts often do ***not*** impose such a detrimental reliance requirement where the promise is a ***charitable subscription***, i.e., a ***written promise*** to make a charitable contribution. Thus § 90(2) of the Second Restatement states that “a charitable subscription … is binding under subsection (1) [which sets forth the promissory estoppel doctrine] without proof that the promise induced action or forbearance.”

   a. **Oral promises to charities not covered:** But observe that the phrase “charitable subscription” means a ***written*** promise to a charity, and the rule that no reliance needs to be shown for a charitable subscription is thus generally ***not held*** to apply to an ***oral*** promise to make a charitable gift.

F. **Gratuitous bailments and agencies:** Suppose that *A* promises, as a favor to *B*, to collect *B*’s mail while *B* is on vacation. Is this promise enforceable? If *A* fails to perform, and the mail is stolen from *B*’s mailbox, is *A* liable?

   1. **Theories of liability:** The courts have traditionally found a ***“gratuitous bailee”*** (one who takes care of another’s property for no consideration) liable if she actually begins to perform the bailment. But if she never starts to perform the bailment at all, most courts have traditionally denied liability for any harm suffered by the would-be bailor. Recently, however, courts have begun to make use of the

doctrine of promissory estoppel where the bailee neglects to perform altogether, and the bailor suffers a loss.

2. **Gratuitous agents:** The same rules apply where a person gratuitously promises to act as another's ***agent*** for some purpose. Thus if *A* promises to ***procure insurance*** for *B*, and gets the wrong kind of policy, he may well be held liable for any loss suffered by *B*. If he never gets any insurance at all, older courts would not hold him liable. A modern court, however, might well apply promissory estoppel theory.

   a. **Reluctance in insurance cases:** But courts are more ***hesitant*** to use promissory estoppel in insurance-procurement cases than in other cases involving gratuitous promises to act as agent. This is so because the promisor would typically be ***exposed to an enormous liability***, and the promisee's (i.e., the prospective insured's) reliance on the promise is often unreasonable. See Comment e to § 90 of the Second Restatement, urging "caution" in applying the doctrine of promissory estoppel in the context of promises to obtain insurance.

G. **Promises to pay pensions:** The doctrine of promissory estoppel has occasionally been applied to promises by employers to pay ***pensions*** and other fringe benefits. Many such promises, insofar as they represent an employer's attempt to ensure continued service by his employees, are supported by consideration, and are therefore enforceable as ordinary contracts. But where the promise of pension is made after the employee has retired, or made under terms allowing the employee to retire immediately, the bargain element necessary for consideration will usually not be present. It is in this kind of situation that the courts have used the promissory estoppel theory to bind the employer (see *supra*, pp. 136).

> **Example:** Employer promises Employee a pension when she retires. She retires shortly after this promise is made, apparently at least in part in reliance upon it. She does not seek other employment, and is eventually stricken with cancer, making further employment completely impossible.
>
> *Held*, the promise to pay the pension is binding under the promissory estoppel theory, since Employee has reasonably and detrimentally relied upon it. Her reliance came in choosing to retire, since she was already of such an age (57) that finding another job would have been impossible even had she not gotten sick.

Feinberg v. Pfeiffer Co., 322 S.W.2d 163 (Mo. App. 1959).

H. Offers by sub-contractors: Suppose a sub-contractor renders a ***bid*** to a general contractor, who relies upon that bid to figure out her own bid on a job which she obtains. Is the sub-contractor's bid binding? As we discussed above (*supra*, p. 59), many courts treat the sub-contractor's bid as temporarily irrevocable, for the period necessary to allow the contractor to obtain the job and accept the sub-contractor's bid. Such holdings in effect apply the doctrine of promissory estoppel, since they are based on the theory that the general contractor has ***reasonably relied upon the sub-contractor's bid***, and would suffer a loss (or at least a reduced profit) if the sub-contractor backed out and a new one had to be found. See Rest. 2d, § 87(2).

1. Reliance by general contractor: In the sub-contractor-bid scenario, be sure to ***check for reliance by the general contractor.*** If there is no real (and justifiable) reliance by the general contractor on the sub-contractor's bid, the general contractor will ***not be permitted to use promissory estoppel*** to make the sub-contractor's bid temporarily irrevocable.

Example: Suppose the sub-contractor discovers its bid is too low and tells the general about this *before* the general's own bid has been opened by the owner. In this scenario, the general contractor might be able to avoid the problem by revising or withdrawing its master bid. If the general has this opportunity and doesn't use it, then the general has not reasonably relied, and will not qualify for promissory estoppel.

a. GC must post a bond: In the sub-contractor-bid situation, the general contractor (GC) is often ***forced to rely*** on the sub's bid by virtue of the fact that the owner (the one receiving bids for the overall job) requires each general contractor who bids to ***post a bond*** ensuring that the GC's bid will be honored. Such a bond prevents the GC from changing or withdrawing the bid based on the sub-contractor's withdrawing his own bid (the GC loses the bond amount if he does so), so the GC meets the requirement of reliance in this situation.

I. Promise to perform business service: A person who promises to ***perform some business service*** for another may be liable under a promissory estoppel theory, if the other person relies on the promise by entering or failing to enter some other transaction.

1. **Promise to obtain insurance:** For instance, suppose an insurance agent or broker promises a business operator to ***"bind" an insurance policy***, i.e., to cause an insurance company to cover a particular risk faced by the operator. If the operator relies on the promise by failing to get the insurance through some other mechanism, promissory estoppel may apply to turn the agent into, in effect, an insurer.

    Example: Biz, a business owner, wants fire insurance on his warehouse. He phones Agent to tell him this. Agent says, "I'll get you $200,000 of coverage from Allstate today. Consider it done." This is probably not a contract, since Biz has not given consideration (he has probably not taken an act or made a promise in return, and if he has done either, it has not been "bargained for" by Agent). But if Agent neither gets the insurance nor tells Biz that he hasn't done so, and the warehouse burns down, there is a good chance that Biz can recover his fire losses from Agent on a promissory estoppel theory: Biz has reasonably and foreseeably relied on the promise, by forbearing from getting insurance from some other source.

2. **Promise to make a loan:** Similarly, a person who promises to ***make a loan*** may be liable to the would-be borrower, if the latter does something in reliance on the promise, and the promisor then refuses to make the loan.

    Example: Owner owns a house with a dilapidated but still functional garage in the back. After Owner applies for a loan to Lender, Lender makes a written and unconditional promise to Owner that Lender will lend Owner $20,000, secured by the real estate, to cover the costs of tearing down the old garage and building a new one. Owner, in reliance, tears down the old garage. Lender then refuses to make the loan, and Owner can't get a loan from anyone else because his credit has worsened.

    A court would likely hold that Owner can recover his reliance expenditures (at least the cost of tearing down the old garage, and probably the lessening of value between a dilapidated-but-functional garage to no garage at all) from Lender, on a promissory estoppel theory.[2]

J. At-will jobs and other at-will relationships: Another important domain in which courts sometimes apply promissory estoppel is that of promises to enter or continue in ***at-will relationships.*** Typically, the promisor promises to enter into or continue in an at-will arrangement, and the promisee relies; the promisor then changes her mind. When the promisee sues for promissory estoppel, the promisor defends by saying, "Any relationship would have been at-will, so I was free to change my mind at any time. Therefore, you could not have reasonably relied on my promise."

However, courts have often disagreed with the promisor's argument, concluding that the mere fact that the promise involved an at-will relationship does not mean that reliance upon that relationship's continuation for at least some additional period was *per se* unreasonable.

1. **Promise of at-will job:** Most commonly, this all arises in an employment context: an employer has promised an ***at-will job*** to an employee, and then revokes the promise before the employee shows up for work, or very soon thereafter. Meanwhile, the employee may have ***quit his previous job***, ***turned down other job offerings***, or otherwise relied on the job promise. In this scenario, a court may well hold that even though the employer could have fired the employee at any time after he started the job (in theory, even after a single day), the employer is ***not free to withdraw the promised job*** without giving the employee at least some chance to "show her stuff." Cf. *Grouse v. Group Health Plan, Inc.*, 306 N.W.2d 114 (Minn. 1981).

2. **Promise of continued at-will business relationship:** The "promise of an at-will relationship" scenario can also arise ***outside of the employment context***. There are many at-will arrangements in business. For instance, "sales agency" arrangements are often made, in which one person resells another's goods or services, and either party is free to discontinue the arrangement on very short notice. If one party tells the other that he intends to continue in the arrangement for the time being, and the other relies somehow to her detriment, the court may well use promissory estoppel to allow the relier to recover at least her reliance damages.

   Example: P is a liquor distributor, and D is one of P's largest suppliers. P has recently lost some other large suppliers, and is financially weak. P is now negotiating to sell itself to N, another distributor. P tells D about these negotiations, and says to D that it has received an offer to be purchased by N, but that it will reject N's offer if D assures P that D has no present intention to terminate its supply arrangement with P. D repeatedly assures P that D has no intention of ending the relationship. In reliance, P turns down N's offer. Later that very day, D terminates the supply arrangement. This termination so weakens P that P is forced to go back to N, and to accept a new offer that is $550,000 lower. P sues D on a promissory estoppel theory for the $550,000 price reduction. D defends on the grounds that because the P-D contract was terminable at will, any reliance by P on D's promise was unreasonable as a matter of law.

   Held, for P. P's reliance on D's continuation (at least temporarily) of the contract was probably reasonable and foreseeable to D. Furthermore, the cancellation of the agreement predictably undermined P's bargaining power in the

P-N negotiations, since once the cancellation was publicly announced N knew that P had no choice but to sell or liquidate. Therefore, the reduction in the purchase price was precise and calculable, making it a form of reliance damages (like the damages of an employee who incurs moving expenses to take an at-will job), not a form of non-recoverable expectation damages (like the reduction in P's future profits from the P-D contract.) Consequently, P may recover the price reduction to the extent it was caused by D's failure to keep its promise. *D & G Stout, Inc. v. Bacardi Imports, Inc.*, 923 F.2d 566 (7th Cir. 1991).

K. Duty to bargain in good faith: So far, we have seen the doctrine of promissory estoppel applied to fairly specific promises and offers, such as a promise to pay a pension. But the promissory estoppel doctrine, or something like it, has also been applied to a much more general type of promise: the promise to ***bargain in good faith***. By entering into ***negotiations*** with another party, a person may be found to have ***promised***, either explicitly or implicitly, that he ***will make a good-faith effort to reach agreement with the other party.*** If the court finds that this promise to bargain in good faith has been breached, it can either award contract damages, or damages based on promissory estoppel.

1. **Letter of intent:** For instance, if two negotiating parties sign a ***letter of intent*** in which they agree that they will attempt to reach a binding contract, the court may find that this letter of intent amounts to a promise to negotiate in good faith. The court can then enforce this "contract to negotiate" just as it would enforce any other contract — it can award contract-based damages, and need not expressly rely on promissory estoppel (though the effect is much the same as if promissory estoppel were used). See Farnsworth, p. 206.

2. **Promises of franchises:** Courts sometimes find that a party made an ***implied*** (but nonetheless ***enforceable***) promise to negotiate in good faith. Courts seem most likely to find an implied promise of good faith where the negotiations relate to the award of a ***franchise***.

   a. **The scenario:** Typically, what happens is that a large national corporation (the franchisor) indicates to a prospective franchisee (typically an individual) that the franchisee's application for a franchise will be accepted. The prospective franchisee then incurs expenses in reliance on this promise (e.g., she sells her existing business, or rents retail space). The deal then falls through, and the prospective franchisee sues to recover her losses and possibly the

profits she would have made had the franchise been granted. Courts have frequently been sympathetic to the franchisee in this context, and have sometimes ***awarded damages*** based either on promissory estoppel or on breach of the implied promise to negotiate in good faith. See Farnsworth, pp. 202-03. For instance, they may award P reliance damages equal to sums he spent preparing to receive the franchise.

b. Contractual recovery irrelevant: Liability in the franchise-negotiation situation may exist under a promissory estoppel theory ***even though the contract contemplated by the parties*** (but never entered into) ***would not have been enforceable***. In other words, promissory estoppel is not always, strictly speaking, a substitute for consideration; it does not necessarily enable the court to find an enforceable contract. Instead, it is sometimes a ***separate remedy*** that contains elements of contract, quasi-contract, and tort. This is illustrated by *Hoffman v. Red Owl Stores*, a very significant case set forth in the following example.

Example: P negotiates with D Corp. to become a supermarket franchisee of D Corp. D assures P that if he raises $18,000 worth of capital and does certain other things, he will be given the franchise. In order to conform with D's recommendations and conditions, P sells his bakery, purchases and then resells a small grocery store to gain experience, makes a payment on the site of the proposed store, moves his residence to a location near where the store is to be, and borrows the $18,000 from his father-in-law. D Corp. then decides that as long as the $18,000 is merely on loan to P, his credit standing is not good enough, and tells P that the deal is off unless P can procure from his father-in-law a statement that the $18,000 is a gift rather than a loan. P refuses and sues.

Held, P may recover for all of the out-of-pocket expenses and losses he suffered in reliance on D's promise of a franchise. The promissory estoppel doctrine applies even though at the time of suit the negotiations between the parties were highly indefinite; no agreement had been reached as to such items as "the size, cost, design and layout of the store building; and the terms of the lease with respect to rent, maintenance, renewal, and purchase options." Thus the parties had not finalized the details of their proposed bargain sufficiently enough even to constitute an offer, let alone a contract. Nonetheless, promissory estoppel recovery is awarded on the grounds that such recovery is not "the equivalent of a breach of contract action." See *Hoffman v. Red Owl Stores*, 26 Wisc.2d 683 (1965).

3. Promises by lenders to renegotiate troubled mortgages: Another context in which a promise to negotiate in good faith has occasionally been enforced via promissory estoppel is that of ***discussions between***

mortgage lenders and homeowner/borrowers regarding possible ***modification of a troubled mortgage***. During and after the Great Recession that began in 2008, millions of homeowners had trouble paying their mortgages, and lenders often conducted discussions with these owner/borrowers about possible modifications of the mortgage to avoid foreclosure.

In the typical fact pattern, the lender tells the borrower, "If you first follow certain procedures, we'll then work with you to try to modify your mortgage to help you avoid a foreclosure." The borrower follows those procedures — which may include ***letting the mortgage go into default*** — but the lender then refuses to even discuss a modification, and instead forecloses. A few of these disappointed borrowers have been found to ***state a valid claim*** for promissory estoppel, even where the lender didn't specifically promise to modify the mortgage, and merely promised to negotiate *towards* a possible modification.

a. The *Dixon v. Wells Fargo* case: Probably the leading case of this type is ***Dixon v. Wells Fargo, N.A.***, 798 F.Supp. 336 (D. Mass. 2011).

i. **Facts:** Taking as true the facts recited in the plaintiffs' complaint, here's what happened in *Dixon*. The Ps, a married couple, owned a home with a mortgage held by D (Wells Fargo Bank). At a time when the Ps were apparently under financial distress but had not yet been late on any mortgage payments, they contacted the D to ask about the possibility that D would modify the mortgage to be more affordable to them. D's employee told the Ps that in order for them to be eligible to have the bank consider a modification, the Ps would have to stop making payments on their loan.[3] The employee also instructed the Ps to furnish certain financial information to the bank. Once the Ps stopped making mortgage payments and furnished the information, the employee said, a bank officer would then sit down with the Ps to see whether the loan could be restructured.

(1) **Foreclosure:** The Ps did as D's employee instructed: they stopped making payments, and they submitted the requested financial information. But six months or so after the conversation, without any negotiations to modify the mortgage having occurred, D started a foreclosure

proceeding. The present lawsuit was an attempt by the Ps to get a state-court injunction against this foreclosure, and to have the bank be ordered to resume negotiations for a modification.[4] It fell to the federal judge hearing the suit to decide whether the Massachusetts courts would apply the promissory estoppel doctrine to these facts.

ii. **The holding:** The court concluded that the facts of the complaint, if proven, ***would*** justify application of the promissory estoppel doctrine, entitling the Ps to some sort of relief.

iii. **A reasonably definite "promise":** As the court noted at the outset, the promissory estoppel doctrine requires that the party against whom it is asserted have made a ***"promise"*** — a commitment to do something, or refrain from doing something. And, in fact, the promise must be (as the Massachusetts courts put it) sufficiently ***"definite and certain in its terms"*** to be enforceable.

(1) **Bank opposes:** This requirement that there be a reasonably definite promise was the heart of Wells Fargo's main defense. The bank noted, correctly, that it had never promised the Ps that it would ***actually modify their mortgage.*** At most, it had indicated that if certain conditions were met, the bank would ***begin negotiations*** with the Ps that might culminate in her modification. And the bank never indicated anything about what the contents or outcome of those negotiations would be if they occurred. Thus even if the bank was found to have "promised to negotiate," it argued, that promise was ***fatally indefinite***.

(2) **Argument taken seriously:** The judge conceded that the Massachusetts courts had often rejected, on indefiniteness grounds, similar claims that a defendant's promises to negotiate or to try to reach agreement should trigger promissory estoppel liability.

(3) **The "dangling on a string" scenario:** But the judge

identified one particular type of fact pattern in which, he said, the Massachusetts courts had been especially ***willing*** to apply promissory estoppel to enforce even a somewhat indefinite promise: "where there has been a pattern of conduct by one side which has ***dangled the other side on a string,***" by repeatedly ***misleading*** that other side. These were cases involving ***extended negotiations***, in which the ***powerful defendant*** appeared to have tried to ***get the upper hand*** over the ***weaker plaintiff*** by promising that the plaintiff would receive some desired benefit if he jumped through a series of hoops. In such cases the Massachusetts courts were quite likely to apply promissory estoppel, at least if they believed that the defendant had acted "in a manner ***not consonant with fairness*** and ***designed to induce action by the plaintiff to his harm***."[5]

(4) **"Dangling" fits the facts here:** The facts alleged here by the Ps, the *Dixon* court said, fell within this "unfair dangling" scenario. The bank hadn't just made a promise (to negotiate a modification) that it broke. Rather, the bank had induced the Ps to ***take an action that was foreseeably to their detriment*** (stopping payment and thus ***putting themselves in default),*** and did this for the bank's benefit. As the judge concluded, "where, like here, the promisor ***opportunistically has strung along*** the promisee, the imposition of liability despite the preliminary stage of the negotiations ***produces the most equitable result."***

(5) Trial ordered: Therefore, the judge in *Dixon* ordered a ***full trial,*** in which the Ps would be given a chance to prove their factual allegations. If they could do so, the judge said, he would somehow "enforce" the bank's obligation to negotiate.

iv. **Remedy:** Suppose that at trial in *Dixon*, the Ps were able to prove all their allegations, and the judge applied promissory estoppel. What would be the appropriate ***remedy***? The judge indicated that the appropriate reliance-based measure would probably involve putting the Ps in the position they ***would have been in had they not***

detrimentally relied on the promise of negotiations by stopping payments on their mortgage. Thus the court indicated that reliance damages would consist of ***"returning [the] loan to non-default status,"*** so that if the Ps still couldn't make payments, they could again be foreclosed on. (For more about the reliance aspect of the case, see *infra*, p. 148.)

4. Summary: So cases like *Hoffman* and *Dixon* can be viewed as granting a party to ***unsuccessful negotiations*** recovery for the losses reasonably and foreseeably sustained by him as a result of the other party's ***negligence*** or ***lack of good faith*** during the bargaining process.

a. Alternative rationales: Sometimes the recovery is based upon violation of a "duty to bargain in good faith." At other times it is based explicitly on promissory estoppel — one party's otherwise-unenforceable promises to the other about the probable result of the negotiations is enforced to the limited extent of giving the latter his reliance damages.

b. Typical contexts: Use of promissory estoppel for unsuccessful contract negotiations is most likely to be applied in cases involving ***franchises, government contracts, and mortgage lending to consumers***, all contexts in which there is typically ***great inequality of bargaining power.*** But the doctrine is also sometimes used in other negotiating situations that don't culminate in contracts.

c. Tort law: It may be best to view this trend as bringing an element of ***tort law*** into contract law: the defendant is held blameworthy for intentionally or negligently inducing the other party to rely on the negotiations, and is thus held liable for something akin to misrepresentation. See generally Farnsworth, pp. 202-07.

L. Theories of recovery: Promissory estoppel is based essentially on the idea of reliance, that one who has relied on another party's promise, to his own detriment, is entitled to be made whole.

1. Reliance as damage measure: Therefore, the most common measure of damages in promissory estoppel actions is the ***"reliance"*** measure, by which the plaintiff is ***placed in the position he would have been in***

had the promise never been made. Often, reliance damages consist of the plaintiff's ***"out-of-pocket" expenses*** incurred in reliance on the promise.

> **Example 1:** In *D & G Stout v. Bacardi Imports* (*supra*, p. 143), P was entitled to recover the difference between the purchase offer it turned down in reliance on D's assurances that the P-D contract would continue in force, and the lower offer that P was forced to accept once D reneged. This recovery was in the nature of reliance damages — P was entitled to recover the quite fixed, definite sum that it turned down, not the "profits" that it would have made from a continuation of the P-D relationship.

> **Example 2:** In *Dixon v. Wells Fargo, supra*, p. 145, recall that the Ps were a homeowning couple who let their mortgage go into default in reliance on the bank's promise to negotiate towards a modification of the mortgage if and only if the mortgage was in default. The judge indicated that a reliance-based verdict would involve putting the Ps into the position they would have been in had they not relied to their detriment, i.e., ***"returning their loan to non-default status[.]"***

2. **Other theories of recovery:** Although reliance-based damages are the standard in promissory estoppel cases, there are ***other theories*** of recovery which will in some situations be appropriate.

   a. **Restitution:** The plaintiff may be able to argue that he has ***conferred something of value*** on the defendant, for which the latter should be required to pay. Recovery is thus based on ***restitution***, or prevention of ***unjust enrichment***.

   > **Example:** D, a property owner, asks P, a contractor, to help him plan for putting up a building on D's land. P makes trips to the property, does a survey, and gets data for an application to a government agency, all in the reasonable expectation of being awarded a contract for the work. D then gives the work to another contractor, and P sues for the reasonable value of the work he did. *Held*, P may recover the reasonable value of his services. *Hill v. Waxberg*, 237 F.2d 936 (9th Cir. 1956).

   b. **Expectation measure:** In some promissory estoppel cases, the traditional contract measure of damages, ***expectation*** damages, will be appropriate. The expectation measure places the plaintiff in the position he would have been in had the contract (or here, promise) been fulfilled. Typically, this means that the plaintiff is awarded the ***profits he would have made*** had the promise been kept. (See *infra*, p. 318.)

      i. **Limited view on lost profits:** However, as in the ordinary contract situation, courts will not award lost profits where

these are too ***speculative*** or ***uncertain***. (See *infra*, p. 323.)

Example: In the franchise negotiation context discussed above, it will usually be the case that even had the promised franchise been awarded, it would have been terminable at some point by the franchisor; therefore, a court awarding damages for failure to grant a promised franchise may limit recovery for lost profits to the period up until the earliest time the franchisor could have terminated.

ii. **Lack of good faith:** If the promisor is shown to have acted in ***bad faith***, this fact will weigh in favor of an award of expectation rather than reliance damages. See Rest. 2d, § 90, Illustr. 9.

Example: In *Hoffman v. Red Owl*, *supra*, p. 145, suppose that D knew at the time it made the promise of a franchise to P that the franchise would never be awarded. This fact would have improved P's chances of recovering some profits he might have made from operating of the supermarket (in addition to or instead of the reliance expenditures that he in fact recovered).

M. Promissory estoppel under the UCC: The doctrine of promissory estoppel is not explicitly recognized in the UCC. However, most courts have held that a party to a contract for the sale of goods may nonetheless invoke the doctrine in appropriate circumstances. See W&S, p. 26. Furthermore, in one situation which is sometimes handled by promissory estoppel, the case of an offeror who revokes his offer after inducing the offeree to reasonably rely on it, the Code may supply its own solution: the offer may be irrevocable under § 2-205's "firm offer" provision (*supra*, p. 53).

Quiz Yourself on
PROMISORY ESTOPPEL

36. Mark Antony promises to buy a new barge for his girlfriend, Cleopatra, as a token of his love for her. He shows her the brochure of the model he has chosen and tells her the boat will arrive in five days. Cleo goes out and leases a berth on the Nile, hires a crew, purchases barge accessories, and, most importantly, buys a new sailing wardrobe. Antony changes his mind and never gives her the gift. Can Cleo enforce the promise? If so, what will the damages be?

37. Ali Baba is out hiking on his property one day and stumbles into a hidden cave that is stuffed with ancient treasure. He runs home and calls

his girlfriend, Scheherezade. She is thrilled. Ali tells her, "Naturally, I'll split it with you." The value of Scheherezade's 1/2 of the treasure would be $1 million (in 1999 dollars).

(A) One hour after making the promise, before Scheherezade has even really started to think about what the treasure will mean to her life, Ali has a change of heart. He immediately calls Scheherezade back and reneges on his promise to split the treasure with her. Can Scheherezade recover anything from Ali, and if so, what amount?

(B) Assume that during his initial phone call with Scheherezade, Ali adds, "I know how much you have been wanting that 200-camel-power convertible Porsche. Now you will be able to buy it." As soon as she hangs up the phone, Scheherezade races over to the Porsche dealer and puts a down a $25,000 deposit on the car of her dreams, which has a market value of $250,000. Ali then decides to keep the treasure all for himself. The dealer refuses to refund any part of the deposit, and Scheherezade can't afford the car without the treasure. Can Scheherezade recovery anything from Ali, and if so, what amount?

38. Hound Dogg, a general contractor, wants to bid on a construction project to be done for casino magnate Steve Winner: a hotel in the shape of Elvis Presley. Hound solicits sub-contract bids from a number of electrical sub-contractors, including Elektra Cution. Elecktra's sub-bid on the electrical work comes in the lowest, $1 million. (The next lowest bid, by Juice Corp., is $1.2 million.) Hound figures in Electra's sub-bid into Hound's own master bid, and bids a total of $10 million, on which Hound projects a profit of $300,000 (it's a low-margin industry, unlike operating casinos.) Two hours after Hound submits its bid, Elecktra phones Hound and says, "My bid was due to a terrible computational error. I can't do the job for less than $1.25 million. I revoke my offer to do the job for $1 million." Hound tells Elektra that Elektra must perform if Elektra is awarded the job, but Elektra still insists on revoking.

The terms of Winner's bid-solicitation say that all master bids are final, and that all such bids must be backed by a construction-completion bond (as Hound's bid is.) Hound is awarded the job at $10 million. When Elektra persists in refusing to honor its original $1 million bid, Hound gives the job to Juice for $1.2 million. What, if anything, can Hound

recover against Elektra?

Answers

36. **Yes, but she'll only recover for her reasonable expenditures.** Despite the lack of consideration, Antony's promise is enforceable due to promissory estoppel — Cleo's reliance to her detriment on Antony's promise was both reasonable and foreseeable. Note, however, that a court will generally only enforce a promise under the p.e. doctrine to the extent ***necessary to avoid injustice.*** That generally means that a court will award ***reliance*** damages, rather than specific performance. So here, Antony will not have to buy Cleo a barge, but he will have to reimburse her for all her out-of-pocket expenses. Also, a court might find that although Cleo's basic reliance was reasonable, some of her particular expenditures were not; in that case she wouldn't recover for the unreasonable ones.

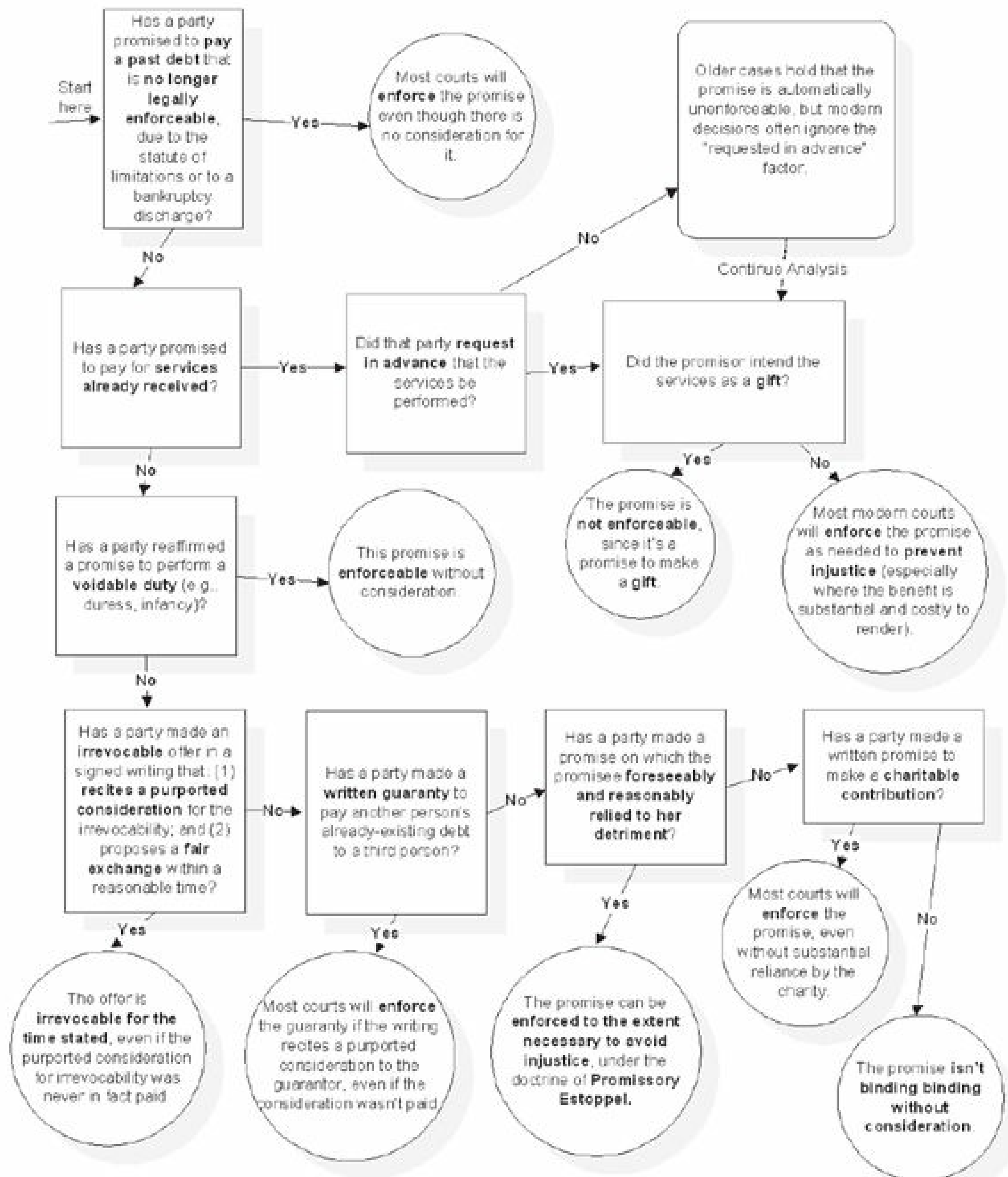
37. **(A) No, because Scheherezade did not suffer a detriment in reliance on Ali's promise.** First, remember that of course promises to make gifts are generally not enforceable, because they're not supported by consideration. Promissory estoppel can overcome this problem, but p.e. only protects against the promisee's reasonable and foreseeable detrimental reliance on the promise. Here, the facts tells us that Scheherezade did not take any action in reliance on the promise before it was retracted. Therefore, there is nothing on which the promissory estoppel doctrine could operate, and the usual "promises to make gifts are not enforceable" rule applies.

    (B) Yes, but only $25,000. Here, unlike in part (A), Scheherezade has reasonably and foreseeably relied on Ali's promise to her detriment. She will therefore be able to enforce his promise under a theory of promissory estoppel. However, the promise will only be enforceable to the extent necessary to prevent injustice, which means that only Scheherezade's reliance expenditures will be protected. In this case, that will mean that Ali will have to reimburse Scheherezade for the forfeited deposit money, since this is the only respect in which Scheherezade has actually relied on the promise.

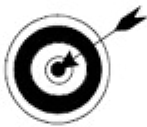
Figure 4-1

Promises Binding Without Consideration

In general, a promise requires consideration in order to be binding. There are several exceptions to this rule, however. Use the chart below to see whether the facts fall within one of the exceptions, making the promise binding without consideration.



38. $200,000. Most courts treat sub-contractors' bids as offers that are temporarily irrevocable for the period necessary to allow the contractor to obtain the job and accept the sub-contractor's bid. The reasoning is based on the theory of promissory estoppel, since the contractor justifiably relies on the sub-contractor's bid. That's what happened here. (If Hound had had the chance to withdraw or amend his own bid to Winner, his failure to do so would have made his continued reliance on Electra's offer unreasonable; but the facts tell us that Hound was stuck with his bid.) The recovery will protect Hound's reliance interest, i.e., the amount by which he was worse off than had Elektra honored her offer. That amount is the difference between Elektra's bid and the next-lowest bid that Hound ended up using, or $200,000.



EXAM TIPS ON PROMISES BINDING W/O CONSIDERATION

- *General Tip:* When a fact pattern contains a contract that you think is enforceable despite the fact that it's not supported by consideration, first discuss your conclusion that consideration is lacking, then discuss why the contract's enforceable regardless of this flaw.

Modification

- **UCC:** A modification of a contract for ***goods*** is enforceable even if it isn't supported by consideration.
  - Look for a ***one-sided change*** in the terms of a sales agreement — even though the change is benefits only one party, it's still enforceable.
    - *Example:* W, a wholesaler of office supplies, contracts with R, a retailer, for the sale of 50 printer cartridges for $450. Two weeks later, W calls R and says that due to a shortage of materials, his costs have increased drastically and that he has to raise the price to $650. R agrees in writing to the change in

price. A few days later R purchases 50 cartridges from another supplier for $500 and later rejects delivery of the cartridges from W. The contract between W and R is enforceable at the $650 price.

- ☞ Watch for the following *traps*:
  - ☞ A modification of an agreement for ***services***. Such a modification must normally be supported by consideration (see prior chapter), and a modification in which only one party's duty changes (and there are no unanticipated circumstances) does not qualify.
  - ☞ A modified agreement that violates the ***Statute of Frauds*** (i.e., the sales price is greater than $500 and the modification is not in writing). The modified contract will be unenforceable, not because of consideration problems but because of the lack of a writing reflecting the change. (See Ch. 9.)
  - ☞ A ***"no oral modification"*** (N.O.M.) clause. In both UCC and non-UCC cases, a N.O.M. clause will be enforced (so even consideration won't save an oral modification that violates such a clause).
    - ☞ But remember, an N.O.M. clause can be ***waived***. So if one party foreseeably relies to her substantial detriment on the other party's oral promise to modify the agreement, despite an N.O.M. clause, you should argue that promissory estoppel dictates that the promise be enforced to the extent needed to protect the person who relies.

Example: Contractor agrees to paint Owner's house for a stated price, work to be completed by August 15, with time of the essence. The contract says that there may be no oral modifications. Contractor's worker gets sick, so Contractor orally asks Owner to give him til Sept. 1. Owner says ok. Contractor relies on the extension, and finishes on Sept. 1. The N.O.M. clause will be deemed waived because a waiver is needed to protect Contractor's reliance interest.

Assignment

- ☛ If the fact pattern involves an assignment of rights or duties, remember that ***consideration isn't required*** because an assignment is a present transfer of rights, not a promise.

Guaranty

- ☛ When you have one person guaranteeing another's debt, look at the timing of the guaranty:
  - ☞ If the guaranty is given ***at the same time the debt is being created***, there is no problem of consideration because the guarantor is bargaining for the loan (even though the loan is given to someone else).
  - ☞ When the guaranty is given ***after the underlying debt has been created***, see if there is any independent consideration. If not, point out that most modern courts hold that the guaranty is enforceable if it's in writing and includes a ***recital*** of consideration — even if no consideration is actually paid.

Promissory Estoppel

- ☛ In the absence of consideration, a contract is enforceable if the promisee ***foreseeably and reasonably relies*** upon the promise to her detriment.
- ☛ Look for fact patterns in which a ***powerful business*** (call it *A*) ***"strings along"*** a less powerful business or consumer (*B*), by indicating over a period of time that if *B* takes various actions, *A* will consider forming some business relationship with *B* to *B*'s benefit. (*Example: A* is a bank, and promises *B*, a borrower with a cash shortage, that if *B* stops making payments, *A* will consider modifying the mortgage.) Courts are especially likely to order P.E. in this "stringing along" situation.
- ☛ Most tested issue: Has there been ***actual reliance***? Look for these common scenarios where reliance has occurred:
  - ☞ **Intra-family promises and oral promises to convey land.** The problems otherwise encountered in these two situations may be surmountable if you can show foreseeable detrimental reliance.

Example: After being told of Daughter's engagement, Father promises her a new home as a wedding present. He shows her the plans and promises that he will build the house on a lot which he owns. Daughter is so pleased with the plans that she immediately cancels a contract which (as Father knows) she has already made for the purchase of a different home, forfeiting a $20,000 deposit. After Father has caused the home to be half-way built, he refuses to complete it or to convey the land to Daughter.

Father's promise (to make a gift) is unenforceable as a contract, since it was given without consideration (Father didn't bargain for Daughter to cancel her prior contract.) However, Daughter may be able to use promissory estoppel to argue that the agreement should be enforced, at least to the extent of reimbursing her for the lost $20,000 deposit, since her reliance on Father's promise seems to have been reasonable, and foreseeeable to him.

- ☞ **Sub-contractor's bid.** If the sub-contractor's bid is relied upon by the general contractor when he submits his overall bid to the customer, the sub-contractor is promissorily estopped from revoking the bid for the time necessary for the general contractor to receive the job and accept the sub-contractor's bid.

  - ☞ *Exception 1:* There's probably no promissory estoppel if the general contractor would still have ***time to revise its bid*** to the potential customer.

    Example: C, a general contractor, has a 3:00 pm deadline for submission of a bid to a potential customer and he solicits bids from sub-contractors for the job. S, a sub-contractor, submits his bid to C at 1:30 pm. C, relying on S's bid, immediately submits his overall bid to the potential customer. S, realizing he has made a mistake in calculating, calls C at 2:58 to withdraw the bid and revise it. S is promissorily estopped from revoking his bid because C reasonably relied on it in submitting his overall bid to the customer. However, if the revocation call from S had come in at 1:40, and there was time for C to revise his bid by taking the next-lowest sub-bid, then C's promissory estoppel argument would probably not work.

  - ☞ *Exception 2:* The sub-bid (like any promise covered by promissory estoppel) is only enforceable "to the extent ***necessary to avoid injustice.***" So if the next-lowest bidder is only $x more, the general contractor's recovery will presumably be limited to $x (and the general won't have the right to recover expectation damages as in the ordinary case of breach).

- ☛ In any p.e. fact pattern, after you have spotted reliance, make sure it's ***justified,*** i.e., ***reasonable***. Confirm that there has been an ***express or***

implied promise.

> **Example:** Sub, a sub-contractor, submits a bid to General, a general contractor on a project. General responds, "Right now you're the low bidder, so if nothing changes and I get the contract, you'll get the work." Sub then reads in the paper that General got the contract. Therefore, Sub buys $30,000 of materials for the job, which have only scrap value if not used on the job. General gives the job to X, a different sub-contractor who bid $1 more than Sub. Probably Sub's reliance on continuing to be the low bidder, and thus getting the job, wasn't reasonable. If so, she won't collect the $30,000 she spent (let alone the profits she would have made had she gotten the job and performed).

☛ Remember that a ***promise to donate money to charity*** is generally not supported by consideration. However, most courts will apply the doctrine of promissory estoppel — even if there ***hasn't been detrimental reliance*** — if the promise to donate is ***made in writing***.

---

1. If *A* intends a gift, then pretty much all courts agree that a later promise by *B* to pay for the services should not be enforced. See Rest. 2d § 86(2)(a) (denying enforcement for any benefit intended as a gift).

2. Note that on the facts as stated, Owner can't recover under standard contract principles, because he hasn't given any consideration in return for Lender's promise of a loan. If, however, Owner had promised that he would use Lender, rather than some other lender, if he decided to borrow (or if Owner had paid an application fee), that promise or fee *would* have constituted consideration for Lender's promise, and promissory estoppel would not be needed.

3. Although the opinion does not say so, apparently the loan-modification program being run by D applied only to borrowers who were no longer making timely mortgage payments. In other words, the employee of D who spoke to the Ps seems to have correctly described this "you must be in default" requirement of the modification program.

4. The opinion is by a federal district judge in Massachusetts because the bank, as a non-Massachusetts citizen, exercised its right to remove the case from state to federal court.

5. Note that *Hoffman v. Red Owl Stores*, *supra*, p. 145, falls quite neatly into this "stringing along" fact pattern, so presumably the Massachusetts courts would agree with the application of promissory estoppel in *Hoffman*.

CHAPTER 12
IMPOSSIBILITY, IMPRACTICABILITY, AND FRUSTRATION

ChapterScope

This chapter covers situations where, after the formation of a contract, unexpected events occur which affect the feasibility or possibility of a party's performance and cause the parties to be ***excused from continued performance*** under the contract. Key concepts:

- **Impossibility:** If performance by a party has been made literally ***impossible*** by the occurrence of ***unexpected events***, then the contract may be discharged. Common situations where a party's performance is rendered impossible include:
  - ☐ ***Destruction or unavailability of the subject matter*** of the contract;
  - ☐ ***Death or incapacitating illness*** of a party;
  - ☐ ***Supervening illegality*** (where a contract is legal when it is entered into, but a subsequent change in the law renders its performance illegal).
- **Impracticability:** If performance by a party has been made highly ***impractical*** by the occurrence of unexpected events, then the contract may be discharged.
- **Frustration of purpose:** When unexpected events completely or almost completely ***destroy a party's purpose*** in entering into the contract, the parties may be excused from performing.
- **Remedies:** When a contract has been discharged because of one of the above reasons, most courts allow parties to ***recover in quasi-contract.*** The measure of damages will be either ***restitution*** damages (the value of the benefit conferred by the plaintiff on the defendant) or ***reliance*** damages (expenditures the plaintiff made in partly performing or preparing to perform).

I. INTRODUCTION

A. Nature of the problem: During the performance of a contract, events may occur which were unexpected by either of the parties at the time of contracting, and which affect the feasibility or even the possibility of

performing the contract. To deal with these kinds of unexpected events, the law provides that the parties may be ***discharged*** from performing the contract if:

[1] performance is ***impossible*** (the doctrine of ***"impossibility"***);

[2] performance is not impossible but is much more ***burdensome*** or difficult than was originally expected (the closely-related doctrine of ***"impracticability"***); or

[3] because of new events, the fundamental ***purpose*** of one of the parties has been ***frustrated*** (the doctrine of ***"frustration"***).

If a party is "discharged" from performing for such a reason, he is ***not liable*** for breach of contract. See Rest. 2d, Ch. 11.

B. Risk allocation: The doctrines of impossibility, impracticability and frustration, discussed in this chapter, are essentially ***gap fillers***. That is, these doctrines will be applied to discharge a party from performing only when ***the parties themselves did not allocate the risk*** of the events which have rendered performance impossible or impracticable, or which have frustrated the purpose of the contract.

1. Parties' right to agree otherwise: Thus the parties are always free to agree that various contingencies which would render the contract impossible, etc., under the usual rules will ***not*** discharge the contract. Similarly, they are free to agree that certain contingencies ***will*** discharge the contract, even though these contingencies would not be sufficient, in the absence of an agreement, to fall within the doctrine of impossibility, etc.

C. Supervening impossibility: This chapter deals with ***supervening*** impossibility, i.e., impossibility which results from events occurring after the formation of the contract. Impossibility due to facts existing at the time of contracting (but unknown to one or both parties) is usually treated as mistake or fraud; see *supra*, p. 156.

D. Subjective vs. objective impossibility: Courts sometimes say that for impossibility to discharge a party, the impossibility must be ***"objective"*** rather than ***"subjective."*** As the Second Restatement puts it, "It is the difference between 'the thing cannot be done' and 'I cannot do it'." Rest. 2d, § 261, Comment e. It is often hard to tell whether a particular

event renders performance “subjectively” or “objectively” impossible. The question arises most frequently in the following kinds of situations:

1. **Financial inability:** If a party’s ability to perform is destroyed by his own ***insolvency*** or lack of the necessary capital, he may ***not*** use the impossibility defense. The impossibility is “subjective,” in this situation, since it is only from the viewpoint of the party who is financially incapacitated that performance appears impossible. C&P, p. 520.
2. **Strikes:** If a ***party’s own employees*** go on strike, most courts do not allow that party to use the impossibility defense. Some courts reach this result by saying that the struck party’s inability to perform is “subjective,” and that therefore she is not excused. Others hold that the inability is the struck party’s “fault,” thus denying her use of the doctrine. C&P, p. 507.
3. **Death or illness:** When a party who has contracted to give personal services dies or becomes ***too ill to perform***, it might be thought that her impossibility would be “subjective,” and that therefore she would not be excused. However, the courts have taken the view that there ***should*** be a discharge in this situation, as long as it is clear that the contract was one for personal, non-delegable services. This subject is discussed further *infra*, p. 440.

> **Note:** Many modern courts, instead of trying to determine whether a particular event rendered performance “subjectively impossible” or “objectively impossible,” simply try to determine whether the parties in fact allocated the risk of the event, and, if they did not, which party they would have cast the risk upon had they thought about it. In a case involving the insolvency of one party, for instance, a modern court might take the view that each contracting party impliedly bears the risk that it will be financially unable to perform, and would thus refuse to allow the impossibility defense. C&P, p. 520.

II. IMPOSSIBILITY OF PERFORMANCE

A. Supervening impossibility generally: Of the various kinds of events which can take the parties to a contract by surprise, the sort that present the clearest case for discharging the contract are those which render its performance ***literally impossible***. The most common categories in which the court is likely to find literal impossibility are:

[1] ***destruction*** or other unavailability of the subject matter of the

contract;

[2] failure of the agreed-upon ***means of performance***;

[3] ***death or incapacity*** of a party; and

[4] ***supervening illegality***.

B. Restatement approach: The Second Restatement illustrates the modern view of impossibility. (The Restatement doesn't use the term "impossibility" at all; it speaks only in terms of "impracticability," but uses this term to include cases that have traditionally been thought of as involving impossibility.) Here's what the Restatement says, in § 261:

> "Where, after a contract is made, a party's performance is made ***impracticable without his fault*** by the occurrence of ***an event the non-occurrence of which*** was a ***basic assumption*** on which the contract was made, his duty to render that performance is ***discharged***, unless the ***language or the circumstances*** indicate the contrary."

1. Summary of Restatement approach: So a party who wishes to be discharged on the grounds of impossibility/impracticability must show the following things:

- ☐ that the event occurred ***after the contract was made***;
- ☐ that the event was one whose non-occurrence was a ***"basic assumption"*** on which the contract was made;
- ☐ that the event was not the ***fault*** of the party seeking the discharge; and
- ☐ that the ***language or circumstances*** don't dictate that discharge should be denied (e.g., because the parties ***allocated the risk*** of the event to the party now seeking to use the impossibility doctrine).

C. Destruction or unavailability of the subject matter: If performance of the contract involves particular goods, a particular building, or some other tangible item, which through the fault of neither party is ***destroyed***, or otherwise made unavailable, the contract is ***discharged***. The discharge of the contract will occur only where the particular subject matter is ***essential*** to the performance of the contract. If the subject matter is of collateral importance, the contract will be only partially discharged, as explained below.

1. ***Taylor v. Caldwell:*** The doctrine of impossibility through destruction of the subject matter was laid down in *Taylor v. Caldwell*, 122 Eng.

Rep. 309 (K.B. 1863), discussed in the following example.

> **Example:** P contracts to hire D's music hall for a series of concerts. After the contract is signed, but before the first of the concerts, the hall is destroyed by fire. *Held*, D is discharged from performing, and his failure to perform is therefore not a breach of contract. The parties regarded the continued existence of the hall as the "foundation" of the contract, and the contract contained an "implied condition" that both parties would be excused if the hall ceased to exist. *Taylor v. Caldwell, supra*.

2. **Determining subject matter of the contract:** The most difficult issue in the destruction-of-essential-subject-matter cases is that of determining whether the contract calls for a particular subject matter, or merely a ***kind*** of subject matter, of which the destroyed items are one example. The difficulty is illustrated by the following example.

> **Example:** Brick Co. is a manufacturer of standard size bricks used for ordinary construction work. The company contracts to sell 1 million bricks to Contractor, to be delivered on June 1. Brick Co. expects to supply the bricks from its own production, and Contractor assumes that this is how Brick Co. will obtain the bricks. But Contractor does not care whether the bricks are Brick Co.'s own product, or are bought by Brick Co. from some other source. The contract does not specify where Brick Co. is to procure the bricks. Just as Brick Co. is preparing to manufacture the bricks which it expects to supply to Contractor, its plant is burned down. Brick Co. could buy the bricks from some other source, but the market price is at this point higher than the price which is set by the contract. Does the destruction of Brick Co.'s plant discharge Brick Co. from performing the contract under the impossibility doctrine?
>
> Most courts would probably hold that since the contract does not specifically require Brick Co. to produce the bricks itself, and since it could perform by buying them elsewhere (albeit at a loss), Brick Co. is ***not*** discharged. These courts would in effect be holding that the subject matter of the contract was any standard bricks, not just bricks produced by Brick Co.'s own plant. If, on the other hand, the contract explicitly required production of bricks by Brick Co., in its own plant, the contract probably would be discharged. See C&P, pp. 499-500. Also, even if the contract said nothing about where the bricks were to be produced, Brick Co. might obtain a discharge under the doctrine of ***impracticability***, discussed below.
>
> **Note:** UCC § 2-615(a), discussed below, would discharge Brick Co. only if the continued existence of its plant was a "basic assumption on which the contract was made." This test in effect lumps the defenses of impossibility and impracticability together.

3. **General rule:** If property which the performing party expected to use is destroyed, that party is discharged only if the destroyed property was ***specifically referred to*** in the contract, or at least understood by ***both*** parties to be the property that would be used. It is not enough that the party who seeks discharge by impossibility intended to use

the destroyed property. This rule is applied in construction cases, building repair cases, and contracts for the sale of goods.

4. **Contract to build a structure from scratch:** Suppose that a building contractor contracts to construct a building ***from scratch*** on particular land. (Distinguish this from renovating an existing building, discussed in Par. (5) below.) If the building is ***destroyed by fire*** when the contractor has almost finished, may he claim impossibility, so as to be discharged from the contract? Or must he start all over again?

   a. **Majority rule:** Most courts hold that the contractor in this situation may ***not*** use the defense of impossibility, on the theory that the contract did not provide for the building of the particular structure that was destroyed, but simply for the building of *some* structure. Under this view, the builder can and must begin anew.

   b. **Recovery where impossibility defense allowed:** Even in those courts which *would* allow the contractor to use the impossibility defense where her partially completed building is destroyed, the contractor will probably not come out whole. The impossibility defense ***merely permits her to avoid having to rebuild, and to avoid liability for damages for breach.*** It will not help her to ***recover on the contract for the work she did before the destruction.*** However, it is possible that the contractor will be able to recover in quasi-contract for the value of the partially-built structure as it existed just before the destruction.

   c. **Destruction due to soil conditions:** Suppose the structure being built is destroyed not by fire but as the result of ***poor soil conditions*** (e.g., the building is built on quicksand, which caves in before completion). Here, the contractor is even less likely to be discharged than in the destruction-by-fire scenario. Courts typically hold that the contractor implicitly ***assumed the risk*** that the soil conditions would not be appropriate. See, e.g., *Stees v. Leonard*, 20 Minn. 494 (Minn. 1874).

5. **Building renovation:** Where a party contracts to ***renovate or repair*** an ***existing*** building, on the other hand, he will usually be ***discharged*** if the building is destroyed. As some courts would put it, the building to be renovated or repaired was the specific subject matter of the

contract, and its destruction discharges the parties' obligations. Or as a modern court might reason, the continued existence of the building was a basic assumption upon which the contract was based.

a. **Quasi-contractual recovery:** The owner of the destroyed premises is also discharged from making payment on the contract, since his duty of payment was constructively conditional upon the contractor's performance — see *supra*, p. 215. However, the contractor will be ***entitled to recover in quasi-contract***, at least for the value of the work which he did before the premises were destroyed (i.e., his restitutionary interest measured as of the time immediately before the destruction.) Some courts permit the contractor to recover not only his restitutionary interest, but also his reliance damages, including materials that were destroyed at the jobsite, and other expenses incurred in preparation (e.g., tests, drawings, etc.). See C&P, p. 503.

6. **Contracts for the sale of goods:** Where a contract is for the sale of goods, the "subject matter" of the contract may be destroyed in any of several ways. First, the seller's means of obtaining or producing the goods may be destroyed or otherwise rendered unavailable. Secondly, the contract may call for the sale of particular identifiable goods, which are destroyed after the contract is made. Thirdly, the contract may not refer to specific, unique goods, but instead call for any conforming goods that the seller wishes to take out of his inventory. In this last situation, the destruction or loss of the goods may occur before they are shipped, during shipment, or after delivery.

   a. **Destruction of source of supply or means of production:** The contract may contemplate that the seller is to procure the goods from a particular source, or that he is to produce them himself. If the source becomes unavailable, or the seller's own means of production is rendered unusable, the seller will frequently try to obtain a discharge from the contract by using the doctrine of impossibility.

      The relevant UCC section in this situation is § 2-615(a), which provides that unless otherwise agreed, "delay in delivery or non-delivery … is not a breach of [seller's] duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was

a ***basic assumption on which the contract was made.…"*** This test is a non-mechanical one, and is designed to allow the court to "allocate the risk" between the parties, based on what it thinks the parties would have done if they had thought about the question.

i. **Failure of source of supply:** If the contract makes it clear that the parties agreed that the goods would be procured by the seller from a ***given source***, failure of production by that source "should, if possible, be ***excused*** since production by an agreed source is without a more basic assumption of the contract." (Comment 5 to § 2-615.) But if the seller is excused because of the failure of his source of supply, he may be required to turn over to the buyer his own right to sue his supplier for breach. *Id*.

ii. **Failure of production:** If the parties contemplate that the seller will ***produce the goods herself***, and her means of doing so is destroyed by factors beyond her control, she will be discharged from performing, on the grounds that the destruction of facilities was a "contingency the non-occurrence of which was a basic assumption of which the contract was made.…"

iii. **Partial failure:** If the failure of the seller's source of supply or means of production affects only ***a part*** of his capacity to perform, "he must ***allocate*** production and deliveries among his customers but ***may at his option include regular customers not then under contract*** as well as his own requirements for further manufacture. He may so allocate in ***any manner which is fair and reasonable***." (§ 2-615(b)).

(1) **Reasonable allocation:** In other words, the seller may give the buyer under the contract only a portion of the goods called for under the contract, as long as he is ***allocating the goods among his various customers in a reasonable manner.***

b. Destruction of identified goods: Some contracts call for the delivery of particular, ***identified***, unique goods. A contract for the sale of a particular painting is an obvious example of such a contract. A contract for the sale of a piece of machinery, prior to

the signing of which the buyer tests and selects a particular machine in seller's inventory, is another. If after the signing of the contract the goods are destroyed, lost, or otherwise harmed by the negligence of one party, that party must of course bear the loss. But if casualty to the goods occurs without fault of either party, § 2-613 sets up special rules for allocating the loss.

i. **Where risk of loss has not passed:** If the casualty occurs "before the risk of loss passes to the buyer," the contract is "avoided" if the loss is total. (§ 2-613(a)). (The time at which the risk of loss passes to the buyer is determined by a series of rules which are discussed below.) "Avoidance" of the contract where the risk is still on the seller at the time of casualty means that the seller in effect receives the benefit of the impossibility defense — she is discharged from the contract, and is not liable for breach. The buyer is also discharged.

ii. **Where risk of loss has passed to buyer:** If the "risk of loss" has already passed to the buyer before the casualty (as it might in an "FOB Seller's Plant" contract — see *infra*), the buyer must suffer the full effect of the loss. That is, he is liable to the seller for the full contract price even if he never gets any value from the goods.

iii. **Partial loss:** If the goods are only ***partially lost***, or have ***deteriorated*** in such a way that they do not conform to the contract, and the risk of loss has not yet passed to the buyer, the buyer can inspect the goods and has a choice between either cancelling the contract (in which case neither party is liable), or accepting the goods with an allowance for the non-conformity (but with no right to sue for breach). (§ 2-613(b).)

c. Goods not identified at the time of contracting: In the most common case, the contract will call for goods to be taken from the seller's ***general inventory***, not for particular identified goods. In this situation, the UCC provides precise rules for determining who bears the loss when casualty occurs at various stages. See § 2-509.

i. **Destruction of inventory or source of supply:** If the seller's whole inventory is destroyed, or his source of supply becomes

unavailable, the question is resolved, as stated above, by determining whether the continued inventory or source of supply was a "basic assumption" when the contract was made.

ii. **Contracts requiring shipment:** Once the seller selects particular goods from his inventory or acquires particular goods from another source, the passage of the risk of loss will depend mostly on how the goods are to be delivered. In the usual case where the contract requires the seller to ship the goods by a carrier (e.g., a truck or plane, but not one belonging to the seller herself), the risk of loss will depend on whether the contract is a "shipment" contract or a "destination" contract.

(1) **FOB Seller's plant:** If the contract states that the seller's only obligation is to deliver the goods to the carrier (this is a "shipment" contract and is usually indicated by the words ***"FOB Seller's plant"***), the ***risk of loss passes to the buyer as soon as the seller delivers the goods to the carrier.*** If the carrier loses the goods, the buyer bears the loss, and must pay the purchase price.

(2) **FOB Buyer's place of business:** If, on the other hand, the contract obligates the seller to see that the carrier delivers the goods to the buyer (a "destination" contract, usually indicated by the words ***"FOB Buyer's place of business"***), the risk of loss does not pass to the buyer until the carrier actually delivers. In such a contract, if the ***carrier loses the goods***, the ***seller bears the risk*** of loss. She is liable for breach of contract, just as if she had never delivered the goods to the carrier.

D. Impossibility of intangible but essential mode of performance: Just as a tangible object needed for performance may be destroyed or rendered unavailable (see above), so an ***intangible*** aspect of a performance may be rendered impossible. If this intangible aspect of the contract is an ***essential and critical*** part of the contract, the entire contract may be discharged.

1. Defective or unrealistic specifications: Contracts, particularly ones

made with the government, often require a party to conform to particular ***specifications*** furnished by the other party. Not infrequently, these specifications turn out to be either defective (in the sense that they will not produce the desired result if followed) or unrealistic (in the sense that they are difficult or impossible to meet, although if met they would produce the desired result.) The party who is obligated to meet the specifications generally seeks to escape the contract by a claim of impossibility, and also frequently seeks to recover expenses which she has incurred in trying to meet the impossible requirements. The success of her impossibility claim usually turns on whether the party furnishing the specifications is held to have impliedly warranted that they would be feasible and produce the desired result.

a. **Warranty of specifications:** When one party unilaterally prepares the specifications, most courts hold that it ***impliedly warrants*** that satisfactory performance will result if the specifications are followed. This is particularly likely to be held to be the case where the specifications are prepared by the ***government***. If the specifications are defective in that they do not produce the result required under the contract, the performing party is often ***discharged*** from the contract, and is also awarded the expenses he incurred in trying to perform. Alternatively, the party who prepared the specifications may be held to have breached an implied warranty (that the plans were adequate) and the other party may recover damages for the breach. See, e.g., *U.S. v. Spearin*, 248 U.S. 132 (1918).

b. **State of the art not sufficient to meet specifications:** If, on the other hand, the difficulty is that current technology is not sufficient to meet the specifications themselves (rather than that meeting the specifications does not produce the contracted-for result), the supplier will often be held to have assumed the risk that she would not be able to develop the necessary "break through," and she will not be discharged or awarded costs of attempting to perform.

   i. **Mutual mistake analysis:** But where both parties believe, at the time of contracting, that the state of the art is sufficient to allow the specifications to be met, courts sometimes discharge

both parties on the grounds that a “mutual mistake” has been made.

ii. **Specifications drawn by vendor:** If the specifications are drawn up by the ***vendor***, rather than the purchaser, and it turns out that the state of the art is not sufficient to enable the vendor to meet the specifications, he is unlikely to be excused from performing. In this situation, he will almost inevitably be held to have ***implicitly borne the risk*** of not being able to make the necessary breakthrough.

2. **Impossibility due to failure of third person:** A promisor may be unable to perform because of a third person’s failure to cooperate with him. The most common example of this is where a ***middleman*** contracts to supply goods that he and his buyer both expect him to procure from a given source, and the source cannot or will not supply the goods to the seller. In this situation, the courts have in some cases allowed the seller to use the defense of impossibility.

   a. **Source not specified in contract:** If the contract ***does not specify the source*** from which the seller is to obtain the goods, then the seller whose source does not pan out is almost always ***out of luck.*** This is so not only where the supplier simply refuses to deal with the seller, but also where the supplier breaches a contract that she has with the seller to supply the goods.

   b. **Where seller is unable to make contract with supplier:** If the contract between the seller and buyer contemplates that the seller will procure the goods from a ***given supplier***, and that supplier is ***unwilling to contract*** to sell the items to the seller, the seller may generally ***not*** assert an impossibility claim. The seller will normally be held to have ***impliedly borne the risk that she would be unable to make the necessary contract*** to procure the goods.

   c. **Where seller’s supply contract is breached:** But if the contract contemplates that seller will arrange to get the goods from a particular supplier, seller does make a contract with this supplier, and the supplier ***breaches***, most courts ***will*** discharge the seller from his contract with the buyer, on the grounds of impossibility (or, in the jargon of UCC § 2-615, “impracticability”).

Example: Selland contracts to buy four school bus bodies from King. (Selland plans to put each body on top of a chassis that it will buy from another source, GM.) The written agreement states that the bodies will be supplied by Superior Manufacturing. After the contract is signed, Superior goes out of business without ever delivering the bodies to King. Meanwhile, Selland has purchased the chassis from GM, and has to sell them at a loss when it can't get the bodies. Selland sues King for its losses on the chassis.

Held, for King (D). Supply of the bus bodies made by Superior was a basic assumption on which the contract was made, especially since Superior was specified in the contract as the source of the bodies. Neither party had any reason to anticipate the financial weakness of Superior, or that it would go out of business. Therefore, King cannot be said to have assumed the risk of Superior's insolvency. Consequently, the case is covered by UCC § 2-615, and King is not liable for breach. *Selland Pontiac-GMC, Inc. v. King*, 384 N.W.2d 490 (Minn. Ct. App. 1986).

Note: In the above example, the court was clearly justified in discharging King on the grounds that the Selland-King contract was expressly made conditional on Superior's performance of his contract with Seller. In other words, the parties can be said to have expressly allocated the risk of Superior's non-performance to Selland. In other situations, however, the court may conclude that the middleman seller and his buyer implicitly agreed that the risk of default by the seller's supplier would be borne by the seller. In determining whether to allow the impossibility defense in this middleman situation, the question to ask is "How did the parties allocate the risk?" If the answer is unclear, the question is then "How would the parties have allocated the risk had they thought about it?"

d. **Breach by third persons in non-goods contracts:** In non-goods cases, the same considerations generally apply to a party whose performance is rendered impossible by a third person's breach. If the contract is held to be conditional on that third person's performance, there will be a discharge. If the party whose performance requires a third person's performance can be said to have impliedly borne the risk of that third person's breach, she will not be discharged.

E. **Death or illness:** The ***death or illness*** of someone connected with a contract may prompt an attempt by either party to have the contract discharged for impossibility. The result depends in large part on whether the contract called for (or contemplated) performance by the particular person.

1. **Death or illness of a party:** First, let's look at the death or illness of a ***party to the contract.***

a. **No personal services by that party:** If a contract does ***not*** call for

significant personal services by a party, that party's ***death*** or ***incapacity*** generally does ***not*** terminate or discharge the contract. The reason for this is that the ill or dead person's duties can be ***delegated*** to some other person, and the contract continued. For instance, if a party is merely to pay money, or do some other duty that could easily be done by another, there will be no discharge.

Example: Boss hires Guy to run Boss' candy store, which Boss owns as a sole proprietorship. The contract is for two years. Boss is an absentee owner, who checks the books once a month and pays the bills. One year into the agreement, Boss dies.

Boss' estate will not be entitled to have the contract discharged, because the Boss-Guy agreement does not contemplate that material personal services will be performed by Boss, and whatever administrative tasks Boss used to do can be performed by someone else. Therefore, Guy can demand that Boss' estate fulfill the agreement.

b. Personal services by that party: But if the contract provides that performance shall be made by a ***particular individual*** who is a party, that person's death or incapacity will ***discharge both parties*** from the contract. This is true not only where the contract explicitly requires performance by the particular party, but also where the surrounding circumstances indicate that a personal relationship was intended.

Example: Same initial facts as the previous example. Now, 10 months into the contract, assume that Guy becomes permanently disabled, so he can't run the store anymore. Since the contract manifests an intention that Guy be the one who does the actual task of running the store, both parties will be discharged on account of Guy's disability — Guy can't sue Boss for breach, but neither can Boss sue Guy.

2. Death or illness of a third person: A contract may similarly be discharged by virtue of the death or illness of some ***third person***, who is necessary to performance of the contract but who is not himself a party to it. Again, the issue is whether that the contract language or the surrounding circumstances indicate that the third person's participation was a basic assumption on which the parties both relied, and the risk of which was not allocated by the contract to the party now seeking a discharge.

Example: P, a theater owner, contracts with D, the manager of Great Lungs Opera Co., an opera company, whereby D promises to supply Great Lungs for a three week engagement. Maria Callous, the principal diva of Great Lungs, without whom the company cannot reasonably perform, becomes ill. D will be discharged from

the contract as a result of Callous' illness, unless there is some indication that the parties intended to place the risk of such illness on D.

3. **Threat of illness or death:** A personal service contract may be discharged because a person necessary for its performance reasonably ***fears*** that he will suffer serious illness or death if he performs.

Example: D, an impresario, contracts to present a play starring Walter Huston in P's theater. Prior to performance, Huston reasonably becomes concerned that he is getting throat cancer, and on the advice of his doctor cancels and undergoes medical treatment. It turns out that Huston is not getting cancer after all. P sues D for breach.

Held, for D. Huston's fears were reasonable, and his cancellation discharged D from the contract. See *Wasserman Theatrical Enterprise, Inc. v. Harris*, 137 Conn. 371 (1950).

4. **Must not be a contrary allocation of risk:** Again, you must always keep in mind that the general principle stated here — that the death or illness of one who was to perform significant services under the contract will lead to discharge of the contract — applies only if the parties ***have not allocated the risk otherwise*** (to the person now seeking discharge).

Example: Same facts as the prior example (the impresario presenting Walter Huston). Now, assume that Huston's stated fears of illness were completely unreasonable, and that he was really just trying to weasel out of his deal with D, the impresario. Here, even though D would not be at fault vis a vis P (the theater owner), a court would probably hold that in a contract between a theater owner and an impresario, the impresario normally bears the risk that the "talent" will break his contract with the impresario. If so, D would not have been discharged under the impossibility doctrine.

F. Supervening illegality: If performance of a contract would, at the time of contracting, be prohibited by law, the contract itself is called "illegal," and neither party is required to perform it. This kind of contract is dealt with in the chapter on illegality, *infra*, p. 460. But it may happen that a contract is legal at the time it is entered into, but its performance is prevented by a subsequent change in the law. In this situation, the ***"supervening illegality"*** is treated as a kind of impossibility, and the contract is discharged.

Example: Contractor contracts to renovate a building owned by Owner in a coastal city, the work to be performed during October. A hurricane strikes the city in September, and the city forbids any new construction projects during the month of October because of the ensuing chaos. Performance is impossible, and both parties

will be discharged from the contract.

1. **UCC:** The UCC makes the "supervening illegality" defense available to a ***seller***. § 2-615(a) provides that "delay in delivery or non-delivery in whole or in part by a seller … is not breach of his duty … if performance as agreed has been made impracticable … by compliance in good faith with any ***applicable foreign or domestic governmental regulation or order*** whether or not it later proves to be invalid."

> **Note:** The UCC does *not* make the "supervening illegality" defense available to a *buyer*. Nor does it explicitly give the buyer a general impossibility defense analogous to that given to seller where a contract has been made "impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made.…" (§ 2-615(a)). See the discussion of this provision *supra*, p. 435.

G. Temporary impossibility: Events may render performance of the contract only ***temporarily*** impossible. The illness of a party who is to perform personal services, for instance, may merely prevent him from performing on time, not forever. "Temporary impossibility" ***suspends the duty of performing*** until the impossibility ends. See Rest. 2d, § 269. If, however, after the temporary impossibility ceases, performance would be much more burdensome on either party than had it occurred on time, the contract may be completely discharged. Hardships on both the party whose performance is temporarily prevented, and on the other party who is awaiting performance, are weighed in determining when the contract should be discharged rather than merely suspended.

> **Example:** Seller contracts to custom-manufacture and supply certain widgets to Buyer, delivery to occur no later than August 1 (90 days away). It is important to Buyer's business that she have the goods on time. Shortly after execution of the contract, Seller's workers go on strike.
>
> While the strike is going on, Seller's duty of performance will be temporarily suspended. If, during the course of the strike, it becomes clear that the strike is likely to prevent Seller from timely fulfilling the contract, Buyer will be entitled to cancel the contract (discharging both parties from liability for non-performance), so that she can procure a substitute supply. For instance, if the strike had still not been settled by July 1, and it would take Seller or any substitute at least three weeks to manufacture the goods, Buyer would clearly be entitled to cancel at that point, because the burden on Buyer of continuing to be locked into the contract with Seller would be unfairly great.

III. IMPRACTICABILITY

A. Impracticability as a kind of impossibility: In the situations considered previously, performance of the contract was a literal impossibility. In some cases, however, performance is extremely costly, time-consuming, or otherwise ***impracticable***, though not literally impossible. Many modern courts ***equate "extreme impracticability" with "impossibility."***

According to these courts, if, due to changed circumstances, performance would be infeasible from a commercial viewpoint (because of an extreme increase in cost, a tremendous increase in the time needed for performance, etc.), the promisor is excused just as she would be if performance were literally impossible. Rest. 2d, § 261. See also Rest. 2d. Ch. 11, Introductory Note and Reporter's Note.

> **Example:** D, who is building a bridge, contracts to procure all his requirements for gravel for the project from P's land, and to pay for it at a fixed rate per yard. D is able to supply over half his needs by excavating the gravel above the water level on P's property. He refuses to excavate the gravel from below water level, however, on the grounds that such excavation would be at least ten times as costly as above-ground excavation.
>
> *Held*, D is excused from excavating below the water level. The fact that performance would have been somewhat more expensive than anticipated by D would not have been enough to excuse him. "But where the difference in cost is so great [as to have] the effect…of making performance impracticable, the situation is not different from that of a total absence of earth and gravel." *Mineral Park Land Co. v. Howard*, 172 Cal. 289 (1916).

1. **Cost increase must be extreme:** If the defense of commercial impracticability is to be based upon an ***increase in the cost of performance***, the increase must be ***extreme***. Also, it must be shown that the contract itself has not explicitly or implicitly ***cast the risk of impracticability*** upon the party seeking to assert that defense. See Rest. 2d, § 261, and Comment d and Illustr. 9 thereto.

    a. **Foreseeability:** One factor in whether the parties cast the risk of impracticability on the supplier (the party seeking discharge) is how ***foreseeable*** the increase in costs was — the more foreseeable, the less likely it is that the parties intended that the buyer of the goods or services would bear the risk of a large cost increase.

    i. **Fixed price contracts:** Thus if the parties agree on a ***fixed price*** for a good or service, and the risk of a rise in the market price was foreseeable, the court will almost certainly hold that the parties ***implicitly allocated the risk*** of the price rise on the party agreeing to supply the good or service for the fixed

price. Cases involving extreme run-ups in the cost of ***energy***, for instance, have generally been resolved in favor of the buyer, and against the seller's claim of impracticability.

Example: Gulf Oil Co. agrees to supply jet fuel to Eastern Airlines on a long-term basis. Because Gulf has agreed to be bound by so-called "posted prices" which fail to keep up with price increases, Gulf finds itself obligated to supply Eastern with jet fuel priced on the basis of $5 per barrel at a time when the free-market price is $11 per barrel (due to the run-up in OPEC prices in 1973-74). Gulf tries to escape the contract on grounds of commercial impracticability.

Held, for Eastern. Even if this run-up in prices constituted a great hardship for Gulf (which the court finds not to be the case), Gulf cannot prevail with its impracticability defense because the events associated with the so-called energy crises were ***reasonably foreseeable*** at the time the contract was executed. At the time the parties signed, they were aware of the volatile Middle East situation, repeated interruptions to normal oil trade, and the arbitrary power of governments who controlled oil deposits. Since Gulf was aware of the possibility of sharp price rises at the time it signed, it must bear the risk of those rises. *Eastern Airlines, Inc. v. Gulf Oil Corp.*, 415 F.Supp. 429 (S.D.Fla. 1975).

B. UCC in accord with modern view: The UCC is in accord with the modern view that extreme impracticability will excuse performance, at least on the ***seller's*** part. § 2-615(a) provides that the seller's non-delivery, or a delay in delivery, is excused "if performance as agreed has been made ***impracticable*** by the ***occurrence of a contingency*** the ***non-occurrence of which was a basic assumption*** on which the contract was made…."

1. What is impracticable under the Code: Comment 4 to § 2-615 elaborates on the kinds of things that may be considered impracticable:

"Increased cost alone does not excuse performance unless the rise in cost is due to some ***unforeseen contingency which alters the essential nature*** of the performance. Neither is a rise or collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a ***severe shortage*** of raw materials or of supplies due to a contingency such as ***war***, embargo, ***local crop failure***, unforeseen s***hutdown of major sources of supply***, or the like, which either causes a ***marked increase in cost*** or altogether ***prevents the seller from securing supplies*** necessary to his performance, is within the contemplation of this section."

a. Price rises: Sellers have been almost completely ***unsuccessful*** in arguing that ***extreme cost increases*** should relieve them from having to perform. The *Eastern Airlines* case, *supra*, is an

illustration of the tendency of sellers to lose under UCC § 2-615. White and Summers (p. 130) concur with this trend, saying, "In our judgment an increase in price, even a radical increase in price, is the thing that contracts are designed to protect against."

2. **Use by buyer:** UCC § 2-615 on its face seems to allows only sellers to escape a contract on grounds of impracticability. But Comment 9 to § 2-615 seems to contemplate giving the ***buyer*** the exemption in certain circumstances (e.g., the buyer holds a defense contract and is buying under a sub-contract; if the main contract is cancelled, the buyer may be able to escape the sub-contract). Also, common-law principles might be used to give the buyer the impracticability defense, even if one interprets the UCC as not giving the buyer a statutory defense.

   a. **Frustration of purpose:** Observe that when the buyer is given the impracticability defense, the result is very similar to that given under the doctrine of ***frustration of purpose***, discussed *infra*, p. 445. That is, the buyer is generally not unable to pay — rather, she finds it not worthwhile to trade the contract price in return for the thing that was contracted for.

3. **Allocation of risk by parties:** In both UCC and non-UCC cases, the parties are always free to ***make their own allocation of the risk of impracticability,*** and the courts will ***enforce*** that allocation. So, for instance, if the parties decide that the seller should not have the right to raise the impracticability defense in the event that all potential suppliers to the seller fail, the court will refuse to allow the defense in that scenario even though the requirements for impracticability might otherwise be met.

   a. **Implicit allocation:** This type of re-allocation by the parties of the risk of impracticability can be either explicit or ***implicit***. Thus the UCC commentary to § 2-615 says that the impracticability defense "[does] not apply when the contingency in question is ***sufficiently foreshadowed*** at the time of contracting to be ***included among the business risks which are fairly to be regarded as part of the dickered terms,*** either consciously or as a matter of ***reasonable, commercial interpretation from the circumstances."***

i. **Risk of technological breakthrough:** For instance, suppose that Seller and Buyer agree that Seller will develop a not-yet-existing product to meet certain specifications, and both parties are aware that a ***technological breakthrough*** will be required in order for Seller to perform. A court would probably conclude, as a matter of "reasonable, commercial interpretation from the circumstances," that the risk of non-occurrence of the breakthrough was to rest upon Seller, in which case Seller would ***not*** be excused by impracticability if the breakthrough did not develop despite Seller's best efforts.

ii. **Foreseeability and relative expertise:** When a court has to decide whether the party whose performance is arguably made impractical by a particular event implicitly bore the risk of that event, two important factors are:

- □ the ***foreseeability*** of the risk (the more foreseeable it was, the more likely it is that the performing party will be found to have borne the risk of it); and
- □ the degree to which the performing party has ***greater expertise*** in evaluating the risk than the other (the greater the performing party's relative expertise, the more likely that party is to be found to have assumed the risk).

Example: Contractor contracts to build a house for Owner, which both parties know will require excavation of a 10-foot-deep basement. The contract calls for a fixed price, and makes no mention of the risk that when Contractor excavates for the basement, Contractor may find large boulders that are unusually expensive to excavate.

Given the high foreseeability of unusually-difficult excavation conditions, and the greater familiarity with excavation issues that a contractor has, compared with a homeowner, the court will likely conclude that Contractor bore the risk that excavation would be much more expensive than usual. In that event, Contractor will not be excused even if the excavation turns out to be so expensive that the contract will end up being a loss for him.

IV. FRUSTRATION OF PURPOSE

A. Frustration of purpose distinguished from impossibility: Events may occur which destroy one party's ***purpose*** in entering into the contract, even though performance of the contract itself is not rendered impossible. Such events are said to constitute ***"frustration of purpose,"***

or “frustration of the venture.” Where one party’s purpose is completely or almost completely frustrated by such supervening events, most courts will discharge him from performing. See Rest. 2d, § 265.

1. **The Coronation cases:** The doctrine of “frustration of purpose” had its origin in what are usually called the “Coronation cases.” The example which follows is based on one of these cases.

   Example: P rents his apartment to D for a two-day period. D’s purpose in making this contract is to view the coronation of King Edward VII; D agrees to pay a price far beyond the ordinary rental value of the apartment for this privilege. The coronation is canceled because the King is taken ill. D does not use the premises, refuses to make the payment, and is sued by P.

   Held, D is excused from performing because his essential purpose in entering the contract has been frustrated; the taking place of the Coronation “was regarded by both contracting parties as the foundation of the contract.” Performance is not, strictly speaking, impossible, since D could stay in the apartment for two days and watch the sights. But because he would not derive any benefit from doing so, he must be excused from performing. *Krell v. Henry*, 2 K.B. 740 (1903).

2. **Restatement formulation:** The Restatement gives a useful formulation for the frustration doctrine: “Where, after a contract is made, a party’s ***principal purpose*** is ***substantially frustrated without his fault*** by the occurrence of ***an event the non-occurrence of which was a basic assumption on which the contract was made,*** his remaining duties to render performance are ***discharged***, unless the ***language or the circumstances indicate the contrary***.” Rest. 2d § 265.

3. **Usually used by buyers of goods and services:** What is the ***difference*** between the defenses of ***impracticability*** and ***frustration***? After all, the two defenses are similar in that each gives a party a chance to escape from a bargain that has turned out to be unfavorable on account of the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made. The main practical difference between the two is that:

   [1] where it is the ***seller or supplier*** of goods, land or services who wishes to escape the bargain, that party typically claims impracticability; whereas

   [2] where it is a ***buyer or recipient*** of goods, land or services who wishes to escape the bargain, that party typically claims frustration.

C&P Hnbk (6th), § 13.12.

B. Factors to be considered: In determining whether the defense of frustration of purpose should be allowed, the courts consider ***several factors***:

- □ the extent to which the event that thwarted the promisor's object was ***foreseeable*** (and foreseen) by the parties when the contract was made — the less foreseeable the event, the more likely the court is to excuse performance under the frustration doctrine;
- □ the extent to which the parties did or did not explicitly or implicitly ***allocate the risk*** of the event to the promisor — if the parties allocated the risk to the promisor, the court will not excuse performance;
- □ the extent to which the event deprived the promise of ***all*** (as opposed to just some) of his anticipated benefit from the contract — the more ***complete*** the thwarting of benefit, the more likely the court is to excuse performance.
- □ whether the party seeking discharge was ***at fault*** in bringing about (or failing to guard against) the event — major fault on that party's part will normally block use of the defense.

Example: In August, 1941, D leases property from P, for purposes of running a new-car dealership and a gas station. Shortly thereafter, the United States enters Would War II, and the Government sharply restricts the sales of new cars. P waives a lease restriction, thereby allowing D to use the premises for purposes other than the dealership and gas station. But D declines to make alternative use of the property, and vacates, claiming that he is released from the lease because of frustration.

Held, D is not entitled to the defense of frustration. First, it was quite foreseeable to the parties at the time the lease was negotiated that the U.S. might enter the War, and might restrict new-car sales. Secondly, D's primary business of selling new cars was not entirely nullified, but merely curtailed (albeit substantially) by the regulations; therefore, his ability to obtain benefits from the lease was not entirely frustrated. (Also, his degree of frustration was eased by the fact that he could have used the premises for any other reasonable purpose.) *Lloyd v. Murphy*, 153 P.2d 47 (Cal. 1944).

1. Foreseeability and the allocation of risk: The first two factors listed above — foreseeability and allocation of risk — are really different aspects of the same issue.

a. Easy to foresee: If the parties ***foresaw*** the possibility of the event (or at least the possibility of the general category of events of which the particular event was an instance) in question, the contract's failure to explicitly excuse the promisor if the event

should occur probably indicates that the parties ***intended that the promisor bear the risk of that event.***

Example: Elder, aged 90, buys a lifetime annuity from Insurer for $100,000, under which Elder will receive $2,000 per month for the rest of his life. Two weeks later (before the first monthly payment is even made), Elder dies of a heart attack.

If Elder's estate tries to recoup the $100,000 on the grounds that Elder's purpose in entering the contract has been frustrated, the court is likely to hold that it is quite foreseeable that a 90-year-old might die soon after the making of such a contract, and that the agreement implicitly allocated this risk to Elder (in return for Insurer's bearing the risk that it would have to pay Elder far more than $100,000 if he lived to be, say, 100).

i. **Hard to foresee:** Conversely, if the event was one that was ***hard to foresee*** (so that the parties probably did not in fact foresee it), then the contract's failure to excuse the promisor in such an event does ***not*** justify the inference that the parties intended to allocate the risk of the event to the promisor.

2. **Extreme economic dislocation:** Often, a party who has agreed to buy or pay for goods, land or services relies on ***extreme economic dislocation*** as the reason she should be allowed to escape from the bargain by use of the frustration defense. For instance, due to some macro-economic event, the good or service for which the plaintiff has agreed to pay a fixed price suddenly becomes ***vastly less valuable*** than indicated by the contract price. In such cases, the argument is typically not that the party seeking avoidance (usually a buyer) cannot physically pay for her side of the bargain, but rather, that requiring her to pay will ***cause her serious economic loss*** of a sort that neither party had reason to anticipate.

   a. **Usually unsuccessful:** Such claims by buyers based on a plunge in the market value of the contracted-for good or service typically ***fail***. There are several reasons courts look with disfavor on this type of claim. But the most common is probably that in the circumstances, a market-price plunge — no matter how great — was ***not the sort of event the non-occurrence of which was a basic assumption*** on which the contract was based. In other words, the court is likely to take the position that where buyer and seller agree on a ***fixed price*** or fee for some good or service, allocating the ***risk of a plunge*** in market prices to the buyer (and the risk of a sharp *rise* in market

prices to the *seller*) is the ***very purpose*** of the contract.

i. **Great Recession and the plunge in house prices:** Consider, for instance, the ***"Great Recession"*** of 2008-09, in which residential real estate prices dropped precipitously, by percentages that had not been seen since the Great Depression of the 1930s. A number of homeowners who took out mortgages argued that they should be at least temporarily spared from foreclosure by use of the doctrine of frustration of purpose, given that the price drop left them ***"under water,"*** i.e., with a property worth less than the balance of the outstanding mortgage. These claims have virtually all ***failed***.

Example: P takes out a $267,000 home mortgage loan on her Arizona home from X, a bank, which eventually assigns its rights to D, a mortgage servicer. The Great Recession occurs, causing the market value of P's home to drop to less than 50% of the amount then owed by P on the mortgage. P falls behind in her payments, and D begins a foreclosure proceeding. P brings a separate suit to enjoin D from continuing the foreclosure. Among various arguments, P asserts that she should be permitted to use the frustration doctrine to be relieved from her loan obligations. More precisely, she contends that "[t]he non-occurrence of extreme real estate depression . . . and the non-occurrence of a drastic loss of value in the Property, were basic assumptions made by the parties under the loan contract," and that "[n]either Plaintiff nor [X] foresaw the market downturn." P alleges, in essence, that since the property is now worth less than half of the outstanding mortgage amount, her purpose of taking out an economically sensible mortgage has been frustrated by the price collapse.

Held (at least on this point), for D. In Arizona, "[u]nder the frustration of purpose doctrine ... ***'mere economic impracticality is no defense*** to performance of a contract.' " Therefore, even though the "sudden depreciation" in the value of P's property may have rendered her loan agreement uneconomical, she is not entitled to avoid that agreement by use of the frustration doctrine. *Bean v. BAC Home Loans Servicing, L.P.*, 2012 WL 10349 (D. Ariz. 2012).

Note: Although the court in *Bean* did not say so, the result there is consistent with the requirement that the party seeking to use frustration (or impracticability) must show that the contract did not explicitly or implicitly ***assign to that party the risk of the type of unlikely event in question.*** (See p. 444.) If the lender and borrower in *Bean* had thought about the risk of a "sharp decline in home values" at the time they entered into the loan, both would almost certainly have understood that the owner/borrower, not the lender, assumed the risk that the house would decline in value so much that it would be worth less than the outstanding mortgage principal. The very reason lenders insist on minimum down-payments, maximum loan-to-value ratios, and personal guaranties is to minimize the lender's likely loss if the "value of the collateral" (the mortgaged home) suddenly declines; so the risk of such a decline is virtually never the sort of risk the parties intend to allocate to the lender.

C. UCC view: In sale-of-goods case, the ***UCC*** does ***not*** expressly grant the frustration of purpose defense either to sellers or to buyers. However, both sides in sales cases may nonetheless be able to use the doctrine.

1. Use by buyers: It's more likely that a ***buyer*** of goods would qualify for the doctrine. However, there's no specific language in Article 2 that a buyer can point to that directly suggests the availability of the frustration doctrine to buyers.

a. Common law fills in the gaps: But remember that the UCC, like any statute, can and must be supplemented by the ***common law***, which in this case is the common-law doctrine of frustration of purpose. See § 1-103(b), making the common law applicable "unless displaced by the particular provisions of this act.…" So the common-law frustration doctrine is probably available to a buyer, if the buyer can convince the court that the Code's failure to give him any express impracticability defense does not mean that the drafters intended to preclude all common-law relief.

Example: Suppose Buyer is a defense contractor who has a U.S. government contract to build a new generation of Stealth aircraft for the Air Force. Buyer contracts with Seller to buy from Seller 200 units of a particular radar detector, one unit to be installed in each of the 200 planes that Buyer is to build under the master government contract. The Buyer-Seller contract says nothing about the chance that Buyer's government contract might be cancelled. After Seller delivers the first 2 units, the U.S. government exercises a rarely-used right to cancel the entire Stealth contract for national budget reasons. Buyer now wants to cancel the remainder of the order with Seller.

On these facts, a court would probably allow Buyer to make use of the common-law frustration doctrine, and to cancel. Buyer's primary (indeed only) purpose in making the contract with Seller was to use the radar detector in planes it was to build under the U.S. contract; that purpose has been entirely thwarted by the relatively unforeseen cancellation on the part of the U.S.

2. Use by sellers: It will be rare that the facts would lead a ***seller*** to try to use the frustration doctrine: the doctrine by its nature applies better to buyers of goods and services than to suppliers of goods or services. But in an appropriate case, a seller might be able to use § 2-615(a)'s general impracticability language to support a frustration defense. That is, the seller might be able to avoid the contract if performance has become impracticable "by the occurrence of a contingency the non-occurrence of which was a basic assumption upon which the

contract was made." *Id.*

> **Example:** Suppose that Seller says to Buyer, a celebrity, "I'll sell 10 of my new super-deluxe widgets to you at 30% below my cost, if you'll agree to endorse the product in advertisements that I'll take out." Suppose further that, before delivery, Buyer is indicted and convicted of a widely-publicized white collar crime. Seller could probably successfully argue that his purpose in making this loss-leader contract (to procure a valuable endorsement) has been totally thwarted by Buyer's conviction and subsequent lack of value as an endorser, and that he (Seller) would not have made the contract had he foreseen this possibility.

Quiz Yourself on
IMPOSSIBILITY, IMPRACTICABILITY, AND FRUSTRATION OF PURPOSE

118. Whinney sells Hoof Hearted, her prizewinning horse, to Grunt for $50,000. Before Hoof Hearted changes hands, it dies from eating a bad batch of Purella Horsey Chow. Grunt tenders the $50,000 and then sues Whinney for breach. Will Grunt recover?

119. Polly Plastiskin contracts to buy 50 gallons of mineral water from the Pisarro Water Supply Co. The contract merely specifies that the water will be "pure mineral water." Pisarro gets its mineral water from several sources, but it primarily relies on the Fountain of Youth, and plans to fill Polly's order with Fountain of Youth water. (Polly doesn't know this — she's never heard of the Fountain of Youth.) Before Pisarro fills Polly's order, the Fountain of Youth is destroyed in an earthquake.

(A) May Polly recover damages from Pisarro for breach of contract?

(B) Same basic facts. Now, however, assume that the contract provides that Pisarro will deliver "pure mineral water from the Fountain of Youth." May Polly recover damages from Pisarro for breach of contract?

120. Michelangelo contracts to create and sell a statue of David to Allota Piazza. The statute is to be delivered on March 21.

(A) For this part, assume that on March 15, several days after Michelangelo finishes the sculpture, he dies. Is the contract discharged due to Michelangelo's death?

(B) For this part, assume that Michelangelo dies one month before he is due to finish the sculpture. At the moment of his death, 1/4 of the work (including the carving of a lot of details of David's lower anatomy) remains to be done. Is the contract discharged due to Michelangelo's death?

121. The Colossus Construction Company contracts to build a palace in Rome, on land owned by Emperor Nero. The job is to be paid for in full at the end of construction. Six months into the construction, during a terrible lightning storm, the building catches fire and is destroyed.

(A) Suppose that Colossus is now unwilling to start the work from scratch, unless Nero pays extra. Nero refuses, and tells Colossus that he expects it to do the work for the original contract amount, which Nero promises to pay on completion. May Nero recover against Colossus for breach?

(B) Assume instead that the palace was already in existence at the time of the Colossus-Nero contract. Assume further that Colossus had contracted to do an extensive remodeling job. The half-renovated palace is destroyed by a fire caused by lightning. Colossus has been paid the pro-rata contract amount for all work completed as of the moment of the fire, on which it earned half the total profit it would have made had the contract been completed. Nero rebuilds the palace from scratch, but has a different contractor (one specializing in palaces-from-scratch) do the rebuilding. Colossus therefore loses the chance to do the second half of the renovation project, and loses the profit it would have made ($100,000) on that second half. May Colossus recover any damages from Nero, and if so, what amount?

122. Gilda contracts to buy a hot foreign sports car, the Pronto Lescargo, from Duke's, a local dealership. Delivery is to take place in six weeks, and the price is fixed in the contract. The newspapers have been filled with speculation (of which both Gilda and Duke's are aware) that the government might place an annual cap on the number of foreign cars that may be imported into the U.S., but nothing has yet happened at the time of the contract. The week after the contract is signed, the government imposes such a cap. The cap has the effect of reducing the annual U.S. imports of the Pronto by 40%. Duke's own allocation of

cars from the manufacturer is reduced by the same 40%. The shortfall means that Duke's has more signed contracts for cars than it can fulfill under the delivery times listed in the contracts. Duke's tells Gilda that she can either cancel, or else delay by up to 4 months, her receipt of the car (her choice). Duke's plans to make delivery to Gilda and its other contract customers in first-signed/first-delivered order. (Duke's could deliver on time to Gilda, but only by breaching a contract with at least one other customer.) If Duke's offers Gilda this choice, will Duke's be in breach?

123. Superbowl XXXIX is to be held in New Orleans on January 20, 2002. In April, 2001, Rabb Id Fann signs a contract for 3 large suites at the Swank Hotel, for the week that ends on Superbowl day. The price is twice as high as the hotel usually charges for those suites for that week in a non-Superbowl year. At the time of booking, there has been labor peace in pro football for several years, and few observers expect that to change. In December, 2001, the NFL Players Association goes on strike, and the 2002 Superbowl is cancelled. The Hotel demands that Fann pay for the suites anyway.

(A) If you represent Fann, what doctrine will you assert in his behalf?

(B) If you assert the doctrine listed in your answer to (A), will Fann be required to pay for the suites?

Answers

118. No. The contract will be discharged due to the doctrine of impossibility. Here, the essential subject matter of the contract, Hoof Hearted, was destroyed through no fault of either party. Therefore, the contract cannot possibly be performed, and both parties are discharged from their obligation to perform.

119. (A) Yes. In impossibility and impracticability cases, discharge will occur only when three main conditions are satisfied: (1) the event relied on was one whose non-occurrence was a "basic assumption" on which the contract was made; (2) the event was not the fault of the party seeking discharge; and (3) the language or circumstances don't indicate that the parties allocated the risk to the party now seeking discharge. On

these facts, test (1) is not satisfied — since Polly didn't know that Pisarro was contemplating using Fountain of Youth water, and since Pisarro could fill the order with other water, it's very unlikely that the unavailability of Fountain of Youth water would be held to be an event the non-occurrence of which was a basic assumption on which the contract was based.

(B) No. The fact that the contract specifically mentions Fountain of Youth as the source of supply indicates that the unavailability of Fountain water was an event the non-occurrence of which was a basic assumption on which the parties based their deal. Thus condition (1) listed in Part (A) is satisfied. Since the earthquake was not Pisarro's fault (condition (2) from Part (A)), and since there's no evidence that the parties intended Pisarro to bear the risk of such an event (condition (3)), Pisarro will be discharged.

120. (A) No, because Michelangelo's estate can carry out the sale — his personal contribution is not necessary to fulfilling the contract at this point.

(B) Yes, probably. If no truly equivalent sculptor is available to finish the work, Michelangelo's unavailability would be found to be an event the non-occurrence of which was a basic assumption on which the contract was made. If so, then since Michelangelo's death was not his "fault" (see the conditions for discharge, described in Part (A) to the prior question), and since there is no indication that the parties intended to allocate the risk of Michelangelo's death to him rather than to the buyer, the death would discharge Michelangelo and his estate.

121. (A) Yes, probably. The majority view is that when a contractor is to build a structure from the ground up, the contractor will normally *not* be excused from performing even if the partially completed building is destroyed by no fault of the contractor. Therefore, Colossus must start over for no additional compensation, or be declared in breach.

(B) No, Colossus may not recover anything. Where a party contracts to repair or remodel an existing building owned by another, *each party* will normally be discharged from its duty to perform by the doctrine of impossibility if the building is destroyed throughout fault of either. That is, in a repair or renovation contract, the destruction of the structure is

normally deemed to be an event the non-occurrence of which is a basic assumption on which the contract was based. Since there's nothing to indicate that Nero and Colossus bargained for a different allocation of the usual allocation of risks (discharge for both in the event of destruction), they'll both be discharged. Discharge here means that Nero doesn't have to put Colossus in a position to finish the contract, or to pay Colossus what it would have earned from full performance.

122. No. It's true that the possibility of a cap was well-known to the parties at the time the contract was signed, so it's hard to say that the cap was a "contingency the non-occurrence of which was a basic assumption on which the contract was made" (quoting from § 2-615(a)'s general language giving sellers the impracticability defense). But there's another clause in § 2-615(a): sellers also get to delay or cancel delivery if the agreed-upon performance is caused by "compliance in good faith with any applicable ***foreign or domestic governmental regulation or order***[.]" That right is ***not*** dependent on the regulation or order being an event the non-occurrence of which was a "basic assumption" in the contract. So the fact that both parties may have foreseen the cap won't block Duke's from using § 2-615(a).

§ 2-615(b) says that if the contingency "affect[s] only a part of the seller's capacity to perform," he must "allocate production and deliveries among his customers," but he may do this allocation "in any manner which is fair and reasonable." Duke's allocation of deliveries in contract-signing order is certainly "fair and reasonable," so he won't be in breach by making Gilda choose between cancellation and keeping her spot in the queue for late delivery.

123. (A) The doctrine of frustration of purpose. (B) No. The frustration-of-purpose defense allows a party (usually a buyer of goods or services) to cancel the contract if: (1) the buyer's primary purpose in making the agreement has been completely or almost-completely thwarted by an event the non-occurrence of which was a basic assumption of both parties to the contract; (2) the parties did not allocate the risk of that event to the party seeking discharge; and (3) the party seeking discharge wasn't at fault for causing (or failing to guard against) the event.

Here, these conditions are satisfied. As to (1), the Hotel obviously knew

that Fann was probably planning on attending the Superbowl (the Hotel's double room rates show it knew that that was the purpose of most guests booking for that week), so both parties knew that the playing of the game was a "basic assumption" behind the contract. As to (2), there is no evidence that the parties intended Fann, as opposed to the Hotel, to bear the risk that something would happen to prevent the game. Also, the relative unforeseeability of the event (continued labor peace was expected at the time the contract was signed) makes it even more likely that a strike was not an event the risk of which the parties thought about imposing on the party whose purpose would be thwarted by that event. As to (3), Fann hasn't been at fault in failing to guard against the strike, since there's little he could have done to protect himself against the strike's occurrence.

V. RESTITUTION AND RELIANCE WHERE THE PARTIES' OBLIGATIONS HAVE BEEN DISCHARGED

A. Shifting the losses: Before a party is discharged from performing by virtue of impossibility, impracticability, or frustration, he or the other party may have rendered a ***part performance*** or may have incurred expenses in preparing to perform. When this happens, should the court refuse to make one party pay anything to the other, thus "letting the chips fall where they may," as of the time the contract was discharged? Or should it award reliance and restitution recovery on a quasi-contract basis? Most courts attempt to adjust the equities of the situation by allowing either party to ***recover the value he has rendered to the other***, and sometimes even the expenditures he has made in preparing to perform. See Rest. 2d, §§ 272 and 377.

B. Return of down payment: If one party has made a ***down payment*** to the other prior to discharge of the contract for impossibility, he will generally be allowed to recover this down payment.

> **Example:** Seller, in England, contracts to sell and deliver a machine to Buyer, in Poland. Buyer makes a down payment of 1,000 pounds in advance on a total price of 4,800 pounds. World War II begins, and renders shipment impossible. Buyer sues to recover his down payment.
>
> *Held*, Buyer may recover the entire down payment, since otherwise Seller would be unjustly enriched. See *Fibrosa Spolka Akcyjne v. Fairbairn Lawson Combe Barbour, Ltd.*, A.C. 32 (1943).

C. Restitution: American courts generally agree that one who has been discharged by impossibility or frustration may recover in quasi-contract for ***restitution***, i.e., for the value of the ***benefit*** he has conferred on the other party.

1. Time for measuring benefit: As of what moment should the "benefit conferred" be measured? Where a party who has partly performed is then discharged for impossibility or impracticability, the event causing that discharge may also dramatically affect the value of the performance to the other party. For instance, if Contractor is in the process of making home improvements for Owner, and the home is destroyed by fire (through no fault of Contractor) halfway through the work, there is a sense in which Owner has derived no long-term benefit from Contractor's work. Nonetheless, the general rule seems to be that the benefit should be measured ***just before the event*** causing the discharge for impossibility or frustration. See Rest. 2d, § 377, Comment b.

a. Cheapest cost avoider: This result is based mostly on economic analysis: insurance markets are set up in such a way that the property owner will find it easier to ***buy insurance*** to cover the loss of the partly-done work than the contractor will. Therefore, it's more economically efficient to place the risk of loss on him. In economic jargon, the owner is the ***"cheapest cost avoider."***

2. Pro-rata contract price: Where the performance has been partly made, recovery will normally be limited to the ***pro-rata contract price***, if such a pro-rating can be sensibly done. See Rest. 2d, § 377, Comment b. (But conversely, if the reasonable value to the other party is ***less*** than the pro-rata price, only the reasonable value may be recovered.)

Example: Plumber agrees to install 200 feet of iron pipe in an existing building. The contract price is $1,000. After Plumber has installed 100 feet, the building is destroyed through no fault of either Plumber or Owner. Plumber is excused from performing because of the destruction of the subject matter (see *supra*, p. 433). If the market value of the work done by Plumber is $600, he can recover in quasi-contract only $500 (the pro-rata portion of the contract price). If the market value of the work he did is $400, he is limited to this amount. The fact that Owner received no ultimate "benefit" from the performance, since the building was destroyed, does not relieve him of the obligation to recompense Plumber for the value of his performance — the existence of benefit is measured as of the moment

before destruction occurred.

3. **Reliance:** Where a party has conferred a benefit on the other, all courts, as noted, agree that she can recover in quasi-contract once the contract is discharged for impossibility, impracticability or frustration. But the courts do not agree on whether he should be allowed to recover the expenditures she had made in ***preparation*** for performance (i.e., her ***reliance*** damages; see *supra*, p. 460), when these expenditures did not benefit the other party. The First Restatement, § 468, and most older cases take the view that such reliance expenses may not be recovered. But the Second Restatement, in § 272(2), provides that if restitution will "not avoid injustice," the court may "grant relief on such terms as justice requires including ***protection of the parties' reliance interests.***

   a. **Courts rarely give:** But courts have rarely followed the Restatement's lead by awarding reliance damages.

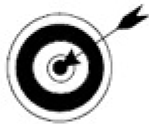
4. **Contrary intent shown by parties:** Just as the parties are free to specify that a discharge will not take place because of impossibility (*supra*, p. 432), they are free to make an explicit provision that a discharged party will not be entitled to recover anything for his part performance.

Quiz Yourself on
RESTITUTION AND RELIANCE WHERE THE PARTIES ARE DISCHARGED

124. Bay Area Design ("BAD") contracts with Rich N. Tasteless to redecorate his San Francisco home. The contract is for $50,000, to be paid upon completion of the project. After BAD has finished about one-third of the project, a terrible earthquake destroys the home. At the moment of the earthquake, BAD has spent $12,000 on labor and materials. The market value of the work done to that point is $18,000. The contract is discharged due to impossibility. However, BAD wants some compensation anyway. Is it entitled to any recovery, and if so, how much?

Answer

124. Yes, $18,000. Where a contract is discharged under impossibility, impracticability or frustration, a party who has already rendered a benefit to the other will normally be entitled to restitution damages. Restitution will usually be computed based on the market value of the benefit rendered (not the cost to the discharged party of rendering the benefit, which would be a reliance measure.) Therefore, BAD will receive the market value of the work done to that point, $18,000. Notice that it's irrelevant that Tasteless did not receive any long-term benefit from the partly-done work — courts figure that Tasteless could ***buy insurance*** to cover loss of partly-done renovation more easily than BAD could, so it's economically efficient to impose the burden of the loss on him.



EXAM TIPS ON IMPOSSIBILITY, IMPRACTICABILITY, AND FRUSTRATION

- Exams often hint at the possibility of a defense based on Impossibility/Impracticability/Frustration (we'll call this "I/I/F" for short). Usually, your fact pattern won't mention any of these defenses — it'll be up to you to spot the issue, based on the fact that some unlikely event has occurred that makes it difficulty or senseless for one party to perform.

Issues Common to Impossibility/Impracticability and to Frustration

- **Failure of basic assumption:** Remember the basic standard for when I/I/F applies: it applies only when the parties made the contract on the ***basic assumption*** that the contingency in question ***would not occur.*** When you try to decide whether this test is met, focus on three sub-issues:

  (1) Assumptions shared by both parties: Look first to see if ***both*** parties made this underlying basic assumption — if the party who's

trying to avoid a discharge (i.e., who's trying to enforce the contract) ***didn't know*** that the contract was predicated on that assumption, I/I/F won't apply.

> **Example 1:** Stu, a high school senior, interviews with Count, an accountant, for a position in his firm in January. Count then writes to Stu: "I offer you employment with my firm, beginning August 1, at $25,000 a year." Stu accepts the offer several days later. In March, Count sends Stu a letter stating: "It was my intention in hiring you to have you work with my International Union account. However, the Union no longer retains my firm. Therefore, I lack the funds and will not hire you. Good luck in securing other employment."
>
> If Count asserts the defense of frustration, Stu can successfully contend that he wasn't apprised of the special reason for hiring him. Therefore, the keeping of the account wasn't a "basic assumption" of the contract, and Count can't be excused on grounds of frustration.

> **Example 2:** In January, *O* and *A* enter into a contract under which A will design a ten-story hotel to be built on a piece of land owned by *O* adjacent to City Airport. The design is to be delivered on or before May 1. *A* is aware that *O*'s interest in building a hotel is on account of the business that will come from travellers using the airport. In March, the government announces that the airport will shut down at the end of the year.
>
> *O* will probably be able to argue successfully that the continuation of the airport's operation was a basic assumption under both parties made the design contract. If he can show this, he'll probably be able to have the contract excused for frustration.

(2) Foreseeability: Remember that the more ***foreseeable*** the contingency was, the ***less like*** it is that the contingency represents the failure of a basic assumption.

- ☞ Circumstances which ***are*** usually foreseeable, and that therefore probably won't lead to discharge:
  - ☞ **Increase in costs.** Look for a sudden large increase in the ***cost*** of labor or materials which the seller of goods or services claims makes it impossible to perform. Usually, such difficulties were relatively foreseeable when the contract was made, in which case they probably ***won't*** excuse performance. (But this won't always be true: if the cost increase is due to a truly unforeseen type of event — a sudden industry-wide strike, outbreak of war, etc. — impossibility will generally apply.)
- ☞ Circumstance which ***may or may not*** be deemed foreseeable:

☞ **Weather conditions.** Look for bad storms that either push off the date of completion of performance or destroy a crop. Note in your answer that foreseeability probably depends upon whether that type of weather was usual for that time of year in that region.

(3) Risk allocation: The last step in determining whether a party's obligations have been discharged because of I/I/F is to make sure that the ***risk*** of one of these outcomes wasn't implicitly ***allocated to that party*** by the contract.

☞ **F.O.B. contracts:** Watch for "F.O.B." and the name of a location in an agreement for the sale of goods. The phrase means that the parties agreed that the risk of loss would not pass to the buyer until the goods were delivered to a carrier at the location specified. Thus if the location specified is the *buyer's* factory ("F.O.B. buyer's plant"), the buyer does not assume the risk until the goods arrive at her factory.

Example: *B* agrees to purchase fifty gallons of chemicals from *S* at $5 a gallon "F.O.B. *B*'s factory." *S* delivers the chemicals to *T*, a trucking company, which loads it onto its truck. While en route to the city where *B*'s factory is located, the truck is hijacked by thieves. *B* doesn't have to pay for the chemicals (she's discharged from the contract), because the risk of loss didn't yet pass to her.

☞ **Fixed-price contracts:** When *S* agrees to sell goods to *B* at a ***fixed price,*** the existence of the fixed price usually means that the parties have agreed to allocate the risk of an ***increase*** in market prices to the ***buyer***, and of a ***decrease*** in market prices to the ***seller***. However, a truly unforeseen many-fold market-price increase (e.g., 10x) might be sufficient.

☛ **Supervening illegality:** When you find a fact pattern where parties have entered into an ***illegal contract,*** pay attention to ***when*** it became illegal. If it became illegal because of a change in law that took effect after the formation of the contract, then the frustration or impossibility defenses may apply. But if the illegality existed before the contract was signed, and one or both parties were unaware, analyze the problem under illegality (next chapter), not I/I/F.

Example: In February, *L*, a landlord, and *T*, a tenant, enter into a written lease agreement for two years beginning April 1 whereby *T* is to rent a building for use as a "sports book,"

an establishment where bets are made on horse races and other sporting events. The rent is $1,000 per month and 20 percent of *T*'s gross profits. *T* gives *L* a $2,000 deposit. Between the time of the signing of the lease and April 1, a law is passed which makes the operation of sports books illegal.

T may sue for the refund of his deposit and the parties will be excused from performing. This is so because *T*'s purpose, of which *L* was aware, has been frustrated by the supervening illegality.

Distinguishing between Impracticability and Frustration

- Both impracticability and frustration involve a significant event whose ***non-occurrence*** was a ***basic assumption*** on which the parties based the agreement. So it can be confusing to know which one to apply on given facts. Here's an easy way to tell which doctrine probably applies:
  - ☐ where it is the ***seller or supplier*** of goods, land or services who wishes to escape the bargain, that party typically claims ***impracticability***; whereas
  - ☐ where it is a ***buyer or recipient*** of goods, land or services who wishes to escape the bargain, that party typically claims ***frustration***.

Frustration of Purpose — Special Issues

- **Total frustration required:** When dealing with a fact pattern where one party claims frustration of purpose, make sure the purpose is ***totally*** (not just partially) ***frustrated***.
  - **Illness:** For instance, in cases not involving personal services, a party's ***serious illness*** may not lead to total frustration, in which case it probably won't lead to excuse for frustration.

    Example: Sol, a homeowner, enters into a written contract with Byer for the sale of Sol's house in Illinois. Three months later Byer informs Sol that he's retiring down South because he has suffered a heart attack, and that he therefore won't be going through with the deal. If Sol sues Byer for breach of contract, Byer won't be excused from performing because of frustration — Byer could still buy the house and re-sell it, so his illness and retirement probably haven't *totally* deprived him of all possible benefits from the transaction.

- **Extreme drop in market value:** Look for situations in which a buyer who has agreed to pay a ***fixed price*** for goods, land or services relies on ***an extreme drop in the market value of the contracted-for item*** as the

reason she should be allowed to escape the contract by use of frustration.

☞ **Claim usually fails:** In such a situation, you should probably say that the buyer's claim of frustration will ***fail***. Point out that where buyer and seller agree on a ***fixed price*** or fee for a good or service, allocating the ***risk of a plunge*** in market prices to the buyer is probably the ***very purpose*** of the contract.

<u>Impossibility — Special Issues</u>

☛ When you're dealing with a fact pattern where one party claims impossibility, make sure performance is ***totally impossible***, and that the event creating the impossibility was ***unforeseeable*** at the time of formation.

☞ **Destruction of subject matter:** Destruction isn't always an excuse.

□ First, determine whether the parties ***allocated*** the risk to the party seeking to be excused — if it was, then impossibility/impracticability won't apply.

Example: Where a builder agrees to build a new structure, most courts say that the builder implicitly assumes the risk of total destruction of the structure during construction (unless the contract expressly says otherwise).

□ Next, if the risk remained with the party claiming impossibility, determine whether the subject matter is ***replaceable*** on a commercially sensible basis — if so, impossibility won't apply.

Example: *B* enters into a written agreement to purchase 100 standard air conditioning units from *S*, F.O.B. *B*'s warehouse. While the truck carrying the units is en route to *B*'s warehouse, it overturns and the shipment is destroyed. Because *S* could readily obtain replacement units, *S* won't be excused on account of the destruction. (But *S would* be excused if what was being delivered was, say, a one-of-a-kind painting.)

☞ Also, make sure that the impossibility isn't due to the ***fault*** of the party claiming impossibility.

<u>Impracticability — Special Issues</u>

☛ **Increased expense:** Although an increased expense generally doesn't rise to the level of fulfilling the requirements for an impossibility

defense, some jurisdictions sometimes allow a party to use the increased costs as an ***impracticability defense***.

- ☞ **Extreme increase:** In addition to ensuring that the parties didn't allocate the risk (e.g., an explicitly fixed-price sales contract), make sure that the impracticality is ***extreme.*** Probably the cost of performance should be a minimum of five times the anticipated cost.
  - ☞ **Slight reduction in profitability:** Also, make sure that the increase wouldn't just make performing ***slightly*** unprofitable. (For instance, even a 10x increase in the cost of one component wouldn't suffice, if the component was only a very small percentage of the seller's overall costs.)

<u>Consequence of Excuse</u>

- ☛ Remember that ***if parties are excused from performing, contract damages aren't awarded, because there hasn't been a breach***.
  - ☞ However, ***quasi-contractual remedies*** for the value of ***work performed (***or benefits rendered) may be appropriate. (See the chapter on Remedies.)

CHAPTER 13
MISCELLANEOUS DEFENSES: ILLEGALITY, DURESS, MISREPRESENTATION, UNCONSCIONABILITY, AND LACK OF CAPACITY MISCELLANEOUS DEFENSES

*ChapterScope*____________________

This chapter discusses miscellaneous defenses that may be asserted by a party being sued for breach of contract. Key defenses:

- **Illegality:** A contract is ***illegal*** if the subject matter is unlawful, whether it is barred by statute or found to be against public policy. (*Examples:* gambling contracts, usurious contracts, unreasonably broad covenants to compete.)
  - **Neither party may enforce:** As a general rule, neither party to an illegal contract may enforce it — the court will leave the parties to the contract where it finds them.
- **Duress:** A party may assert the defense of ***"duress,"*** i.e., that he entered into or modified a contract because of unfair coercion arising from the other party's wrongful act or threat. The act or threat must be great enough to overcome the free will of the party asserting the defense.
- **Misrepresentation:** An aggrieved party may sue for rescission or breach or defend in a suit when the other party to the contract makes an intentional or even innocent ***misrepresentation.*** The aggrieved party must have ***justifiably relied*** on a misrepresentation of ***fact*** (not opinion).
  - **Concealment and disclosure:** There are some instances in which a party may rescind or recover on account of the other party's mere ***failure to disclose*** information (as opposed to that other party's making of an affirmative misrepresentation).
- **Unconscionability:** The ***unconscionability*** defense is available to consumers who enter into contracts that are so one-sided that they are considered ***shockingly unfair***.
- **Capacity:** A party who does not possess the ***capacity to contract*** may generally avoid the contact. (The option to avoid the contract belongs solely to the party lacking capacity, not to the other party.)

☐ **Infants.** Until a person has reached his ***majority*** (usually age 18), most contracts which he enters into are voidable at his option.

☐ **Mental incompetents.** Persons who are ***mentally incompetent*** (the insane, mentally ill, retarded and intoxicated) may sometimes avoid contracts they sign.

I. ILLEGALITY

A. Kinds of illegal contracts: There are many kinds of illegal contracts, ranging from those that are explicitly barred by statute, to those that are rendered illegal only by judicial decisions that they are "against public policy." See Rest. 2d, § 178. (The Restatement does not use the term "illegal," but refers to such contracts as unenforceable on grounds of public policy. See Ch. 8, Topic 1, Introductory Note.) Because the ***effects*** of illegality on contractual recovery are more important to the contracts student than a cataloging of the various kinds of illegal contracts, we summarize here only a few classes of illegal contracts:

1. Gambling contracts: Contracts involving ***wagering*** are generally held illegal, and thus unenforceable. The most common types of unenforceable gambling contracts are: (1) a ***bet*** between the plaintiff and the defendant (that is, the court will not allow the winner to sue the loser to collect on the bet); and (2) contracts involving the ***lending of money*** which the lender knows will be used for gambling (e.g., a casino that gives credit to one of its customers may ordinarily not recover against the customer, absent special legislation allowing casinos to do so — but such legislation exists in the few states that have legalized casino gambling).

a. Legality of underlying wager: The legality of a particular wagering contract will generally depend on whether the underlying wager is made a ***crime***. For example, in a state where lotteries are run by the government, an agreement between two people that they will share ownership of what turns out to be a winning ticket will normally be enforced, whereas an agreement by two people to share ownership of an entry in an illegal numbers game would presumably not be upheld because the underlying wager itself is illegal.

2. **Contract to buy an illegal business:** Contracts relating to the ownership or operations of a ***business*** that both parties know or should know is principally engaged in ***illegal operations*** generally will not be enforced. For instance, a contract to purchase a business which the buyer knows to be a ***criminal enterprise*** typically will not be enforced against either party.

   Example: D agrees to purchase from P a corporation that is mainly in the business of manufacturing drug paraphernalia, such as bongs and roach clips. D signs promissory notes as part of the purchase price, then fails to pay on them. P bring suit on the notes.

   Held, for D, on grounds of illegality. There is a strong public policy against manufacturing paraphernalia that facilitates the use of an illegal drug. "Refusal to enforce the instant contract will further that public policy not only in the present circumstances but by serving notice on manufacturers of drug paraphernalia that they may not resort to the judicial system to protect or advance their business interests." *Bovard v. Amer. Horse Enterprises, Inc.*, 247 Cal.Rptr. 340 (Cal. App. 1988).

3. **Usurious contracts:** Every state has its own ***usury*** statute, under which the legal rate of interest for particular kinds of loans is limited to a specified figure. A contract calling for interest to be paid above the legal rate is generally unenforceable (and the creditor cannot recover even a lower, legal, interest rate).

   a. **Limits:** But the usury laws of most states apply only to loans made to ***individuals***, not to those made to ***corporations***. Furthermore, most statutes do not apply to ***purchase money mortgages***, whereby the seller of real property gives the buyer credit, and retains a security interest in the property. In many but not all states, the usury statutes apply to retail installment credit sales, i.e., purchases made "on time."

4. **Covenants not to compete:** There are two main situations in which a person can promise ***not to compete*** with another person: as part of a ***sale of his business*** to that other person, and as part of his ***employment*** by that person. Since our economy is supposedly based on free competition, such covenants not to compete are carefully scrutinized; if they are ***unreasonably broad***, they will be held to be illegal and not enforced. See Rest. 2d, § 188.

   a. **Sale of business:** If the seller of a business is selling its "good will"

as well as its physical assets, her ancillary promise that she will not compete in the same business as the purchaser will be upheld, provided that it is ***not unreasonably broad either geographically or in duration.***

i. **Geographical overbreadth:** If the geographical area specified is substantially greater than that within which the seller and the buyer are now doing business, and even beyond the buyer's area of probable expansion, the covenant will probably be held to be unduly far-reaching.

Example: D sells P a liquor store, whose customers almost all come from no more than 3 miles away. D has no plans to open new stores. As part of the sale, D agrees that for 3 years, D won't operate or work in any liquor store within a 200-mile radius of the store that's being sold. One year later, D opens a store 190 miles away. P seeks an injunction. A court is likely to hold that the restriction is unreasonably broad, geographically, in which case the court will deny the injunction.

ii. **Length of time:** Similarly, if the non-compete is for a length of time longer than the seller's goodwill is likely to continue, it will also be invalid. See C&P, p. 634.

Example: Same facts as above Example, except the non-compete is drafted to last for 15 years. Fourteen years later, D opens a competing store near the original store. A court is likely to hold that all the goodwill that D had at the time of sale has long-since been either lost, or transferred to P. Therefore, the court will probably deny the injunction.

b. **As part of employment contract:** An employee will often be required, as part of his employment contract, to sign an agreement in which he promises not to compete with his employer if he leaves the latter's employ. Such covenants are usually more closely scrutinized than those mentioned above regarding sales of businesses. Courts will generally permit the employment covenant to stand only if it is designed to accomplish one of the following two purposes:

[1] **Trade secrets:** To prevent the employee from ***disclosing or using confidential information*** or ***trade secrets*** gained from the employer; or

[2] **Taking of good will:** To prevent the employee from taking advantage of his contacts with the employer's ***customers*** by

approaching them and trying to ***steal them*** from the employer.

i. **Standards:** Even where an employee non-compete *does* merely prevent the employee from disclosing confidential information or soliciting the employer's customers, the non-compete will not necessarily be found "reasonable," and thus not necessarily enforced by the court. A good summary of most courts' approach is that "a restraint is reasonable only if it (1) is ***no greater than is required*** for the protection of the employer, (2) does not impose ***undue hardship*** on the employee, and (3) is ***not injurious to the public***." (73 Harv. L. Rev. 648-49, quoted approvingly in *Hopper v. All Pet Animal Clinic, infra*.) Courts pay close attention to whether the non-compete is reasonable as to the ***type of conduct*** proscribed, the ***geographical reach*** of the prohibition, and the ***length of time*** for which it applies.

Example: D, who has recently completed her education as a veterinarian, goes to work for P, a pet clinic in Laramie, Wyoming. A few months after D starts to work for P, D and P sign an employment/non-compete agreement that provides that: (1) either party may terminate the employment on 30 days notice to the other; and (2) upon termination, D "will not practice small animal medicine for a period of three years from the date of termination within 5 miles of the corporate limits of the City of Laramie." Two years later, D begins negotiating to buy a competing practice, P fires her because of this, D buys the practice and starts competing, and P sues on the non-compete.

Held, the non-compete here is partially enforceable. When D first moved to Laramie and began work for P, D had no significant professional contact with the Laramie community. The introduction that P gave to D of P's "clients, client files, pricing policies, and practice development techniques provided information which exceeded the skills [D] brought to her employment." This exposure to clients and knowledge "had a monetary value for which [P is] entitled to reasonable protection from irreparable harm." The fact that P proved at trial that D successfully recruited 187 of P's clients to D's new practice shows that P suffered actual harm from D's unfair competition.

The subject-matter scope of the non-compete here was reasonable: the limitation of the non-compete to "small animal medicine" meant that while D could not care for domesticated dogs and cats and other household pets, she could still care for large animals, a significant area of practice in Wyoming. Nor was the five-mile radius unreasonable, since it allowed D to set up a practice in other parts of the county. However, the three-year duration was unreasonable as a matter of law, and should be replaced by a one-year limit. *Hopper v. All Pet Animal Clinic*, 861 P.2d 531 (Wy. 1993).

c. Divisibility: If the covenant not to compete, as written, is overly broad, most modern courts will enforce it up to reasonable limits. See Rest. 2d, § 183, Comment a and § 184, Comment b.

i. **Traditional rule:** Some courts still follow the more traditional rule that an unreasonably broad contract should not be enforced at all.

ii. **"Blue pencil" rule:** Other courts follow the ***"blue pencil"*** rule. Under this rule, the unreasonably broad contract will be enforced only if a hypothetical "blue pencil" could be ***drawn through certain portions*** of the agreement, leaving other portions intact to be enforced.

Example: To see how this blue-pencil rule would work, suppose the covenant in *Hopper, supra,* had said that D would not care for "cats, dogs, horses or cows." If the court decided that the limitation as to cats and dogs was reasonable but that the limit as to horses and cows was not, under the blue-pencil rule the court would be permitted to draw a metaphorical line through the words "horses or cows," leaving the prohibition in place as to cats and dogs. On the other hand, the court would not have been permitted to change the three-year duration to one year, because this would require replacement of words, not mere deletion of them.

(1) **Pros and cons:** As you can see from the above Example, the blue-pencil rule is quite stilted and artificial. However, it does have the virtue of ***discouraging*** the draftsman of the contract from writing the most ***overreaching*** contract he can conceive of. See C&P, pp. 639-40.

iii. **Modern "reasonable" rule:** Most courts today do not follow the blue-pencil rule. Instead, they tend to enforce an overly-broad noncompete ***up to reasonable limits***, even if those limits cannot be spelled out by use of the "blue pencil." This is the approach of the Second Restatement; see Rest. 2d, § 184(2), Comment b and Illustr. 2 thereto.

Example: At the time the Ds come to work for P (a collection agency), they sign non-competes prohibiting them, for a two-year period after they leave P's employ, from maintaining any relationship with any past customer of P anywhere in the United States. Under substantive state law, a non-compete must involve time and territorial limits no greater than is necessary to protect the business interests of the employer.

Held, this non-compete is overly broad, but the court will grant it limited enforcement. The court will do so by means of the "rule of reasonableness" rather

than the “blue pencil” rule. That is, the court will enforce a one-year limitation rather than the stated two-year limit, will enforce it only as to customers who were clients of P at approximately the time the Ds left P’s employ, and will enforce it only in the narrow geographical area where the Ds worked while they were in P’s employ. *Central Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 8 (Tenn. 1984). (But a dissent argued that the majority’s approach “will permit an employer to insert oppressive and unnecessary restrictions into [non-compete] covenants, knowing that the courts will modify and enforce the covenants on reasonable terms.”)

5. **Commercial bribery:** Nearly all states have statutes preventing the ***bribery of an employee*** to induce her to give the briber the employer’s business, or to take other official action. See, e.g., N.Y. Penal Law § 180.00. Where a supplier procures a contract with a business by bribing the latter’s employee, he will almost certainly not be able to recover on the contract, even if he has delivered the goods.

   a. **Bribe paid to third party:** If the plaintiff has paid a bribe not to the defendant’s agent, but to some ***third party***, the court is less likely to refuse to enforce the transaction than if payment had been made to the defendant’s employee. But such a refusal to enforce may nonetheless occur if the court finds that the public policy behind the bribery statute is sufficiently compelling. See, e.g., *McConnell v. Commonwealth Pictures Corp.*, 166 N.E.2d 94 (N.Y. 1960).

6. **Exculpatory contracts:** There are a number of situations in which one party may contract to ***indemnify*** or hold harmless another from tort or contract liability. The legality of such contracts depends upon who the victim is, and on the kind of tort or contractual liability involved. See Rest. 2d, § 195.

   a. **Release by potential defendant:** If *A* promises *B* that *A* will not hold *B* liable for any ***torts*** which *B* may in the future commit against *A*, the agreement will be held to be ***illegal*** with respect to intentional torts. Such an agreement will normally be allowed, however, insofar as it applies to negligent torts.

   b. **Indemnification for torts and crime:** If *A* promises to indemnify *B* from any consequences that may occur in performing a ***crime,*** the contract will be unenforceable unless *B* acts in good faith and without knowledge of the illegality. But a contract by *A* to

indemnify *B* against the consequences of *B*'s own negligence, where a third person is the victim, is normally not illegal.

7. **Licensing requirements:** Where a statute prohibits a person from engaging in a specified business or occupation without a ***license*** or ***permit***, a contract for the performance of such services by an unlicensed person will be illegal "if the [statute] has a ***regulatory purpose*** and the interest in the enforcement of the promise is clearly ***outweighed by the public policy*** behind the [statute]." Rest. 2d, § 181.

   Example: A person who performs highly-regulated services such as those provided by stockbrokers, doctors, lawyers, etc., without having the necessary license or permit, will not be allowed to recover for those services, either on the contract or in quasi-contract.

8. **Impairment of family relations:** One area in which the courts have traditionally struck down parties' attempts to contract is the area of ***family relations***, especially marriage. When parties attempt by contract to vary the legal treatment of such relationships as marriage, cohabitation, reproduction, and the like, courts often refuse to enforce the contract on grounds of public policy.

   a. **Prenuptial agreements:** The ***"prenuptial agreement"*** is a dramatic example of courts' historical hesitation to enforce agreements that modify the rules governing family relationships. (A prenuptial agreement is one in which the "non-moneyed" spouse, typically the wife, agrees that in the event of divorce or separation, that spouse will receive lesser alimony, or a smaller property-division, than the standard legal rules of the jurisdiction would impose.)

      i. **Traditional view:** Traditionally, courts have either entirely refused to enforce such agreements, or subjected them to much tighter scrutiny than other types of contracts, on the grounds that society has a strong interest in ensuring that men support their ex-wives. For instance, many courts traditionally declined to enforce a prenuptial agreement if the court concluded that the agreement did not make "reasonable provision" for the wife's financial needs. And frequently, the court phrased the issue as being whether the agreement was reasonable as viewed ***as of the time of the divorce***, not merely

reasonable as of the time it was signed. Therefore, in cases where the man was merely affluent at the time the agreement was signed and then became wealthy, there was a good chance that the court would conclude that the husband's increased fortune made the agreement no longer reasonable, and thus one which ought not to be enforced.

ii. **Modern approach:** But more and more courts are willing to ***enforce*** prenuptial agreements now, especially where basic conditions of procedural fairness are observed before signing. For instance, about half the states have enacted the ***Uniform Premarital Agreement Act***, under which voluntarily-signed prenuptial agreements are enforceable if *either*: (1) the agreement was ***not unconscionable*** when signed; or (2) even though the agreement *was* unconscionable when signed, the signer was either ***provided a fair and reasonable disclosure*** of the other party's financial condition, ***knew or reasonably could have known*** of that financial condition, or voluntarily and expressly ***waived*** in writing any right to such disclosure.

So in a state that has adopted the UPAA, if the wife receives fair disclosure of the husband's financial condition before signing, or voluntarily signs an agreement in which she waives the right to get that information, the court will enforce the agreement ***without ever even entertaining the question of whether the agreement was "fair" or "conscionable"*** at the time it was made (and will certainly not look at whether ***post-signing events*** have made the agreement unfair). See UPAA § 6.

b. Agreements regarding cohabitation: Suppose two unrelated adults ***cohabit*** without getting married. Suppose further that one of them alleges (probably after the relationship breaks up), that both orally agreed early in the relationship on some ***financial arrangement***, such as a sharing of assets obtained during the relationship. In theory, such an agreement regarding finances should be enforceable like any other oral agreement — it seems not to fall within any Statute of Frauds provision (see *supra*, p. 276), and should be enforced if the court is convinced that the alleged oral meeting of the minds in fact occurred.

i. **Traditional view:** But courts traditionally have ***refused to enforce*** such ***"living together"*** agreements, on the grounds that they amount to payment for sex, and are thus illegal. See,

e.g., *Hewitt v. Hewitt*, 394 N.E.2d 1204 (Ill. 1979) (“enhancing the attractiveness of a private arrangement over marriage…contravenes the…policy of strengthening and preserving the integrity of marriage”).

ii. **Emerging trend to enforcing:** But a strong emerging minority of courts is now willing to ***enforce*** such living together arrangements, at least where they do not explicitly trade sex for money. See, e.g., *Marvin v. Marvin*, 557 P.2d 106 (Cal. 1976).

B. Effects of illegality on contractual recovery: As a general rule, ***neither party to an illegal contract may enforce it***. This is the case even where only one party’s performance is illegal. Thus if *X* promises to do something legal in return for *Y*’s promise to do something illegal, neither *X* nor *Y* can sue for either specific performance or damages. C&P, p. 820. However, there are some exceptions to this general rule, which are explored below.

1. Enforceability of contracts that are wholly executory: If neither party to an illegal contract has rendered any performance, there are only a few situations in which the court will allow one party to recover damages for breach:

a. Ignorance of facts: If one of the parties to an illegal bargain is justifiably unaware of the facts which make the contract illegal, and the other is not, the former will usually be allowed to recover damages for breach. Rest. 2d, § 180.

Example: Contractor hires Electrician to perform the electrical work on a project being built by Contractor. Contractor does not find out that Electrician lacks the required license until after the contract is formed, but before Electrician has done the work. Contractor may cancel the contract, and sue Electrician for damages for breach, if Contractor had no reason to know of Electrician’s lack of a license.

b. One party has wrongful purpose: Some contracts are illegal solely because one of the parties has a ***wrongful purpose***. For instance, a contract to sell goods to one who plans to smuggle them into another country is illegal, but if the person without the illegal purpose ***does not facilitate the crime***, and the crime is not one involving “serious moral turpitude,” the innocent party may recover for breach even though at the time of contracting he knew of the

unlawful purpose. Rest. 2d, § 182.

Example: *A* agrees to sell goods to *B*, knowing that *B* plans to smuggle them into the country. Since the crime is not one involving serious moral turpitude, A can recover for breach of contract. But if he ***facilitates*** the smuggling (as by packing the goods in such a way as to conceal them from customs inspectors), he will ***not*** be able to recover for breach. C&P, p. 823.

c. **Statute directed at one party:** Some statutes are designed to ***protect one party,*** and make only the other one's conduct criminal. "Blue sky" laws, designed to protect investors from unscrupulous promoters, are an example. Where such a statute is involved, ***the person for whose protection the statute is designed may enforce the contract***, or sue for its breach. Thus a person who agrees to buy stock in a transaction that would be prohibited by a blue sky law may nonetheless obtain specific performance of the contract, or sue for its breach. C&P, p. 824.

2. **Partially or fully performed illegal contracts:** If one or both parties have ***partially or fully performed*** an illegal contract, the courts are somewhat more willing to partially enforce it, or at least grant a quasi-contractual remedy. While the general rule is still that the court will leave the parties to the illegal contract where it finds them, there are a number of situations in which some remedy will be afforded. In addition to the circumstances described above, in which even before partial performance a party may have a remedy, courts will grant relief in the following contexts:

a. ***Malum prohibitum:*** There are many statutes which render illegal conduct which cannot be said to involve moral turpitude. The illegal act in such a case is sometimes said to be ***"malum prohibitum"*** rather than *"malum in se."* Where the illegality is of this non-serious sort, the courts will sometimes allow the party who has partially performed to recover at least the ***restitutionary value*** of his services.

Example: Bank loans Borrower money at 10% interest, in a jurisdiction where the legal limit on interest is 8%. Because violation of the usury laws is usually held to be *malum prohibitum* rather than *malum in se*, Bank will probably be able to recover the principal, and perhaps the legal interest. It will not be able to recover the excess interest, and might be subject to either a penalty or to forfeiture of the entire interest.

i. **Licensing statutes:** Thus many ***licensing statutes*** are held to be mere revenue-raising laws, and their violation is *malum prohibitum*. One who performs services without having the necessary license is allowed to recover the value of his services. This might be the case for a person who lacks a building contractor's license, where it is clear that the licensing fee is a disguised occupancy tax. But where the license is required to ***protect the public,*** such as a license to practice law, lack of it is usually deemed so serious that a person performing services is generally denied all recovery. C&P, pp. 826-27.

b. ***Pari delicto:*** In addition to the *"malum prohibitum"* situation just discussed, a party who has performed an illegal contract may recover the value of his performance if he meets two requirements: (1) he was not guilty of serious moral turpitude; and (2) although he knew of the illegality and was blameworthy, he was ***less guilty*** than the other party. If these two requirements are met, the partially performing plaintiff is said not to be in ***"pari delicto"*** (i.e., not equally culpable).

> **Example:** P, a Jew who is desperate to escape from Hitler-occupied France, gives $28,000 worth of jewelry to D, in return for D's promise to use the jewelry to bribe the Portuguese consul in France so that a visa will be issued to P. Instead of using the jewelry for this purpose, D absconds with it. P escapes by some other means, and happens across D in New York City. P sues for return of the jewelry.
>
> *Held*, P is not in *pari delicto*, since he is less blameworthy than D, and since his offense (attempted bribery) is not, considering the circumstances, morally repugnant. Therefore, he may obtain restitution of the jewelry or its value. *Liebman v. Rosenthal*, 57 N.Y.S.2d 875 (N.Y. Sup. Ct. 1945).

i. **Deterrent effect:** In deciding whether to apply the *pari delicto* doctrine, the court will mainly consider whether barring the plaintiff from recovery will ***encourage***, rather than deter, the illegal conduct in the future. If the court thinks that barring the plaintiff will encourage the wrongdoer to engage in the same kind of wrongdoing in the future, it will stretch towards a finding that the parties are ***not*** in pari delicto.

3. **Divisibility:** A key way in which courts avoid the unfairness that may result from total refusal to enforce an illegal contract, is by use of the

doctrine of ***divisibility***. Recall that a party in breach may nonetheless recover on a portion of the contract if that portion was "divisible" and he substantially performed his side of that portion. (See *supra*, p. 221.) A similar doctrine is often applied in the case of an illegal contract: if a divisible part of the contract could be performed on both sides without violating public policy, the court will ***enforce that divisible portion.*** Rest. 2d, § 183.

> **Example:** P, an unlicensed plumber, makes an agreement with D to do certain plumbing work for D for an agreed price. P completes the work by supplying both labor and materials. A local ordinance requires a plumber to be licensed in order to furnish plumbing services. P will be able to recover that portion of the contract price fairly representing the charge for materials, even though he may not recover the portion representing services.

a. Three requirements: There are three requirements which must be satisfied before the doctrine of divisibility will be applied in the illegal contract situation:

i. **Divisibility:** First, the contract itself must indeed be ***divisible***, just as in other situations where divisibility is to be applied. That is, it must be possible to apportion the parties' performances into "***corresponding pairs*** of part performances." Farnsworth, p. 354. Also, it must be fair to "regard the parts of each pair as ***agreed equivalents***." *Id.*

ii. **Not affect entire agreement:** A second requirement is that the illegality ***must not affect the entire agreement***. Farnsworth, p. 355. "If the entire agreement is part of an integrated scheme to contravene public policy, none of it will be enforced." Rest. 2d, § 183, Comment b.

iii. **Serious misconduct:** Finally, the party seeking performance "must not have engaged in ***serious misconduct***." *Id.* For instance, suppose that P, a lawyer, promises to pay certain sums to D, a private investigator; some of the money is for D's services in finding a missing witness, W, and the rest is for D's persuading W to give false testimony. If D fully "performed," a court would probably deny him any recovery, even for his services in locating the witness, since his subornation of perjury was a serious offense.

Note: In all of the situations which have been treated thus far, the illegality existed both at the time the contract was made, and at the time it was to be performed. If a contract is legal at the time it is entered into, but due to subsequent legislative action ***becomes*** illegal before its performance, the problem is treated as one involving impossibility. See *supra*, p. 441. In such a situation, both parties are generally discharged, with restitution awarded to return them as nearly as possible to the positions they occupied prior to contracting. See *supra*, p. 453.

Quiz Yourself on ILLEGALITY

125. Hy Nickin sells Bud Wizer his small beverage store in New York City for $25,000. As part of the deal, Hy promises that for the rest of his life (he's 32), he will never compete in the retail beverage business anywhere within 20 miles of the shop being sold. Eight years later, Nickin opens a beverage store of his own, six miles from Wizer's. Can Wizer enforce the covenant not to compete?

126. The U.S. has a ban on trade with Iraq. The Snakeoil Pharmaceuticals Company gets an unsolicited order for $100,000 worth of medicine from Abdul Hussein. It ships the medicine on credit to Hussein in New Jersey, knowing Hussein intends to smuggle it into Iraq. Hussein doesn't pay. Can Snakeoil recover the $100,000 due under the contract?

Answers

125. Probably not, but it depends on the court's precise approach to non-competes that are unduly broad as drafted. A person's promise not to compete, entered into as part of that person's sale of a business, will be enforceable if (but only if) the non-compete is ***not unreasonably broad*** as to either: (1) the type of activity constrained, (2) the non-compete's duration, and (3) the non-compete's geographic reach. Here, requirement (1) is no problem: the business being sold and the activity proscribed are in the same industry (retail beverage sales). But requirement (2) is probably a problem: Hy has an estimated remaining working life of over 30 years, which is longer than Bud's store's goodwill is likely to last, so a court will probably conclude that the lifetime duration is unreasonable. Requirement (3) is probably also a

problem: it's unlikely that a small beverage store in a populous place like N.Y.C. has a 20-mile radius within which it competes with other similar stores; therefore, the 20-mile radius provision is probably unduly broad.

However, a court might enforce the non-compete up to reasonable limits. That is, if the court believes that an 8-year non-compete, applicable to, say, a 6-mile radius, would have been reasonable (which the court might well conclude), the court might choose to bar Hy even though the non-compete as written is way too broad. But not all courts will perform this task of "editing the contract down to reasonable limits." Some won't enforce an unduly-broad-as-written non-compete *at all.* Others will do so only if a hypothetical "blue pencil" could remove the offending provision and leave something left to enforce; since no amount of excision — as opposed to rewriting — can turn a lifetime limit into an 8-year limit, or a 20-mile radius into a 6-mile radius, a court following the blue-pencil rule would refuse to enforce this agreement no matter how reasonable it thought an 8-year or 6-mile-radius limit would be.

126. Yes, probably. Normally, neither party to an illegal contract may recover. But where only one of the parties has an illegal purpose, the other party may be able to enforce the contract, under the "pari delicto" doctrine. Under that doctrine, the "innocent" party can recover, even if it knew about the other party's illegal purpose, as long as: (1) the innocent party is not guilty of moral turpitude; and (2) the innocent party is less blameworthy than the party with the illegal purpose. That's probably the case here: Snakeoil's behavior probably isn't deeply blameworthy (since it involves medicine), and Snakeoil is clearly less blameworthy than Hussein, who's the one who's doing the smuggling.

II. DURESS

A. Duress generally: The defense of duress is available if the defendant can show that he was ***unfairly coerced*** into entering into the contract, or into modifying it. It is much more broadly available today than prior to this century, when it could be used only if a party's person or property was put in actual danger. Today, the essential rule is that duress consists of "any wrongful act or threat which ***overcomes the free will*** of a party."

C&P, p. 309. See also Rest. 2d, § 175.

1. **Subjective standard:** A ***subjective standard*** is used to determine whether the party's free will has been overcome. That is, regardless of whether the will of a person of "ordinary firmness" would have been overborne, if the party can show that he was unusually timid, and was in fact coerced, he may use the defense. But the fact that the hypothetical "person of ordinary firmness" would or would not have been overborne has evidentiary value in ascertaining whether the party's own decision was coerced. C&P, p. 309.

B. Ways of committing duress: Facts which constitute duress seem to fall mostly into four categories: (1) ***Violence*** or threats of it; (2) ***Imprisonment*** or threats of it; (3) Wrongful ***taking*** or ***keeping*** of a party's property, or threats to do so; and (4) Threats to ***breach*** a contract or to commit other wrongful acts (e.g., threats to exercise legal rights in oppressive ways). See C&P, p. 311-12.

1. **General rule:** A detailed examination of these various categories is outside the scope of this outline, except for threats to breach a contract, discussed below. However, one important general principle may be stated: If one party threatens another with a certain act, it is ***irrelevant*** that he would have the ***legal right*** to perform that act, if the threat, or the ensuing bargain, are ***abusive or oppressive.***

> Example: P works for D under an at-will arrangement, by which the employment may be terminated at any time at the option of either party. D threatens to fire P unless he agrees to sell shares of stock in D back to the company. This would probably be found to constitute duress, even though D theoretically has the right to fire P for no reason. Therefore, if P sold (or agreed to sell) the shares to D under these circumstances, a court would probably void the transaction.

C. Threat to breach contract: Perhaps the most frequently alleged form of duress in contract litigation occurs where one party ***threatens to breach the contract*** unless it is modified in his favor, or a new one drawn up. The modern rule seems to be that there will be duress in this situation if the threatened breach would, if it were carried out, result in ***irreparable injury*** that could not be avoided by a lawsuit or other means, and the threat is made in "breach of the duty of good faith and fair dealing." See Rest. 2d, § 176; see also C&P, p. 318.

> **Example:** D has a government contract to produce $6 million worth of radar sets

for the navy. D sub-contracts with P for production of certain components of the sets. After P has begun delivery of these parts, D gets a second contract for more sets. P tells D that unless it receives a sub-contract for an even greater portion of this new work than it had under the first contract, and an increased price under the first contract, P will stop making deliveries under that contract. It then does indeed stop deliveries. D checks with all the sub-contractors on its approved list, but none can make deliveries under the first contract in time to meet the requirements of D's contract with the Navy. In desperation, therefore, D agrees to P's demands. After the last of the deliveries under both contracts, D stops making any more payments, and says that it will sue to get back the excess amounts paid. P sues first (for the balance due), and D counter-claims for these excesses.

Held, D agreed to the modification and the second contract only under "economic duress," and is therefore entitled to damages. To prove such duress, D needed to show that it could not have gotten the goods elsewhere, but this showing was made here. *Austin Instrument, Inc. v. Loral Corp.*, 272 N.E.2d 533 (N.Y. 1971).

1. **Remedy:** Usually, the remedy for duress is ***restitutionary*** in nature. That is, the party claiming it is allowed to recover an amount sufficient to undo the ***unjust enrichment*** that the other party has obtained. Thus in *Austin Instrument*, D might have been able to recover the increased price in the first contract, and everything beyond a fair and reasonable price on the second contract (less, of course, the amount owed on that contract).

III. MISREPRESENTATION

A. Misrepresentation generally: A claim of ***misrepresentation*** can be used either as a defense against enforcement in a suit brought by the misrepresenting party, or as a grounds for rescission or damages by the misrepresented-to party suing as plaintiff. The contract law of misrepresentation is somewhat similar to misrepresentation in tort law; for a full discussion of the latter, see Emanuel on *Torts*. However, courts have generally made misrepresentation claims easier to establish in contract cases (particularly suits for rescission of contracts) than in tort cases. See Rest. 2d, Ch. 7, Topic 1, Introductory Note.

B. Elements of proof required: In order for a person to rely on misrepresentation for purposes of rescinding a contract, defending against a claim of breach of contract, or suing for breach, the person claiming misrepresentation (we'll call her "P") must show the following elements:

□ D ***misstated*** a ***material fact*** (though the misstatement does ***not*** have

to have been ***intentional*** or even ***negligent***);

☐ P ***in fact relied*** on the misstatement;

☐ P's reliance was ***justifiable***; and

☐ P was damaged in a ***pecuniary way*** from the misstatement.

1. **Other party's state of mind:** It is ***not*** usually necessary for the claimant to prove that the misrepresentation was ***intentionally*** made; a ***negligent***, or even ***innocent, misrepresentation*** is generally sufficient to avoid the contract if it goes to a material fact. See Rest. 2d, § 164. (This is an important respect in which the contract law of misrepresentation is more liberal than the usually-applied tort principles.)

2. **Justifiable reliance:** The party asserting misrepresentation must show that he ***justifiably relied*** on the misstatement. This requires him to show not only that he ***in fact*** relied, but also that his reliance was ***justifiable.***

   a. **Gullible people sometimes protected:** However, the latter requirement, that the reliance be justifiable, has not been rigorously enforced in recent years. This is particularly true where the misrepresentation is ***intentional***.

      Example: P buys a house from D, in reliance on D's assurance that the house is suitable for multi-family rental use. D knows that his representation is misleading in that such a use would violate local zoning laws. P believes the misrepresentation without checking the public records, which would have disclosed the zoning problem.

      Held, P may recover for misrepresentation despite his failure to exercise due diligence in checking the zoning laws. This is so in part because D knew that it was making misleading statements. *Kannavos v. Annino*, 247 N.E.2d 708 (Mass. 1969).

3. **Must be misrepresentation of fact:** The misrepresentation must be one of ***fact***, rather than of ***opinion***. If a new car dealer tells a potential customer, "This is a great little car," the buyer probably can't sue on a misrepresentation theory, even if he can prove that not only is the car not "great," but that the dealer had reason to know that it wasn't. This expression of opinion is likely to be termed "mere puffing" or "trade talk," and thus not actionable. See Rest. 2d, §§ 168 and 169.

   a. **Thin line between opinion and fact:** But courts are increasingly

willing to find that a statement has crossed over the thin line between opinion and fact. For instance, if a used car is represented to be "mechanically perfect," this may constitute a statement of fact. See C&P, p. 330.

b. Special circumstances making opinion actionable: Furthermore, the relationship between the parties may be such that even what is obviously an opinion is actionable. For instance, if there is a ***fiduciary relationship*** between the parties (e.g., a corporation and its shareholders), or the person making the statement ***holds himself out as an expert*** (e.g., a jeweler stating that his stone is, in his opinion, worth at least $1,000), the other party may claim that the opinion was a misrepresentation.

> **Example:** P, a 51-year-old widow, becomes a student at D's dance school (an Arthur Murray franchise). During the space of 16 months, she is sold 14 "dance courses," totaling 2300 hours of dance lessons, for a total of cash price of over $31,000 (in 1968 dollars!). P does so in part because D repeatedly assures her that in D's opinion P has "excellent potential" for dance, and that she is developing into a "beautiful dancer." In reality, P has no dance aptitude whatsoever, and can barely hear the musical beat. P sues to have the contracts rescinded for fraudulent misrepresentation. D moves to dismiss on the grounds that he merely expressed his opinion about P's abilities, and that statements of opinion cannot be the basis for a misrepresentation suit.
>
> *Held*, for P. It's true that as a general rule, a misrepresentation is actionable only if it is one of fact rather than opinion. But there are important exceptions, such as "where there is a fiduciary relationship between the parties, ... or where the representee does not have equal opportunity to become apprised of the truth or falsity of the fact represented." Here, D had ***"superior knowledge"*** about whether P had dance potential, so P's complaint falls within the exception, and states a cause of action. *Vokes v. Arthur Murray, Inc.*, 212 So.2d 906 (Fla. Dist. Ct. App. 1968).

c. Statement of law: It used to be generally held that a ***"statement of law"*** could not constitute a misrepresentation. Some courts said that this was because a statement about law was necessarily merely an opinion; others said that it was because "[e]veryone is presumed to know the law." C&P, p. 333.

i. **More liberal modern rule:** But today, this rule is breaking down. Some courts have simply abolished the rule, and hold that a statement as to law may be the basis for a misrepresentation claim under the same circumstances as an opinion could be (e.g., when made by a person presumed to be

an expert, such as a lawyer). Others hold that where a statement involving the law is really a statement about facts (e.g., "this house conforms to all building and zoning requirements"), it is actionable the same way any other statement of fact is actionable.

C. Concealment and nondisclosure: Most misrepresentations are affirmative statements (e.g., "This car has less than 50,000 miles on it."). If, however, a party has simply ***failed to disclose*** information, it has traditionally been much harder to make a case for misrepresentation. See Rest. 2d, § 161.

> **Example:** P buys a house from D. At the time of sale, D knows that the house is infested with termites, but says nothing to P. After discovering the termites, P sues to recover the money he spent on repairs.
>
> *Held*, P has no cause of action. There is no liability for "bare nondisclosure." "If this defendant is liable on this declaration every seller is liable who fails to disclose any nonapparent defect known to him in the subject of the sale which materially reduces its value and which the buyer fails to discover." The law has not reached the stage of imposing such a requirement. *Swinton v. Whitinsville Sav. Bank*, 42 N.E.2d 808 (Mass. 1942).

1. More liberal present rule: Today, courts are substantially more willing to allow a recovery based on a failure to give information. While it is still true that in a bargaining situation, there is ***no general duty*** to disclose information to the other party, there are a number of ***special situations*** in which this rule does not prevail:

a. Half truths: If ***part of the truth*** is told, but another portion is not, so as to create an overall misleading impression, this may constitute misrepresentation. See Rest. 2d, § 159, Comment b.

b. Positive concealment: If the party has taken ***positive action*** to conceal the truth, this will be actionable even though it is not verbal. See Rest. 2d, § 160. Thus if the defendant in *Swinton* had carefully swept up the evidence of termites and repainted the affected area just before the sale, this would probably be held to be actionable.

c. Failure to correct past statement: If the party knows that disclosure of a fact is needed to prevent some ***previous assertion*** from being ***misleading***, and doesn't disclose it, this will be

actionable. See Rest. 2d, § 161(a), Comment c.

Example: At the start of negotiations on January 1 for a house sale, Seller truthfully states, in response to a question by Buyer, that his house has no termites. But by the time the contract for sale is about to be signed in April, Seller knows that he now has termites. Seller's failure to disclose that fact will constitute a misrepresentation. (And that's true even if Buyer doesn't repeat the question — Seller has an affirmative duty to step forward and volunteer any information needed to prevent his previous statement from being misleading.)

d. Fiduciary relationship: If the parties have some kind of ***fiduciary relationship***, so that one believes the other is looking out for his interests, there will be a duty to disclose material facts. See Rest. 2d, § 303(d).

e. Failure to correct a mistake: If one party knows that the other is ***making a mistake*** as to a ***basic assumption***, the former's failure to correct that misunderstanding will constitute a misrepresentation if the non-disclosure amounts to a "failure to act in ***good faith***" or to act "in accordance with reasonable standards of ***fair dealing***." Rest. 2d, § 161(b).

Example: Jeweler offers a stone for sale without stating what kind of stone it is. Consumer looks at it and says, "Oh, what a beautiful emerald." Probably Jeweler's failure to correct this basic misunderstanding would constitute bad faith, especially in view of Jeweler's superior knowledge. If so, Jeweler's silence would constitute misrepresentation.

f. Easier standard for rescission: Finally, some courts have held that even where one party's silence does not justify the other in suing for damages, the court may grant the ***equitable*** relief of ***rescinding*** the contract.

Quiz Yourself on
DURESS AND MISREPRESENTATION

127. Wicked Witch corners Dorothy and her little dog, Toto, behind the stacks in the public library. Witch snatches Toto and says to Dorothy, "Sign this contract promising to sell me the ruby slippers for $100, or you'll never see Toto alive again." Witch's fingers close ominously around Toto's throat as she says this. Toto whimpers. Dorothy signs.

(A) Dorothy reneges, and Witch sues to enforce the contract. What

result?

(B) Before Dorothy hands over the slippers, Witch changes her mind, says, “Forget it,” and hands Toto back to Dorothy. Dorothy would actually rather have the $100 than the slippers. Will a court enforce the contract on her behalf? (Ignore the issue of whether the appropriate remedy is an order of specific performance or a damages award.)

128. Kermit takes his livestock to the county fair in hopes of selling it. Fozzie Bear shows a particular interest in one of Kermit’s sows, “Miss Piggy.” Kermit says the pig will cost Fozzie $10,000 because it is a special dancing pig. Fozzie asks for a demonstration, and he sees what he thinks is Miss Piggy dancing. In fact, Kermit has her pen electrified, and a few well-timed shocks are what create the appearance of “dancing.” Fozzie buys Miss Piggy, and subsequently finds out she can’t dance. He seeks his money back on grounds of misrepresentation. Assume that a person of ordinary credulity attending the fair would not have believed that Miss Piggy was dancing, but that Fozzie did believe that she was. May Kermit have the contract rescinded?

129. Gail Ible meets with her long-time stockbroker, Bully Bear, for some investment advice. Bully advises Gail to invest $2,000 in a local biotechnology company. Bully knows, but carelessly fails to mention, that the president of the company was just indicted on fraud charges and that no successor has yet been picked. (The news is not yet public — Bully knows the info through his contacts at the company.) Gail signs a contract to buy the stock through Bully’s firm. After the news becomes public, the stock price falls by 50%. Gail sues Bully for contract damages based on misrepresentation.

(A) Will the fact that Bully’s misstatement was negligent rather than intentional make a difference in the outcome?

(B) If you’re representing Bully’s firm, what defense will represent your best shot at getting him off?

(C) Will the defense you asserted in part (B) work?

Answers

127. (A) Dorothy can avoid the contract due to duress. The defense of duress is available whenever the other party makes a threat or wrongful act that overcomes the free will of the defendant. When the defense is available, the party asserting it is discharged from the contract.

(B) Yes. A contract entered into under duress is voidable only at the option of the *wronged* party, not at the option of the wrongdoer.

128. Yes, probably. Courts have traditionally said that a party may recover for contractual misrepresentation only if the party's reliance on the misrepresentation was "reasonable." However, the modern trend is to hold that if the misrepresentation was intentional, and the party asserting misrepresentation honestly believed the misrepresentation, the fact that the reliance was "unreasonable" will not bar recovery. Therefore, a court following the majority approach will find in favor of Fozzie, and allow rescission.

129. (A) No A contract action for misrepresentation can be based on a negligent (or even non-negligent but incorrect) misrepresentation of a matter of material fact — unlike a tort action for fraud or deceit, there is no particular mental-state element in a contract misrepresentation action.

(B) That Bully never made any affirmative misrepresentation; he merely failed to make a disclosure. (C) Probably not. It's true that as a *general* rule, a party's failure to make a disclosure won't be treated as equivalent of an affirmative misstatement, and therefore won't serve as the basis for a misrepresentation action. But there are a number of exceptions to this general rule. On of those exceptions is that if there is a relation of ***"trust and confidence"*** between the plaintiff and the defendant, the defendant's failure to make disclosure will be treated as the equivalent of an assertion. Since the facts tell us that Gail has used Bully for a long time, and has come to him for advice, a court would probably hold that the requisite relation of trust and confidence existed between them.

IV. UNCONSCIONABILITY AND ADHESION CONTRACTS

A. Weapons against unfair contracts: A party is normally bound to the terms of a contract which he signs. The parol evidence rule, discussed in a previous chapter, is one indication of courts' unwillingness to tamper

with the terms of a writing. But if the provisions of a contract are so grossly unfair as to shock the conscience of the court, the judge may decline to enforce the offending terms, or the entire contract. The two principal tools at his disposal for doing this are the special rules on adhesion contracts, and the related doctrine of unconscionability.

B. Adhesion contracts: Most business contracts in use today are probably "***standardized***"; that is, they consist of a large number of non-negotiated pre-drafted terms put together by one party, with room for negotiation as to only a few aspects of the deal (e.g., price and quantity). It is often the case that the party for whom the standard contract was drafted has substantially greater bargaining power than the other party to the transaction. It is also frequently the case that the standardized terms are complicated, unclear, exceptionally favorable to the drafter, and printed in small type. Such contracts are commonly called "***adhesion contracts***."

1. Refusal to enforce: Courts have always been reluctant to enforce such adhesion contracts; despite the objective theory of contracts (see *supra*, p. 6) they have generally relied on the theory that the non-drafter has ***not really assented*** to the bargain. This has led a number of courts to refuse to give effect to all or part of such contracts.

2. Steps for avoiding contract: A litigant who wants to avoid enforcement of a contractual term on the grounds that it is part of an adhesion contract usually has to make two showings:

[1] that the contract itself is an ***adhesion contract***; and

[2] that the contract (or the clause complained of) either (i) violates his ***reasonable expectations*** or (ii) is ***unconscionable***.

a. What is an adhesion contract: In determining whether a contract is an "adhesion contract," courts look at several factors. The most important two factors (both of which must usually be satisfied) seem to be:

i. **Standardized form:** That the contract was a ***standardized form*** (as opposed to one whose terms were individually negotiated). Thus an adhesion contract is generally offered to the other party on a ***"take it or leave it"*** basis — the offering party refuses to modify any terms.

ii. **Gross disparity in bargaining power:** That the complaining party had ***grossly less bargaining power*** than the party who drafted the standardized agreement. Thus if market conditions or the special circumstances of the case meant that the plaintiff had no other suppliers to choose from (or all the other available suppliers imposed the same terms), the requisite "gross disparity in bargaining power" is likely to be met. In general, ***consumers*** (especially ones who are poor and/or uneducated) are much more likely to be found to have been at a gross bargaining disadvantage than are ***businesses***.

b. Proof as to reasonable expectations or unconscionability: Once the plaintiff has shown that the contract was a contract of adhesion, she must still show that her ***reasonable expectations were thwarted*** by the actual provisions of the contract, or that the contract is ***unconscionable***:

i. **Reasonable expectations:** When the court decides whether the plaintiff's ***"reasonable expectations"*** were thwarted, this determination is based mostly upon whether a ***reasonable person in P's position*** would have ***expected*** that the clause in question was ***present in the contract***. So a very ***unusual and burdensome clause*** stuck into the ***fine print*** on the back of a standard form contract might flunk this "reasonable expectations" test, and entitle the plaintiff to avoid the contract.

Example: Suppose P (a consumer) rents a car from D (a rental agency). D's standard form contract contains, buried in the fine print on the back of the form, a clause stating that "If the car is damaged in any way, whether due to the renter's negligence or not, the renter agrees to pay an additional rental fee equal to five times the actual out-of-pocket cost to the agency of repairing the damage." A reasonable renter in P's position would be unlikely to expect to find this kind of punitive no-fault provision in a car-rental contract. Therefore, a court would probably conclude not only that this agreement was an adhesion contract, but also that the clause in question fails the "reasonable expectations" test. If so, a court would decline to enforce the clause without ever reaching the issue of whether the clause was unconscionable.

ii. **Unconscionable:** Even if the contract or a disputed clause is not at variance with the plaintiff's "reasonable expectations" (e.g., the plaintiff knew exactly what the contract said),

plaintiff can still get the contract or clause knocked out on the grounds that it is ***"unconscionable."*** Essentially, a contract or clause will be found unconscionable when it is so ***shockingly unfair*** that the court decides that it should not be enforced. The issue of unconscionability is discussed extensively beginning *infra*, p. 478.

3. **Tickets stubs and other "pseudo-contracts":** Most adhesion-contract cases involve plaintiffs who knew that they were entering a contract, and the only question was whether the court should decline to enforce the contract or a particular clause because it is unfair or because the plaintiff didn't understand its details. A related but different question arises where the non-draftsman does not even necessarily ***realize that he is entering a contract at all***. For instance, when a person parks his car, and is handed a ***ticket stub*** with a number on it, he is likely to assume that this stub is merely a kind of receipt, to identify his car and enable him to get it back. If the stub includes a lot of fine print on it, in which the parking lot owner disclaims all liability for negligence, intentional torts, etc., the court is likely to hold that the customer had no idea he was making a contract at all, and that all the fine print is completely ineffective.

   a. **Restatement view:** The Second Restatement attempts to deal with this problem of the contract that does not necessarily appear to be a contract. Under Rest. 2d, § 211, a document binds a party only if she "signs or otherwise ***manifests assent***" to it, and furthermore "***has reason to believe that like writings are regularly used to embody terms of agreements of the same type***...." Thus the parking lot owner would have to prove that the customer first of all gave some sign of being aware that there were contractual provisions on the ticket (e.g., testimony that the customer read the ticket), and further that an ordinary person in the customer's position would ***expect to find terms similar to those which the ticket actually contained.*** These would probably be difficult things for the parking lot to establish.

      i. **Which terms apply:** Once the party who drafted the document proves these things, the document is to be interpreted, if possible, by "treating alike all those similarly situated, without

regard to their knowledge or understanding of the … terms. …" (§ 211(2)). This seems to apply a sort of "common denominator" standard, by which even if the customer were a lawyer who read the ticket in full, he would only be held to an interpretation which the average layman would make of the document.

ii. **Terms that eliminate the transaction's purpose:** As a corollary, Rest. 2d, § 211(3), provides that if the drafting party has "reason to believe that the party manifesting … assent would not do so if he knew that the writing contained a particular term, ***the term is not part of the agreement***." Comment f to that section explains that the drafting party might have reason to believe that the term would not be assented to if "it ***eviscerates the non-standard terms*** explicitly agreed to, or … it ***eliminates the dominant purpose*** of the transaction."

Example: Suppose D sells P a generator under a contract that lists "1136 kilowatts" as part of the typewritten specifications, but that also includes a printed disclaimer of warranty. The disclaimer will not prevent D from being held to warrant that the generator will produce 1136 kilowatts. Otherwise, the non-standard term, 1136 kilowatts, would be "eviscerated." See Rest. 2d, § 237, Illustr. 8.

C. Unconscionability generally: The other principal judicial weapon against unfair contracts is the doctrine of ***unconscionability***. The idea that a contract may be unenforceable because it is shockingly unfair dates back hundreds of years. See W&S, pp. 83-84. Today, courts tend to turn away from time-honored methods of avoiding enforcement of unfair contracts (e.g., by holding that even completely clear, but unfair, language is ambiguous and therefore to be construed against the draftsman) and towards flat holdings that a contract, or part of it, is shocking and unconscionable.

1. **Restatement treatment:** Thus Rest. 2d, § 208, allows a court to decline to enforce all or part of an unconscionable contract. That provision is almost word for word the same as UCC § 2-302(1), discussed below.

2. **Dependence on UCC cases:** Most of the important unconscionability cases in recent years have involved sales of goods, and have therefore

involved the UCC. Accordingly, non-sales cases (e.g., contracts to provide services) have generally looked to the Code, and to cases decided under it. Our discussion of unconscionability will therefore focus on the Code.

D. The Code view generally: UCC § 2-302(1) provides that "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may ***refuse to enforce the contract***, or it may ***enforce the remainder of the contract*** without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."

1. **No definition of unconscionability:** The statutory language of the Code itself does not define the word "unconscionable." Comment 1 to § 2-302 attempts to do so; it states that the test for unconscionability is "whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so ***one-sided*** as to be unconscionable under the circumstances existing at the time of the making of the contract." The Comment goes on to say that "the principle is one of the ***prevention of oppression*** and ***unfair surprise*** … and ***not of disturbance of allocation of risks because of superior bargaining power.***"

   a. **Look at contract as of signing:** The contract must be judged ***as of the facts existing at the time of signing it***. The fact that one of the parties (usually the seller) acted in bad faith after the contract was signed (e.g., by delivering shoddy merchandise) has no effect on whether the contract itself was unconscionable. (But these post-contract actions may constitute a violation of the party's duty to perform in good faith, imposed by § 1-203.)

2. **Used mostly by consumers:** Virtually the only successful use of unconscionability under the Code has been made by ***consumers***. See W&S, pp. 138-39. The courts usually presume that where a contract is between two ***businesspeople***, each is capable of protecting his own interests, and should not receive the benefit of judicial assistance via the unconscionability doctrine.

3. **Decision made by judge:** Observe that by the language of § 2-302(1), the decision as to whether a contract is unconscionable is to

be made by the ***judge***, not the jury.

E. Varieties of unconscionability: Elements which render a clause or entire contract unconscionable may be divided (as do W&S, pp. 135-149) into two main categories: (1) "***procedural*** unconscionability" and (2) "***substantive*** unconscionability." In those contracts found to be unconscionable, often there will be elements of *both* categories present.

1. Procedural unconscionability: "***Procedural*** unconscionability" refers to the fact that one party was induced to enter the contract without having any ***meaningful choice***. Thus oppressive clauses tucked away in the ***boilerplate***, ***high-pressure salespeople*** misleading ***illiterate consumers***, ***oligopolistic industries*** in which all sellers offer the same unfair "adhesion contracts" so that no bargaining is possible, are all indications of a lack of real assent.

Example: P sells a freezer to D on credit. D speaks very little English, and the provisions of the installment contract which he signs are written in English. P's salesman neither translates nor explains the contract, and also tells D that the freezer will cost him nothing, because he will be paid a bonus of $25 for each sale which he later makes to his friends.

Held, the contract is unconscionable, and P may not recover the contract price. (In addition to the misleading sales practice, the court was influenced by the fact that the total time-price was over $1,100, in contrast to a wholesale cost to P of $348 and a cash sales price of $900.) See *Frostifresh Corp. v. Reynoso*, 274 N.Y.S.2d 757 (1966), rev'd in part 281 N.Y.S.2d 964 (so that P could recover a reasonable profit, service and finance charges in addition to its own cost of $348).

a. Clues to procedural unconscionability: Rest. 2d, § 208, Comment d, lists several factors indicating that the bargaining process was unconscionable. These include:

[1] "belief by the stronger party that there is ***no reasonable probability*** that the weaker party will ***fully perform*** the contract";

[2] "knowledge of the stronger party that the weaker will be ***unable to receive substantial benefits*** from the contract"; and

[3] "knowledge of the stronger party that the weaker party is ***unable reasonably to protect his interests*** by reason of ***physical or mental infirmities, ignorance, illiteracy*** or ***inability to understand the language of the agreement***...."

The facts of *Frostifresh, supra*, are given as Illustr. 3 to § 208.

2. **Substantive unconscionability:** A clause is ***"substantively unconscionable"*** if it is unduly unfair and one-sided. Most of the cases involving substantive unconscionability involve either an ***excessive price***, or an unfair ***modification of either the seller's or buyer's remedies***. W&S, p. 140.

F. Excessive price: An important type of substantively-unconscionable provision is one where the ***price is excessive***. For instance, ***credit installment sales*** in which the total price over the length of the contract is two or three times the standard cash market price of the item are often held unconscionable. The *Frostifresh* case, cited in the above example, is one such case. Another is described in the following example.

> **Example:** The Ps, who are on welfare, contract to buy a home freezer for $900 from D, through its door-to-door salesperson. The various credit-related charges (interest, credit life insurance, etc.) add another several hundred dollars to the price. The Ps pay over $600 toward the purchase price, yet the evidence indicates that the freezer had a maximum retail value of about $300.
>
> *Held*, the contract is unconscionable. This is principally due to the disparity between the $300 reasonable retail value and the $900 (before credit charges) price. Another factor is the "very limited financial resources of the purchaser, known to [D] at the time of sale.…" Therefore, since the Ps have already paid more than $600, they may keep the freezer without further charge. *Jones v. Star Credit Corp.*, 198 N.Y.S.2d 264 Sup. Ct. Nassau Co. 1969).

1. **What constitutes excessive price:** The courts have not agreed on any well-defined test for determining whether a particular price is so excessive as to be unconscionable. However, almost all of the cases that have held a price to be unconscionably excessive involved prices that were ***two to three times*** the approximate "market price" at which similar goods were sold in the same areas. W&S, p. 143.

G. Remedy-meddling: The other main category of substantively unfair terms that has been recognized in courts is what has been called ***"remedy-meddling."*** W&S, pp. 144-45. The term refers to a variety of tactics by which creditor-sellers try to enlarge their rights upon default by the buyer, and to diminish their own liability for breach if sued by the buyer.

1. **Varieties of remedy-meddling:** There are a whole host of terms which a creditor-seller might insert into his form contract which under certain circumstances may be unconscionable remedy-meddlers.

These might include a liquidated damages clause for when the buyer refuses to accept the goods, a clause limiting the seller's liability for consequential damages, a limitation of the seller's warranty liability, a clause allowing a secured creditor-seller to repossess the goods when he "deems" himself "insecure," etc. Some of these clauses are discussed explicitly or implicitly at various places in the Code:

a. Liquidated damages: UCC § 2-718(1) provides that "a term fixing unreasonably large liquidated damages is void as a penalty." Presumably the same considerations used in unconscionability cases would be used in determining whether liquidated damages were "unreasonably large."

  i. **Sum set too low:** A liquidated damages clause setting an unreasonably ***low*** amount might also be held to be unconscionable, either on general principles governing liquidated damage clauses (see *supra*, p. 357) or on grounds of unconscionability.

b. Warranty disclaimer: § 2-719(3) provides that "consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for ***injury to the person*** in the case of ***consumer goods*** is *prima facie* ***unconscionable*** but limitation of damages where the ***loss is commercial*** is ***not***." Disclaimers of liability are discussed in greater detail in the chapter on Warranties.

c. Limitation on remedies: A seller may, rather than disclaiming warranties, try to ***limit*** the buyer's ***remedies*** for breaches of warranty that do occur. He might do this, for instance, by limiting the remedy to ***repair or replacement*** of the defective part or item. UCC § 2-719(2) provides that "where circumstances cause an exclusive or limited remedy to ***fail of its essential purpose***," the other Code-provided remedies (e.g., suit for damages) may be used. Comment 1 to this section indicates that the section applies where the modification or limitation of remedy operates "in an unconscionable manner."

Example: Consumer buys a new car from Dealer. The purchase contract does not disclaim any warranties (such as the implied warranty of merchantability). But the

contract does say that Consumer's sole remedy for any breach of any warranty, express or implied, shall be the right to have Dealer attempt to repair any defect, but only if the defect is called to Dealer's attention during the first 30 days of ownership. Three months after purchase, the transmission entirely breaks, due to a fundamental fault in it that Consumer could not reasonably have discovered by inspection during his first 30 days of ownership.

It is quite likely that a court would conclude that enforcement of the clause limiting remedies to attempted repair of defects discovered within 30 days would cause all of Consumer's remedies here to "fail of their essential purpose," since the defect couldn't have been caught earlier. If so, the court would find that the limitation of remedy was unconscionable and should be discarded. In that event, Consumer would be allowed to recover damages for the car's failure to be merchantable.

2. **Arbitration clauses:** The remedy-meddling clauses that have triggered the largest number of unconscionability claims are so-called ***"mandatory arbitration"*** clauses. By such a clause, both parties to the contract agree that any dispute between them ***must be subject to arbitration rather than resolved by a lawsuit.***

   a. **Nature of arbitration:** In an arbitration, a private person (usually a lawyer) is appointed to hear and decide the dispute. Arbitration is sometimes thought of as "litigation lite" — it usually includes ***limited discovery***, ***abbreviated presentation*** of ***evidence***, and a written decision by the arbitrator that frequently does not include any ***statement of reasoning***. Typically, the arbitration agreement prevents either party from ***appealing*** either the legal or factual conclusions made by the arbitrator.

   b. **Arbitration in employment contracts:** Arbitration clauses in ***employment agreements*** — in which the ***employee agrees to mandatory arbitration for any claim against the employer*** — have sometimes been found to be unconscionable. The California courts have been the leader in this area. While the California courts have not broadly found mandatory-arbitration clauses in employment contracts to be unconscionable, they have found such clauses unconscionable if the clause's design ***is procedurally one-sided.***

      i. **"Modicum of bilaterality" required:** For instance, the California Supreme Court has held that arbitration agreements must have a ***"modicum of bilaterality,"*** and that a clause providing that ***only claims by employees,*** not those by

employers, must be arbitrated is unconscionable for lack of bilaterality. *Armendariz v. Foundation Health Psychcare Services, Inc.*, 6 P.3d 669 (Cal. 2000).

c. **Class-action waivers combined with arbitration clauses:** A claim that a mandatory-arbitration clause is unconscionable is especially powerful when the clause ***combines*** a mandatory arbitration provision and a ***waiver*** of the ***right to bring a "class" arbitration.***

i. **Rationale:** A large corporation typically wants to be able to adjudicate each dispute separately. That's because the corporation typically wants to ***avoid*** in advance the possibility that the corporation's counter-parties in the contract (e.g., individual consumers or employees) will ***join together*** somehow, and make the corporation take the risk of being hit with a single large "bet the company" verdict. Putting a mandatory arbitration provision into each contract partially achieves this goal, because it ***prevents the filing of a class action lawsuit*** by hundreds or thousands of similarly-situated plaintiffs.

ii. **"Class arbitration" would defeat:** But if all the large corporation does is to insert a generic mandatory-arbitration clause — without specifying ***the procedures*** to be used in the arbitration — a lawyer specializing in bringing plaintiffs' class actions will typically be free to bring a "class arbitration." That is, hundreds or thousands of plaintiffs who signed the same contract could band together in a single class-based arbitration proceeding, in which the same type of cripplingly-large money judgment and attorney award might result as in a class-action lawsuit.

iii. **Ban on class arbitration:** Therefore, in recent years large corporations have tended to specify, in the mandatory-arbitration clause, that any arbitration must be ***"one on one" (or "bilateral")***, i.e., must involve ***only a single plaintiff***. That way, at least where each contract tends to be for a small amount, no lawyer is likely to find it worthwhile to take the

case on contingent fee, since only a small recovery, and thus a small attorney fee award, is likely.

iv. **Struck down by state courts:** State courts have often been ***sympathetic*** to the claims of plaintiffs — especially consumers — that a combined mandatory-arbitration and no-class-arbitrations clause is unconscionable because it tends to leave plaintiffs in small-dollar-amount contract cases ***without an effective remedy.*** The case in the following example is a good illustration of a successful unconscionability claim.

Example: The Ps sign service contracts with D, a cellular telephone company. The contracts state that each P waives the right to sue in court for breach; instead, each agrees that any dispute under the contract shall be subject to mandatory arbitration, and that the arbitration shall involve only one claimant. The Ps later conclude that D is overcharging each of its customers about $40 each month. The Ps bring a class action lawsuit against D on behalf of all customers who were overcharged. D argues that the arbitration clause should be enforced as written, thereby requiring each individual plaintiff to bring a separate arbitration. The Ps argue that the arbitration provision, insofar as it bans any kind of collective proceeding, is unconscionable and thus unenforceable.

Held, for the Ps: the combined arbitration / class action waiver provision here is substantively unconscionable. First, forbidding class actions and class arbitrations would reduce the public's ability to enforce the state's consumer protection laws. Second, forbidding these class-oriented procedures would, as a practical matter, exculpate D from any liability for small harms it inflicts on customers, because in cases like those it will never make economic sense for the Ps to arbitrate with D individually; the stakes for each P are too small. Only a class action lawsuit makes it feasible to press small claims. *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007).

d. The U.S. Supreme Court steps in (the *AT&T Mobility* case): But in a dramatic 2011 development, the U.S. Supreme Court ***took away*** a large portion of the right of courts to find that mandatory-arbitration clauses — including ones that prohibit class arbitrations — are unconscionable under state law. In ***AT&T Mobility v. Concepcion***, 131 S.Ct. 1740 (2011), the Court held that a federal statute intended to encourage arbitration pre-empted the right of the trial court to strike down on state-law unconscionability grounds a mandatory-arbitration clause that forbade class arbitrations and class actions.

i. **The FAA statute:** The federal statute at issue in AT&T Mobility, the ***Federal Arbitration Act (FAA)***, essentially

compels both state and federal courts to ***enforce as drafted any arbitration*** clause that is part of any transaction "involving commerce," which today includes virtually all arbitration clauses.

(1) **The "savings clause":** However, the FAA contains a so-called ***"savings"*** clause. That savings clause says that the FAA does ***not*** prevent either party to an arbitration clause from asserting any general state-law grounds allowing "for the ***revocation*** of any contract." Thus any general ***defense*** that state law would recognize as sufficient to allow a party to ***avoid a "contract"*** — defenses like lack of consideration, mistake, duress, fraud, and (of particular importance) ***"unconscionability"*** — may in theory be used by the plaintiff to avoid a bilateral-arbitration clause that would otherwise be enforceable under the FAA's main provision.

(2) **Narrow view:** But as we'll see shortly below, the Supreme Court in *AT&T Mobility* took a ***narrow view*** of when the state-law defense of unconscionability may be used by a plaintiff to avoid an agreement to arbitrate.

ii. **Facts:** In *Concepcion*, the Ps (a couple named Concepcion) purchased a cell-phone service plan from D (AT&T), which advertised free phones as part of the plan. The Ps were not charged for the phones, but were charged $30.22 in sales tax based on the phones' retail value. Although the cellphone plan contained a mandatory bilateral-arbitration clause, the Ps nonetheless brought a conventional suit against D in federal district court for the Southern District of California. Their suit was later consolidated into a putative class action alleging various acts of fraud by D in cellphone marketing. D then moved to have the Concepcions' part of the case dismissed, and replaced by one-on-one arbitration as required under the Concepcions' original contract with D.

iii. **D's motion for arbitration denied below:** But the federal district court ***denied*** D's motion, on the grounds that: (1) the

California courts would regard this particular mandatory-bilateral-arbitration clause as being unconscionable; and therefore (2) the FAA's "savings" clause applied, in a way that prevented the FAA from pre-empting the states' use of unconscionability doctrine to strike the arbitration clause.

iv. **FAA pre-empts state doctrine of unconscionability:** But by a 5-4 vote, the Supreme Court decided that Congress, in enacting the FAA, had never intended to allow the use of state-law doctrines treating bilateral arbitration as unconscionable.

(1) **Rationale:** The majority in *Concepcion* reasoned that Congress' "principal purpose" in enacting the FAA was to "***ensur[e]*** that ***private arbitration agreements are enforced according to their terms."*** California was subjecting class arbitration to a stricter unconscionability review than that to which it subjected individual arbitration. By so doing, the state's use of unconscionability was fundamentally altering the parties' agreement about arbitration, by ***letting consumers force corporate defendants into the much-less attractive (for the defendant) format of class arbitration.*** And because forcing defendants to use the class- rather than individual-arbitration format rendered arbitration less attractive, California's approach was pre-empted by the pro-arbitration purposes of the FAA.

(2) **Status:** It's not yet clear just how far state courts' powers to strike arbitration clauses for unconscionability are impeded by *Concepcion*. "Most courts apply *Concepcion* more or less mechanically, typically finding that state law is preempted if it makes class litigation unconscionable [merely because] there is ***no other effective remedy***." FSCB&G, p. 548.

Example based on *Scott*: For instance, it seems pretty clear that *Scott*, *supra*, p. 483, would have to be decided differently after *Concepcion*. The court in *Scott* concluded that a clause banning both class actions and class arbitrations was automatically unconscionable merely by virtue of the fact that it would leave any consumer who had only a small-dollar claim with no effective remedy. *Concepcion* almost certainly means that it takes ***more*** than a showing of "lack of effective remedy" to avoid pre-emption by the FAA of the court's power to strike that individual-arbitration clause as unconscionable under state law.

(3) **So one-sided as to still be unconscionable:** On the other hand, a defendant might come up with an arbitration clause that was ***so one-sided and unfair*** that even under *Concepcion*, a state court's use of unconscionability to strike the clause down would not be found to be pre-empted by the FAA.

Example: Suppose D, a powerful corporation with a near-monopoly over a particular consumer market, inserts into each consumer contract a clause providing that (1) not only must all disputes be subjected to individual (not class) arbitration, but (2) unless the consumer completely prevails in the arbitration, the arbitrator must make the consumer reimburse D for its actual legal fees, with no cap, and (3) even if the consumer *does* completely prevail, he may not recover *any* attorneys fees from D. It's doubtful that *Concepcion* would be interpreted to mean that the FAA preempts the state's ability to strike such a one-sided and substantively unfair clause as unconscionable.

3. Other examples: Two last types of remedy-meddling that courts have sometimes held unconscionable involve: (1) a clause whereby the buyer ***waives all defenses*** in a suit against him by the seller's assignee; and (2) a ***"cross-collateralization"*** clause by which a secured seller who has sold multiple items to a buyer on credit has the right to repossess all items until the last penny on the total debt to the seller has been paid.

Example 1 (waiver of defenses): Buyer signs a contract to buy 140 record albums and a stereo from Seller, the price to be paid over a period of several years. Buyer also signs a separate promissory note for the purchase price. The contract contains a clause in which Buyer agrees that if he is sued for the contract price by any assignee of Seller, Buyer will not raise any defense related to Seller's defective performance. Immediately after the signing, Seller assigns the contract and the note to Finance Co., a company formed exclusively for the purpose of financing Seller's retail sales contracts. Seller delivers a few of the albums, but then fails to deliver the rest. Finance Co. sues Buyer for the contract price, and argues that the waiver-of-defense clause prevents Buyer from asserting Seller's default as a defense.

Held, the waiver-of-defense clause is unconscionable, particularly since the beneficiary of the clause, Finance Co., is closely associated with the seller. *Unico v. Owen*, 232 A. 2d 405 (N.J. 1967).

Note: After *Unico* was decided, ***federal law*** was changed to make such waiver-of-defenses clauses in consumer credit agreements illegal. See 16 CFR 433.2. So today, the buyer in *Unico* would be permitted by federal law to defend by showing Seller didn't deliver.

Example 2 (cross-collateralization): D, a welfare mother with seven children, has made a number of purchases from P on credit. Each purchase was made under an

installment contract containing a complicated cross-collateral agreement, by which any payment made by D is credited pro-rata against all purchases ever made by D. The effect of this is to give P a continuing right to repossess all the purchases until D has reduced her total balance to $0. D's last purchase is a stereo set for $515, bringing her total purchase from P to $1,800. After paying back over $1,400 of this amount, D falls into default, and P seeks to repossess not only the stereo but all other goods that she has bought from him.

Held (by the Court of Appeals), the case must be remanded to the trial court, because the cross-collateral clause may well be unconscionable. "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.… In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power." *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

H. Remedies for unconscionability: Once the court has found a particular clause or contract to be unconscionable, it has a number of options. It may merely ***excise*** the unconscionable clause, and then proceed to enforce the contract in the normal manner. Or, it may ***"reform"*** the contract by ***modifying*** the offending term, particularly where an excessively high price is involved. Finally, it may simply refuse to allow the plaintiff to ***recover at all*** on the contract. See § 2-302(1).

V. CAPACITY

A. Capacity generally: Certain classes of persons have only a limited power to contract. The most important of these classes are ***infants*** and the ***mentally infirm***. In most instances, these persons can in effect "have their cake and eat it, too." That is, if they enter a contract they can enforce it against the other party. But if they wish to escape from the contract, they may do so. In other words, the contact is voidable at their option (but not at the option of the other party).

B. Infants: Until a person reaches her majority, any contract which he enters into is ***voidable*** at her option. That is, the minor has the power to ***"avoid"*** or ***"disaffirm"*** the contract before, or soon after, reaching majority. The age of majority is a matter of statute, and in most states is now 18. See Rest. 2d, § 14.

Example: *A*, a minor, agrees to sell Greenacre to *B*. *A* later changes his mind and refuses to go through with the sale. *B* may not enforce the agreement against *A*. But *A*, if he wishes, may enforce it against *B* (e.g., sue *B* for damages for failure to make the purchase).

1. Effect on third person: A minor's right to avoid, or disaffirm, a

contract is sometimes effective even against ***third persons***. Thus if, in the above example, *A* had gone ahead with the conveyance to *B*, and *B* had conveyed to *C*, A could still disaffirm the contract, and in effect regain title from *C*. This would be so even if *C* had no knowledge of A's infancy.

a. **But UCC has different view:** But under the UCC, the rights of a third person cannot be disturbed by the infant's disaffirmance. UCC § 2-403 provides that "a person with voidable title has ***power to transfer a good title*** to a ***good faith purchaser for value***." Thus if *A* had sold goods to *B*, who had then sold them to *C*, and *C* did not know of *A*'s infancy, *A* would not be able to avoid the contract and recover the goods from *C*. (But *A* would probably still be able to demand return of the goods from *B*, and recover damages from *B* if *B* could not return them.)

2. **Unavoidable transactions:** Statutes or case law may prevent an infant from avoiding certain kinds of contractual obligations. Obligations that are held to be unavoidable in many jurisdictions include an agreement by the infant to support his illegitimate child, a bail bond taken out to secure his bail, and a promise by a minor employee not to use his employer's secret customer lists. C&P, pp. 282-83. See Rest. 2d, § 14, Comment b.

3. **Sales by guardian:** Since people who know of a minor's right to disaffirm contracts will generally be reluctant to deal with him, statutes often allow the infant's ***guardian*** to contract on his behalf. Such sales must often be made with court approval, but have the advantage (from the other party's viewpoint) of not being disaffirmable. The Uniform Gifts to Minors Act, for instance, allows the guardian of an infant to whom securities have been given to sell the securities and to reinvest the proceeds for the infant's benefit. C&P, p. 283.

4. **Disaffirmance:** In every state except Michigan, an infant may avoid (or disaffirm), the contract ***even before he reaches majority***. C&P, p. 283. He may do so orally, by his conduct (e.g., a manifest unwillingness to go through with the deal), by the entry of a defense of infancy when sued by the other party on the contract, or in any

other way that brings home the fact that the infant does not wish to proceed.

a. **Conveyances of land:** Where the contract is for a conveyance of land, however, most states do not allow the infant to disaffirm the contract until he has reached majority. This rule seems to be part of the general traditional judicial policy of treating land contracts more seriously; the theory seems to be that the infant is not mature enough to know whether the contract is in his interest or not until he has reached adulthood. C&P, p. 284.

b. **"Necessaries":** Where the contract is for the provision of ***"necessaries"*** to the infant, (e.g., food, clothing or shelter), the contract may not be disaffirmed if the services have been rendered. See *infra*, p. 488.

5. **Ratification:** Because a contract made by an infant is not void, but merely voidable at his option, he can choose to enforce it if he wishes. If he so chooses, he is said to have ***ratified*** the contract. ***He may not ratify it until he has reached adulthood***, since otherwise the whole purpose of the rule allowing disaffirmance would be thwarted. Ratification may occur in three separate ways:

   [1] **Failure to make a timely disaffirmance:** The infant may be held to have ratified the contract by inaction, if she ***fails to disaffirm it within a reasonable time*** after reaching her majority. There is no definitive test for determining what is a reasonable time; if the infant has received benefits under the contract both before and after she has attained her majority, a "reasonable period" will be shorter than if the contract remains completely executory. C&P, p. 284.

   [2] **Express ratification:** The contract may be ratified by ***words***, either written or (in most states) oral. The more fully the contract has been performed, the less specific the words of ratification must be.

   [3] **Ratification by conduct:** If the former infant ***actively induces the other party to perform***, this conduct may constitute a ratification. This will be the case, for instance, if both parties begin to exchange performances under the contract at a time

after the infant's majority. But part payment or performance by the former infant, without express words or benefits received from the other party, is probably not a ratification. C&P, p. 287.

6. **Economic adjustment after disaffirmance:** When an infant disaffirms, courts have to deal with whether and how an ***economic adjustment*** should be made after disaffirmance. Because many courts have treated cases in which the infant is a plaintiff differently from that in which he is a defendant, we consider these two situations separately.

   a. **Where infant is defendant:** Frequently the issue of infancy and disaffirmance arises only when a suit is brought ***against*** the infant (or disaffirming ex-infant) because he has not gone through with the contract. In this situation, the non-infant will not be allowed to recover the profits he would have made under the contract, or any other kind of contract damages. But he will have a ***limited right of restitution***, i.e., the right to require the defendant infant to ***return the goods*** or other value ***if he still has them***. But if the infant has ***disposed*** of the goods or destroyed them, he has ***no obligation*** to pay for their reasonable value, although some courts may require him to return any goods which he received in exchange for them.

      Example: Infant buys a car from P on credit. The contract price is $4,000. If P sues and Infant disaffirms the contract, P will not be able to recover any contract damages (e.g., the profits he would have made on the deal). But if Infant still has the car, he will have to return it to P. If Infant has wrecked the car, or sold it for cash which he has then spent, he will not have to make any kind of restitution. If he has traded it for another car, or received money for it which he still has on hand, he will probably be required to give the new car or the proceeds to P (but only up to the value of the original car). C&P, p. 288.

   b. **Where infant is plaintiff:** If it is the ***infant*** who is suing to recover money already paid by her, most courts treat her less leniently than where she is the defendant. Not only must she return whatever consideration she received from the sale that she still has on hand, but any other value which she received and has ***dissipated*** will be ***subtracted from her recovery.*** In other words, the court will attempt to prevent the infant plaintiff from becoming unjustly enriched.

      Example: P, an infant, buys a car from D, a dealer. Three months later (two

months after she reaches majority), she returns the car to D, and sues to get her money back. P may get her money back, but D may recover on a counterclaim for the difference between the value of the car when it was bought and the value when it was returned.

c. Necessaries: Virtually all jurisdictions allow a person who supplies ***"necessaries"*** to an infant to recover in ***quasi-contract*** (not on the contract) for the ***reasonable value*** of those necessaries. The minor cannot use disaffirmance to avoid such a recovery. What constitutes "necessaries" varies from state to state, but needed ***food, clothing, shelter, medical care*** and ***legal services*** are among the items that are likely to be covered. Farnsworth, § 4.5.

Example: Minor shows up at the emergency room of Hospital with appendicitis. Minor agrees to pay the bill. Hospital treats him. Hospital will be entitled to recover the reasonable value of the services directly from Minor — since the services were "necessaries," Minor does not have the right to disaffirm the contract.

7. False representations as to age: If the infant willfully lies about his age, to induce the other party to contract with him, courts differ as to the effect of such misrepresentation.

a. Greater restitution required: Some courts place a greater burden of restitution on the infant than if he had not made the misrepresentation. Thus an infant defendant who had procured goods on credit by lying about his age might be required to pay the reasonable value of the goods, even if he no longer possessed them. But most courts nonetheless give the lying infant the right to disaffirm the contract, so that he can at least escape its executory portions and avoid having to pay expectation damages. C&P, p. 291.

b. Court action: Some states allow the party who has been lied to to bring an independent action in tort for misrepresentation against the infant, even though the contract itself may still be disaffirmed by the latter. Other courts, however, view such a tort action as merely a contractual action in disguise, and do not allow it. C&P, p. 291.

c. Avoidance by other party: Virtually all jurisdictions allow the party who has been lied to by the infant to ***avoid the contract*** on the grounds of fraud. This is in distinction to the usual rule, which is that the infant may, if she chooses, enforce the contract even if

the other party is unwilling. C&P, p. 292.

C. Mental incompetents: Mental incompetents, like infants, are treated as having limited contractual capacity. This category includes not only the insane, but also those who are mentally ill, senile, mentally retarded, or drunk. In general, the rules applied to the mentally incompetent are similar to those that apply to infants.

1. Definition of mental incompetence: A broader class of persons would probably be found to be incompetent to contract today than several decades ago, where something bordering on lunacy was usually required. Rest. 2d, § 15(1), provides that a person lacks capacity because of mental illness or defect if either: (1) "He is unable to ***understand*** in a reasonable manner the nature and consequences of the transaction"; or (2) "He is unable to ***act in a reasonable manner*** in relation to the transaction and the other party has reason to ***know*** of his condition." That is, he lacks capacity if he doesn't understand the contract, or if he understands it, but acts irrationally, and the other person knows he is acting irrationally.

a. Total lack of understanding: Where the first branch of the Restatement test applies — the person is completely unable to ***understand*** the contract — the contract is voidable even where its substantive terms are ***completely fair***, and even where the other party has ***no reason to know*** of the mental impairment.

b. Understands, but cannot act reasonably: Where the second branch of the Restatement test is relied on — that the person has some understanding of the transaction, but is "***unable to act*** in a ***reasonable manner*** in relation to the transaction" — the transaction is less likely to be set aside. Here, the transaction will be set aside only if the person opposing it shows that: (1) the other person ***knew*** of the mental condition; and (2) the transaction is ***not one which a reasonably competent person might have made***. See Rest. Rest. 2d, § 15, Comment b.

Example: P, a teacher in the D school system, has during her forty years of work built up a $70,000 credit in the system's retirement plan. She leaves work due to "involutional psychosis." (She has also been diagnosed as having cerebral arteriosclerosis, a life-threatening condition.) P has previously elected to receive a lower monthly retirement benefit so that her husband will receive benefits if she

dies first. But after the onset of her psychosis, she revokes this election, borrows money from the plan, and elects to receive an extra $75 per month, in exchange for which her husband loses his right to benefits if she dies first. Two months after this change of election, she dies of cerebral arteriosclerosis. Her husband sues to avoid her change of election.

Held, P's husband should get a chance to prove that she was psychotic at the time of election; if he can do so, the election can be voided. D knew, or should have known, of P's mental illness, since she was on leave because of it. In view of P's arteriosclerosis and thus her reduced life expectancy at the moment she made her decision, that decision was foolhardy, and can only be explained on the theory that when P made the decision, she was unable to contemplate the possibility that she would die before her husband. Furthermore, while substantial performance, or reliance, by the other party (here, the retirement plan) might sometimes make it unfair to allow avoidance, in this case there were "no significant changes of position by the [retirement plan] other than those that flow from the barest actuarial consequences of benefit selection." *Ortelere v. Teachers' Retirement Board*, 250 N.E.2d 460 (N.Y. 1969). (See also Rest. 2d, § 15, Illustr. 1, based on *Ortelere*.)

c. **Right of avoidance terminates:** Assuming that the right of avoidance exists because of a party's mental incompetence, ***how long*** into the contract does that right of avoidance last? Where the contract is not on fair terms, or the other party has knowledge of the mental illness or defect, the rule seems to be that the contract can be disaffirmed ***at any time*** until it is completed. But where the contract is made on fair terms *and* the other party has no knowledge of the mental illness or defect, then the power of avoidance "***terminates*** to the extent that the contract has been ***so performed in whole or in part*** or the circumstances have so ***changed*** that avoidance would be ***unjust***. In such a case, a court may grant relief as justice requires." Rest. 2d, § 15(2).

2. **Intoxication:** Intoxication will give a party the power of avoidance only if: (1) she is so intoxicated that she can't ***understand*** the nature of her transaction; and (2) the other party has ***reason to know*** that this is the case. Rest. 2d, § 16. Most (but not all) states agree with this Restatement approach. (A few states don't recognize the intoxication defense at all.)

Example 1: Steve and Bill go out drinking. After Steve has had so many drinks that Bill knows (or should know) that Steve is very intoxicated, Steve says to Bill, "I'll sell my house to you for $100,000." Bill accepts. The fair market value of Steve's house is in fact $100,000. Steve will be able to avoid the transaction, because it was or should have been apparent to Bill that Steve did not truly understand the consequences of what he was saying, due to his extreme

intoxication.

Example 2: Steve writes a letter to Bill one day saying, "I will sell you my house for $100,000." Completely unbeknownst to Bill, at the time Steve wrote the letter he was utterly intoxicated. The fair market value of the house is $100,000. Steve will not be able to avoid the contract, even though he was so intoxicated as to not understand the nature or consequences of the proposed deal. This is because Bill had no way of knowing that Steve was intoxicated, and the objective theory of contracts (*supra*, p. 6) applies.

3. **Voidability:** Contracts made by an incompetent, like those made by an infant, are voidable, not void. Thus if the maker regains his mental capacity, or has a guardian appointed for him, the contract may be ratified. The other party never has the power of avoidance.

4. **Restitution:** No clear rule exists to determine what obligation of restitution a mental incompetent has to the other party to the contract. The general considerations are similar to those applied in the case of infants. Thus if the contract is wholly executory, the incompetent will have no obligation of restitution. Another factor considered by the courts is the ***apparent mental state*** of the incompetent at the time of contracting, if the incompetent seemed to be capable of intelligently contracting, the other party is more likely to be able to obtain restitution than if it should have been obvious that the incompetent was not in his right mind. C&P, p. 299.

5. **Exploitation:** In many situations, a party's mental state may be less than alert, yet not so diminished as to allow him to avoid the contract under the above incompetency rules. The contracting party may, for instance, be slightly intoxicated, dull-but-not-retarded, slightly senile, etc. In such a situation, if the other party ***took advantage*** of the slight infirmity, the court may allow avoidance either on grounds of infirmity or fraud.

Example: P is injured by D's railway train. He is in the hospital suffering from great pain and is under some anesthesia, but is not so narcotized that he is unaware of what he is doing. One of D's claims adjusters, knowing that P is in pain, procures a release from him in return for a $500 check. P's out-of-pocket expenses are much more than $500, as the adjuster knows. A court would probably void the release because of D's exploitation of P. See C&P, p. 303, n. 5.

Quiz Yourself on

UNCONSCIONABILITY AND ADHESION CONTRACTS; CAPACITY

130. The Krullen Heartless Appliance Store is located in a poor neighborhood. Sam Shyster is the sales manager. He puts a sign in the window reading, “New Dishwashers — only $19.” Fred Farkus, fourth-grade dropout, sees the sign and asks, “Is it really $19?” Sam says, “Yeah — take a look at this contract. See? $19!” What Sam doesn’t point out is that it’s $19 a month for ten years, chargeable to a credit card. This is in small print buried toward the bottom of a 10-page contract. Sam tells Fred to sign, and he does, although he doesn’t really understand the contract since it’s all words and no pictures. The actual cost of the dishwasher under the contract, expressed as a present value, is $1,900; the same model is on sale nearby at an all-cash price of $600. Fred soon goes into default, and Sam not only seeks to repossess the dishwasher but also to collect the balance owed.

(A) If you represent Fred, what defense should you assert on his behalf?

(B) Will the defense you assert in (A) be successful.

131. Krullen Heartless, the same appliance store featured in the prior question, offers the same “$19/month for 10 years” deal, on the same dishwasher, to Pete, owner of Pete’s Tavern. (Pete’s tired of having to wash glasses in his bar by hand all night.) Sam Shyster, Krullen’s sales manager, doesn’t make any factual statements about the provisions of the contract — he just hands it to Pete and says, “Look, you can buy for no money down.” Pete glances at the contract, doesn’t realize that he’ll be paying triple the cash price, signs, and then soon goes into default. Krullen sues on the contract. If Pete defends on grounds of unconscionability, what result?

132. Roger Thornhill, teetotaler, is at a party one night. He’s delighted that there’s a big punch bowl full of fruit punch. He drinks a lot of it, not realizing that it’s *Electric Kool Aid*, a very potent brew indeed. He gets completely intoxicated, and in a drunken state calls Windshear Airlines and puts a plane ticket to South Dakota on a credit card. (The ticket agent thinks Roger sounds a bit weird, but doesn’t realize he’s dead drunk.) The ticket is not refundable. Before Roger’s due to leave, he sobers up and wants to get out of the purchase. Can he disaffirm the purchase?

133. Zeus, an adult, sells his chariot to Apollo, aged 17, for $50 down and $50 a month until the $2,000 purchase price is paid off. Apollo, while still 17, rides the chariot much too fast one day, and crashes it into a wall. It bursts into flames and is destroyed; Apollo jumps free, unhurt. He then disaffirms the contract with Zeus, and returns the remnants of the chariot in a shoebox.

(A) Can Zeus recover the remainder of the purchase price?

(B) Say instead that Apollo immediately sells the chariot to an acquaintance, Mars, for $1,000. (Mars thinks Apollo's 18, which is the age of majority in the jurisdiction.) Apollo then disaffirms the contract with Zeus, at a time when he still owes Zeus $1,950. Can Zeus recover any of the unpaid balance from (i) Apollo or (ii) Mars? If recovery from either is possible, how much will Zeus recover?

(C) Now assume that Apollo pays $2,000 cash for the chariot, and totally wrecks it so that it has no value. He then disaffirms the contract, and sues Zeus to get back the $2,000. How much, if anything, may Apollo recover?

(D) Now assume that, after the agreement for an all-cash sale is signed, but before Apollo has received possession or title to the car, Zeus realizes he can get more for it by selling it to someone else and tries to get out of the contract. Assume that Zeus realized, at the time of the agreement, that Apollo was a minor. Can Zeus escape the contract?

(E) Same facts as Part D, except now assume that before the contract is signed, Zeus is worried that Apollo may be underage. He asks Apollo his age, and Apollo falsely replies, "18." After the contract is signed, and before delivery, Zeus learns that Apollo has lied about his age; Zeus also realizes that he can get more money for the chariot from someone else. He therefore purports to rescind the contract on account of Apollo's underage status. If Apollo sues to have the contract enforced, will he prevail?

134. Lizzie Borden axe murders her parents when she is sixteen years old. She is acquitted of the crime on a technicality. While still a minor, she contracts with Shyster & Shyster Publishers to write her memoirs for $500,000. When she turns eighteen, she writes to Shyster & Shyster,

reaffirming her acceptance of the contract terms. Shortly thereafter, Lizzie gets religious and decides she doesn't want to relive the horror of her past. Can she avoid the contract on the grounds that she was a minor when she made it?

Answers

130. (A) That the contract is unconscionable.

(B) Yes. A consumer contract will be held void for unconscionability under UCC § 2-302 if it is unduly one-sided under the circumstances existing at the time of signing. The fact that the party opposing a finding of unconscionability concealed the true nature of the contract from the other party will strongly militate towards a finding of unconscionability. So will the weaker party's lack of sophistication or education, as will the extreme substantive unfairness of the terms. Here, all of these factors work in favor of a finding of unconscionability, so that's what the court will probably do. As a remedy, the court will then probably either order the contract rescinded (in which case Fred would give back the used dishwasher and be relieved of the need to make further payments), or will "rewrite" the contract so that the payments due will approximate the dishwasher's fair value.

131. Pete will probably lose. Where the buyer is a business or a businessperson, it's exceptionally rare for the court to find the contract unconscionable. Here, where there's been no affirmative misstatement of the contract's terms — and the only unfairness is the substantive one of an excessive price — the court is unlikely to depart from this general refusal to use unconscionablity in commercial disputes.

132. No. A party seeking to avoid a contract that he entered into when drunk must show *both* (1) that he was so intoxicated that he couldn't understand the nature of his transaction, and (2) that the other party knew, or had reason to know, that this was the case. Here, the airline had no reason to know that Roger was drunk, so the second requirement isn't met.

133. (A) No. Apollo, as a minor, has a right to disaffirm the contract. An infant who disaffirms a contract and still has the consideration in his

possession must return it. If the goods have been disposed of or destroyed, the infant has no obligation to pay for them. Since Apollo destroyed the chariot, he doesn't owe Zeus anything.

(B) Probably, but just the $1,000, and just from Apollo. When a minor doesn't have the item in question anymore because he *sold* it, the UCC doesn't let the original seller recover from the good-faith third-party purchaser for value; UCC § 2-403. However, a court will probably require the minor in such a situation to return to the original seller whatever the minor received (and still has) for selling the item. So here, Apollo will probably have to fork over the $1,000 in sale proceeds, if he still has it.

(C) Nothing. When the disaffirming infant is the plaintiff, most modern courts will cut his recovery by the diminution in value of the item. Since the chariot is worthless, what would otherwise be a $2,000 recovery will be reduced by the full $2,000 in diminished value, leaving Apollo with a $0 recovery.

(D) No. Contracts that infants enter into are voidable at *their* option *only* — the other party does not have the option of voiding the contract.

(E) No. Virtually all jurisdictions hold that where the infant lies about his age to induce the transaction, the other party may avoid the transaction. So the usual rule — that only the infant may disaffirm — does not apply to the fraud-by-the-infant scenario.

134. No. Lizzie's initial promise was voidable at her option due to her infant status. However, once she reached the age of majority, she had the right to reaffirm the contract. Once she exercised that right of reaffirmation, the contract became fully enforceable as if she had been an adult at the time the contract was made.

EXAM TIPS ON MISCELLANEOUS DEFENSES

☛ The defenses in this chapter don't appear as frequently on exams as do those that are covered in the previous chapter. Basically focus your efforts on capacity, illegality and unconscionability.

Capacity

☛ **Who may disaffirm:** Pay attention to who's attempting to disaffirm. ***Only the minor may disaffirm***, not the other party.

> **Example:** Myner, a minor, and Deal, a motorcycle dealer, enter into a written agreement for the sale of a new motorcycle to Myner for $1,000, to be paid on delivery within two weeks. One week later, Deal notifies Myner that the motorcycle is ready for delivery, but that Deal will not deliver it unless Myner shows proof of majority or brings an adult as a co-purchaser. If Myner sues Deal for breach of contract, Myner will be successful because Deal is obligated to perform — only Myner can disaffirm the contract.

☛ **Offset:** If the minor is suing for rescission or restitution, her recovery is ***offset by the reasonable value of the benefit*** which she has received.

> **Example:** Mine, a minor, purchases a used car from Carman for $3,000. After two months, the steering fails, and Mine decides that the car is unsafe to drive. Therefore, she returns it to Carman and demands her money back. If the reasonable rental value of the car is $300 a month, Mine is entitled to $2,400 (purchase price less 2 months' rental value) when she returns the car.

Illegality

☛ Make sure ***both parties are aware of the purpose*** of the contract (though not necessarily aware of the illegality of that purpose). If only one party is aware, that party won't be able to claim illegality.

> **Example:** Tenn enters into a 2-year lease for premises from Land. Tenn intends to use the premises for an illegal bookmaking operation. At the time of the lease, Land has no idea that this is Tenn's purpose. Tenn will not be able to have the agreement declared void for illegality, because Land did not know of the illegal purpose; however, Land will probably be able to void the agreement.

☞ **Severable:** Look for a contract whose primary purpose isn't illegal, but which contains an illegal provision. Argue that the illegal provision should be ***severed*** and the remaining provisions enforced if these condition are all met:

- □ the contract is ***divisible*** (i.e. there are corresponding pairs of part performances),

- □ the illegality doesn't affect the ***entire agreement***, and
- □ the party seeking performance ***hasn't engaged in serious misconduct***.

Example: A premarital agreement is signed by Wilma, a pregnant woman, and Alan, the man with whom she lives. The agreement provides, among other things, that in case of divorce, Alan will not be responsible for payment of child support for the unborn child, in return for the Alan's advance relinquishment of custody and visitation rights. A state statute says that mothers may not agree to waive the right to child support.

The "no child support" provision is arguably severable, since: (1) the child support and custody provision are arguably a "corresponding pair of part performances; (2) other aspects of the agreement (e.g., division of property) are not affected by the illegal provision; and (3) signing the clause does not constitute serious misconduct by either party. If the court agrees, either Wilma or Alan may enforce the contract, except that the court will not enforce the child-support provision (or, probably, the custody/visitation waiver, since that was part of the illegal trade).

Unconscionability

- ☛ Look for a contract involving a ***consumer***. The unconscionability defense is rarely applied to a contract between businesspeople.
  - ☞ Consider applying the doctrine in any non-UCC context involving a consumer contract, where the party seeking to use the doctrine has ***substantially weaker bargaining power*** and the contract or clause seems substantively or procedurally "unfair" to you.

Example: Same facts as the above example (the premarital agreement between Wilma and Alan). Now, assume that Wilma has been living with Alan for 15 years, and that in the agreement she has agreed to waive not only her rights to child support but also her rights to alimony and to her share of any earnings by Alan during the forthcoming marriage. Alan is a wealthy businessman, and Wilma is unemployed as well as pregnant. Assume further than Alan told Wilma that if she didn't sign the agreement as drafted, he wouldn't marry her.

On these facts, you should argue that Wilma should be given the benefit of the unconscionability doctrine as to the entire agreement, since it is substantively unfair, and the product of the parties' very unequal bargaining positions.

- ☛ Gauge for unconscionability ***at the time the contract was made,*** not later on.
- ☛ In order for a ***price*** to be unconscionable, it must be very excessive (e.g., two to three times the market price), not just substantially higher than

the prevailing market price.

Capacity

- ☛ Where one party was under 18 at the time of the contract, remember that the minor has the power to "***disaffirm***" (avoid) the contract, whether before or shortly after reaching 18.
  - ☞ But if the non-minor supplied ***"necessaries"*** to the minor (e.g., badly-needed food, shelter or medical care), then the supplier can recover in ***quasi-contract*** for the fair value of the supplies, even if the minor disaffirms the actual contract.