Contracts–Spring 2006
Answer Outlines

The following are outlines of model answers in narrative form. They indicate the issues reasonably raised by each question but do not contain the amount of detail that an answer would ideally include.

Question One
(60 points)

Hops are goods because they are moveable, so the UCC governs. What H is entitled to recover depends on whether B was entitled to enforce the liquidated damages provision, which in turn depends on whether the first contract is still binding and whether the liquidated damages operate as a penalty.

H may argue that her obligations under the first contract are excused because of impossibility, which requires: (1) an unexpected event; (2) not H's fault; (3) which she does not bear the risk of; and (4) which makes her performance substantially more difficult or expensive. Under the UCC a rise in price is never sufficient, but H may be able to argue that the unexpected event is the poor crop yield. While the poor yield is not her fault, a court might assign the risk to her because a grower would be in the best position to insure against it. The rise in price of 25% is probably not sufficient for impossibility, and (although H would like to take advantage of the rise) it is not even clear that the poor crop yield has made her performance more difficult at all.

H may also argue that the modified contract omits the liquidated damages clause. The UCC has no pre-existing duty rule, but does require that modifications be made in good faith, because of an unforeseen economic exigency and without coercion. The poor yield and price rise were unforeseen, but it is not clear that having to forego a chance to make more money should count as an exigency. Coercion is also a close question. On the one hand, H apparently thought she was doing B a favor. On the other hand, her remarks that she had "lots of offers" and that it would be a "real shame" if B didn't win a gold medal might be viewed as an implied threat to breach.

B might argue that the modification was void on grounds of duress, which requires an improper threat, no reasonable alternative, and an objection to preserve the defense. H's remarks just noted might be deemed an improper threat to breach the first contract in bad faith. B likely has no reasonable alternative since no other grower can provide what he needs for less and since changing his grower may affect the taste of his IPA. But B did not object to the modification until after H had performed and so has not preserved this defense.

H might also argue that the liquidated damages are unenforceable as a penalty. To be enforceable, liquidated damages must be reasonable in light of the anticipated and/or actual loss caused by the breach. The contract's characterization of the amount as actual damages is irrelevant because the intent of the parties does not control. Even though some of B's losses, like

harm to reputation, might be difficult to determine, $40,000 is not reasonable judged prospectively because it does not vary with the gravity of the breach. Judged retrospectively, the liquidated damages might be reasonable because they are not disproportionate to B's lost profits of $25,000 (50,000 bottles not made x $0.50). (H might argue that his actual loss is just $2500–the difference between the original contract price and the market price on the date of breach–but this assumes that B had an obligation to mitigate by covering, which he probably didn't if it would change the taste of his IPA).

If, as seems likely, the modification is valid and the liquidated damages provision is not, H could recover expectation damages for breach of the modified contract, which would be the contract price of $48,000 less the $8,000 she has already received. She could not recover restitution based on the market value of the hops because she has fully performed. [Note that she could not recover the additional $2,000 as market damages because B accepted the hops and because, in fact, the change in market price would work in her favor. Also note that I gave some credit for calculating damages under alternative scenarios–e.g. the modification was not valid–but only if those scenarios were plausible.]

Question Two
(75 points)

The merger clause in paragraph 21 is evidence that the contract is a completely integrated agreement. If it is, then S's statement about the floors being original could not be used to supplement the written agreement with an express warranty. On the other hand, merger clauses are not dispositive and if the court believes that S did make the statement, it might conclude that the agreement is only partially integrated and allow the supplementation. Additionally, whether or not the contract is completely integrated, parol evidence may be sued to establish one of the defenses below as a basis for rescinding the contract.

The Es may seek to rescind the contract and recover their money in restitution on grounds of misrepresentation, nondisclosure, or unilateral mistake. Misrepresentation requires a material or fraudulent misrepresentation and justifiable reliance. Here, S misrepresented that the wood floors were original. Because E asked about them specifically the misrepresentation is material, and because S seems to have intended to deceive E the misrepresentation is fraudulent. Because S lived in the house and was in a position to know about the floors, E was justified in relying.

Nondisclosure requires a duty to disclose and justifiable reliance. The Ss must have known of past termite infestations if the house had been treated last year. Termites are material because a reasonable person would consider that fact important, and therefore the Ss had a good faith duty to disclose this fact since they acquired the information simply by living in the house. The E's seem to have justifiably relied.

Unilateral mistake requires a mistake of one party about a basic assumption of the contract, that the party seeking to void the contract not bear the risk of the mistake, and that

enforcement of the contract would be unconscionable, the other party knew of the mistake or caused the mistake. Here, the Es were mistaken both about the floors and the termites. Because the sellers are in the best position to prevent the mistake, they probably bear the risk. The Ss likely knew about both mistakes and they caused the mistake about the floors.

If, in the alternative, the Es wish to hold the Ss liable for the costs of treating the termites and replacing the floors, they will have to establish not just a defense but a breach. The Ss breached the express warranty about the floors being original. Additionally, although the Ss misrepresentation and nondisclosure before the contract could not be a breach of the implied obligation of good faith, the delivery of a pest report they knew was wrong would be. To put the Es in the same position as if the contract had been fully performed, the termites will have to be treated and the floors replaced, so the Es may recover these costs as expectation damages.

Damages for emotional distress may be recovered only where the breach results in physical harm or where emotional distress was a particularly likely result of the breach (innkeepers, mortuaries, etc.). The termites caused no physical harm and contracts involving houses have been held not involve a high likelihood of emotional distress. Therefore, the E's could not recover for the costs of therapy.

The Es may sue TBM only if they are intended third-party beneficiaries of TBMs contract with the Ss. Although courts are divided, the better rule is that beneficiaries can sue if the promisee intended to benefit them and the promisor had reason to know of this. Here, the Ss intended to benefit the Es by providing for a pest inspection and TBM had reason to know because it was told that the inspection was for the purposes of selling the house. TBM breached its contract with the Ss by failing to provide a reasonably adequate inspection. As a result, the Es bought a house worth less than they paid for it and could recover the same costs of treatment and repair against TBM (but not damages for emotional distress).

Question Three
(45 points)

In favor of the American courts' position, one may argue that interpreting the implied covenant of good faith to require good cause for termination of an at-will employment contract would mean that the contract was no longer at-will. Because good cause depends on the circumstances of each case, such a rule would be more difficult to administer and might lead to an increase in litigation. Employers have little reason to fire employees who are working out, so the market may act as a sufficient check. The increased burden that having to demonstrate cause would place on employers might discourage them from hiring some employees in the first place. One might also note that employment relationships often turn on personal factors that are highly subjective. Finally, given the long history of the at-will doctrine, it may be that any change in that doctrine should be made by the legislature.

On the other hand, common-law courts created the at-will doctrine and have a perfect right to change it through interpretation of the implied covenant of good faith or otherwise

(subject, as always, to override by the legislature). The at-will doctrine accentuates the imbalance of power in favor of the employer, who would still be free to insist on a right to terminate without cause even if the doctrine were abolished. Requiring good cause for termination would protect the employee's reliance on his job and perhaps his expectations as well. Employers may also benefit to the extent that the cause requirement prevents the termination of employees who benefit the company but are at odds with their supervisors.

[I did not care which position your answer took with respect to whether the American courts' position is justified or not.]