

AGN:

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FALL SEMESTER 2011

CONTRACTS

THREE HOURS.

THIS IS A CLOSED-BOOK EXAM.

Try to show thought and critical analysis of the materials and issues dealt with in the course.

DO read the questions carefully and think about your answers before beginning to write.

DO refer to statutory provisions, cases and other materials where appropriate. If you make general statements, try to back them up with specific references.

DO NOT use abbreviations unless you explain what you are using them to stand for.

DO NOT make assumptions in answering the hypothetical.

DO explain what further information you might need in order to answer the question properly.

DO write legibly and clearly.

You will get credit for following these instructions, and may be penalized for failing to do so.

Note that there is some potential for overlap in answers to these questions. Avoid substantial overlap in your answers, because, as a general rule, you will only get credit once for each piece of information you give me. If you incorporate information in one answer into the other answer, for example by writing "see above", or "see answer to Question x" in your second answer, your grade for the second answer may suffer.

SECTION A (60% of the exam grade)

The following events all occur in Arcadia, a state in the US. Article 2 of the UCC applies in Arcadia and selected provisions of Article 2 are supplied at the end of this exam.

Avocado Corporation is a leading developer of electronic health care management systems. Until recently its products have been aimed at hospitals and other health care providers but Avocado has been working on a new product for consumers (a consumer health management system or CHMS). The people who run Avocado believe that consumers are increasingly interested in managing their own health and that the CHMS will be a very successful and profitable product. Avocado planned the CHMS launch date for November 1, 2011. In preparation for the product launch Avocado entered into a contract with Massive Manufacturing (MM) for MM to manufacture the CHMS in accordance with Avocado's detailed specifications. The CHMS product is a mixture of hardware and software. MM would build the hardware and would then load it with Avocado's software.

The contract between Avocado and MM provided that MM would supply 1000 of the CHMS products to Avocado by September 14, 2011 (the parties understood that there would be subsequent contracts for the supply of additional product on later dates). Avocado would pay to MM \$100 per CHMS, and half of the total amount payable for the first lot of products was payable on signing of the contract, with the balance to be payable on delivery. In addition the contract specified that Avocado planned to enter into contracts to supply the CHMS to stores, and that Avocado would suffer losses if MM delivered the CHMS products after September 14. The contract provided that if MM were to deliver the CHMS products to Avocado after September 14, MM would pay to Avocado \$50,000 for each week of delay.

At the time MM and Avocado entered into the manufacturing contract, MM was very confident that it would be able to meet the delivery date. The manufacturing contract was very important to MM because it was a profitable contract and MM had

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been suffering from a shortage of orders. Just before signing the contract with Avocado, MM had laid off a number of workers. MM hoped for future manufacturing orders for the CHMS and other products from Avocado.

Avocado contracted to sell the first set of CHMS to be produced to Better Life, a retailer of health care items for \$150 per CHMS. The contract specified that the date for delivery of the CHMS to Better Life was October 5. Better Life was thrilled to be distributing the CHMS which it planned to sell for \$200 per item. Better Life understood that Avocado planned an advertising campaign for the month of October to encourage consumer interest in the CHMS and Avocado agreed to provide display materials for the CHMS for Better Life's stores. Better Life thought that the advertising campaign for the CHMS, which would state that Better Life was the sole retail source of the product, would bring new business to Better Life's Stores and Better Life therefore agreed to pay for part of the cost of the advertising.

Eggplant Corporation competes with Avocado in the health management field. Eggplant's President, Fred, heard a rumor many months ago that Avocado was planning to develop a consumer health management system and decided that it would be a good idea for Eggplant to develop a similar product. Fred approached Diana, the head of Avocado's product development team and offered to pay her \$50,000 for the details of Avocado's CHMS. Fred told Diana that if she did not agree to provide the information to him he would tell Avocado that she had been providing Fred with information about Avocado's products for years (although this was not true). Diana provided the information to Fred, because she knows that Avocado takes very seriously even the slightest hint that its employees are unreliable. In Arcadia it is a criminal offence to bribe an employee to disclose confidential information and it is a criminal offence for an employee to accept payment for disclosing confidential information. Diana is an at will employee of Avocado, and she is subject to a contractual obligation to keep information she obtains about Avocado's products secret. Fred then refused to pay the \$50,000 to Diana. Using the information Fred had obtained from Diana, Eggplant immediately began work on production of its own CHMS system.

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Both CHMS systems require a product called inventium for their manufacture. Unfortunately there is a limited supply of this product and Eggplant managed to acquire most of the available inventium before MM had the opportunity to acquire the inventium it needed. Because of Eggplant's purchases of inventium, by the time MM tried to acquire enough inventium to be able to manufacture the CHMS in time to meet the September 14 delivery date the market price of inventium had increased to a level which would make the manufacture of the CHMS unprofitable for MM (it would make a loss of \$5 per CHMS if it continued to try to perform the contract). At the time MM entered into the contract to manufacture the CHMS it expected to make a profit of \$50 per product. The shortage and consequent high price of inventium was a temporary problem, however, and inventium would be available very soon at a price similar to the prices in effect before Eggplant began to buy up inventium. MM finally manufactured the 1000 CHMS products and delivered them to Avocado on October 31, which was too late to supply them to Better Life in time for the Avocado product launch on November 1.

Answer the following 3 questions based on the facts set out above:

1. What contract remedies does Avocado have against MM with respect to MM's late delivery of the CHMS products? In your answer explain what arguments Avocado and MM will want to make about the available remedies. Would your answer have been different if MM had announced to Avocado on September 1 that it would be unable to deliver the CHMS products at all? (30 points)

2. What contract remedies does Better Life have against Avocado for Avocado's breach of its obligation to deliver the CHMS to Better Life by October 5? If Better Life acquires a similar quantity of the Eggplant CHMS product for a price of \$175 per item, what difference would this make to your views about the remedies which are available to Better Life? (15 points)

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3. Is the agreement between Diana and Fred an enforceable contract? Should it be? If Avocado discovers the existence of the agreement between Diana and Fred will Avocado be able to fire Diana? Would you need to know any additional facts to answer this question? (15 points)

SECTION B (40% of the exam grade)

ANSWER ONE QUESTION FROM THIS SECTION

1. It is a detriment, not a benefit, to one's long-run interests not to be able to make a binding commitment (Judge Posner in *The Selmer Company v Blakeslee-Midwest*). Using examples from the materials we studied during the semester (you may discuss this issue with respect to the decision in *The Selmer Company v Blakeslee-Midwest* or more generally (but with specific examples)), explain whether or not you agree with this statement. How is what you have learned about contract law this semester consistent with an idea that the law should generally treat commitments as binding?
2. Write a critical analysis of any two cases we studied this semester.

Appendix

UCC § 2-606. What Constitutes Acceptance of Goods.

(1) Acceptance of goods occurs when the buyer

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or

(b) fails to make an effective rejection (subsection (1) of Section 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

UCC § 2-608. Revocation of Acceptance in Whole or in Part.

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

UCC § 2-706. Seller's Resale Including Contract for Resale.

(1) Under the conditions stated in Section 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and

(c) if the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) the seller may buy.

(5) A purchaser that buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (Section 2-707) or a buyer that has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of Section 2-711).

UCC § 2-708. Seller's Damages for Non-acceptance or Repudiation.

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

UCC § 2-709. Action for the Price.

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment

entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (Section 2-610), a seller that is held not entitled to the price under this section shall nevertheless be awarded damages for non-acceptance under the preceding section.

UCC § 2-710. Seller's Incidental Damages.

Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

UCC § 2-712. "Cover"; Buyer's Procurement of Substitute Goods.

(1) After a breach within the preceding section the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

UCC § 2-713. Buyer's Damages for Non-delivery or Repudiation.

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

UCC § 2-714. Buyer's Damages for Breach in Regard to Accepted Goods.

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

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

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

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

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes:

(a) a right to recover damages under the provisions of this Article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

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